December 16, 2014

Yoon-Young Lee
[redacted]

Via email to rule-comments@sec.gov

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

Re: Comments Regarding File No. SR-FINRA-2014-048 – Proposed Rule Change to Adopt FINRA Rule 2242 (Debt Research Analysts and Debt Research Reports)

Dear Mr. Fields:

We are writing on behalf of our clients, Barclays Capital Inc., Citigroup Global Markets Inc., Credit Suisse Securities (USA) LLC, Deutsche Bank Securities Inc., Goldman, Sachs & Co., J.P. Morgan Securities LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated, Morgan Stanley & Co. LLC, RBC Capital Markets, LLC, and UBS Securities LLC (together, the "Firms"), in response to a request for comments by the Securities and Exchange Commission ("SEC" or the "Commission") regarding the above referenced rule proposal by the Financial Industry Regulatory Authority, Inc. ("FINRA").[1] The Firms appreciate the opportunity to comment on FINRA's proposal to establish new FINRA Rule 2242 regarding debt research analysts and debt research reports (the "Proposed Rule"). As discussed more fully below, the Firms support much of the Proposed Rule. The Firms ask, however, that FINRA consider certain important modifications and clarifications to the Proposed Rule, which are consistent with the objectives of providing clarity to the industry and reducing costs and burdens on member firms without undermining investor protection.

I. Introduction

As an initial matter, the Firms greatly appreciate the deliberative process that FINRA has taken with respect to the development of Proposed Rule 2242, including through the publication of a concept proposal in 2011 and two rule proposals,[2] each refining the previous proposal in response to comments. The Firms further appreciate FINRA's recognition that the debt markets operate differently from the equity markets in many respects. To this point, the Firms applaud

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[1] Notice of Filing of a Proposed Rule Change to Adopt FINRA Rule 2242 (Debt Research Analysts and Debt Research Reports), Release No. 34-73,623, 79 Fed. Reg. 69905 (Nov. 24, 2014) ("Rule Filing"). In a separate comment letter, the Firms are also submitting comments regarding Notice of Filing of a Proposed Rule to Adopt FINRA Rule 2241 (Research Analysts and Research Reports) in the Consolidated FINRA Rulebook, Release No. 34-73622, 79 Fed. Reg. 69939 (Nov. 24, 2014) ("Equity Research Rule Filing").

[2] *See* FINRA Regulatory Notice 11-11 (Mar. 2011), FINRA Regulatory Notice 12-09 (Feb. 2012) and FINRA Regulatory Notice 12-42 (Oct. 2012).

FINRA's recognition that quiet periods are not necessary in the context of debt research, that the burdens of an equity research-like disclosure regime regarding a firm's credit exposure would outweigh the benefits, and that the impact of a debt research report on the market for an equity security is attenuated at best. The Firms support many specific provisions, in particular:

- Proposed Rule 2242(b)(2)(E), which now would allow revenues and results of the firm as a whole to be considered in determining the debt research department budget and allocation of debt research department expenses, and which would allow member firms to permit any personnel to provide senior management with input regarding the demand for and quality of debt research;

- Proposed Rule 2242(b)(2)(J), which provides a flexible framework for addressing personal trading,[3] and Proposed Supplementary Material .10, which would provide a transitional structure for debt research analyst accounts to unwind, in an orderly and planned manner, holdings that might be construed as prohibited under the Proposed Rule;

- Proposed Rule 2242(k), which would allow FINRA to provide exemptive relief from the requirements of the Proposed Rule for good cause; and

- Proposed Supplementary Material .11, which allows for a transitional period for the distribution of institutional debt research.

Recognizing these efforts, the Firms have nevertheless identified a few concerns and a number of important changes and clarifications to the Proposed Rule that FINRA should consider in order to provide greater clarity to the industry and reduce the burdens and costs on the industry without compromising investor protection. We set forth these comments below, which are organized sequentially to correspond to the relevant provisions of the Proposed Rule.[4]

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[3] The Firms assume that the proposed principles-based approach to research analyst personal trading would permit trading that is currently allowed for equity research analysts in NASD Rule 2711(g)(5) (*e.g.*, allowance for trading in any registered diversified investment company as defined under Section (5)(b)(1) of the Investment Company Act of 1940).

[4] The Firms note that certain comments below are also provided in their comment letter to the Equity Research Rule Filing for corresponding provisions in Proposed FINRA Rule 2241. These common comments appear in Sections II.A.1, II.A.3, II.C, II.D, II.F, II.I.2, II.K, and II.N.4 of this letter.

II. Specific Areas of Comment

A. Proposed Rule 2242(a) Should Be Supplemented To Include Certain Important Definitions and Carve-outs.

1. "Debt Research Report"

Proposed Rule 2242(a) should be amended 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. As an initial matter, the Firms note that such offering-related documents are typically prepared by investment banking personnel, or other non-research personnel on behalf of investment banking personnel. Thus, including such materials in the definition of "debt research report" would have the incongruous effect of turning investment banking personnel into debt research analysts (because a debt research analyst is defined as someone who produces a "debt research report"). Additionally, Proposed Rule 2242(a) currently includes an exclusion from the definition of "debt research report" for "communications that constitute statutory prospectuses" (which also are prepared by or with input from investment banking personnel). The Firms believe that the basis for excluding prospectuses from the definition of debt research report should apply equally to private placement memoranda and similar offering-related documents prepared by non-research personnel in connection with investment banking services transactions.

2. "Principal Trading" and "Principal Trading Personnel"

The terms "principal trading activities," "principal trading personnel," and "persons engaged in principal trading activities" are used throughout Proposed Rule 2242. For example, the Rule Filing would require member firms to prohibit prepublication, clearance, or approval of debt research by principal trading personnel, restrict or limit input by principal trading personnel into debt research coverage decisions, limit supervision of a debt research analyst to persons who are not engaged in principal trading activities, and 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 principal trading activities.[5]

However, these key terms are not defined in the Proposed Rule. Because the debt market is primarily a principal-based trading market and, unlike equity, principal trading is required to facilitate routine client trades, the Firms believe it is critical to craft a definition of "principal trading" that is tailored to identify those persons whose interests are not aligned with investor clients and therefore represent the greatest potential conflicts of interest. Otherwise, the term "principal trader" could apply to all or almost all fixed income trading personnel, including those trading personnel with whom investor clients interact frequently and, in some cases, without the involvement of any sales personnel.

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[5] *See* paragraphs (A), (C), (D), and (H) of Proposed Rule 2242(b)(2).

The Firms therefore urge FINRA to 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, even if such trading is done on a principal basis. As discussed below, without such an exclusion, research management and senior management would be deprived of important information reflective of client feedback for purposes of evaluating the impact and value of debt research analysts to clients. To the extent that FINRA is concerned that traders that make a market may pressure debt research analysts to support firm inventory positions, the Firms note that the Proposed Rule contains many new provisions specifically designed to prevent traders from improperly pressuring or retaliating against analysts.[6]

3. "Sales and Trading Personnel"

Proposed Rule 2242(a) should be amended to define the universe of persons covered by the terms "sales and trading personnel" or "persons engaged in sales and trading activities." This clarification is critical because the Proposed Rule contains significant restrictions, prohibitions, or limitations relating to "sales and trading personnel" or "persons engaged in sales and trading" activities.[7]

The Firms believe a definition along the lines of the following would be consistent with a stated purpose of the Proposed Rule: "persons who are primarily responsible for performing sales and trading activities, or exercising direct supervisory authority over such persons." Such a definition would provide member firms with the flexibility to organize their supervisory structures and reporting lines in a manner that aligns with their particular structures and business models, but at the same time would not undermine investor protection because research analysts would be adequately insulated from those persons who are directly engaged in sales and trading activities.[8] For example, this definition would make clear that it is permissible to have reporting lines where research analysts, sales, and trading personnel ultimately report up to the same person.

Without a limitation regarding supervisory reporting lines, provisions like Proposed Rule 2242(b)(2)(E) would result in drastic limitations on member firms' ability to manage themselves. Proposed Rule 2242(b)(2)(E) prohibits "senior management engaged in investment banking

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[6] Existing FINRA rules, such as FINRA Rule 5280, also provide safeguards by requiring member firms to "establish, maintain and enforce policies and procedures reasonably designed to restrict or limit the information flow between research department personnel ... 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." FINRA Rule 5280(b).

[7] *See* paragraphs (A), (C), (D), (G), and (H) of Proposed Rule 2242(b)(2).

[8] *See* Rule Filing, *supra* note 1, at 69910 ("FINRA believes this approach [of mandated policies and procedures] will impose less cost than a pure prescriptive approach by requiring members to adopt a compliance system that aligns with their particular structure, business model and philosophy.") This suggested approach is also consistent with the approach adopted by the Commodity Futures Trading Commission ("CFTC") in Rules 1.71(a)(2) and 23.605(a)(2), under which the "business trading unit" includes persons who directly perform or exercise supervisory authority over the performance of the tasks listed in the rule.

services or principal trading activities" from being involved in the determination of the debt research department budget. Because the fixed income market is a principal trading market, if member firms were to exclude anyone with indirect supervisory authority over principal traders as well as anyone with indirect supervisory authority over investment bankers, budget decisions would have to be made by the few remaining senior managers who only have research or sales reporting to them. Such restrictions would effectively put the debt research department in a bubble, isolated from the larger firm community.

The use of the term "primarily" is also an important clarification because it accurately captures those persons whose job responsibilities are properly classified as sales and trading.[9] Notably, this is the same approach that FINRA took in its proposed amendments to NASD Rule 1050, which appropriately recognize that an individual's categorization as a "research" versus "sales and trading" employee should turn on that person's primary responsibilities.

4. "Subject Company"

Proposed Rule 2242(a) would define "subject company" as "the company whose debt securities are the subject of a debt research report or a public appearance." Because FINRA declined to exclude foreign sovereigns from the scope of this Proposed Rule and because debt securities include structured products issued by a special purpose vehicle, for purposes of clarity, the Firms ask that the definition of "subject company" be amended to specify that the term means "the issuer whose debt securities are the subject of a debt research report or a public appearance."

B. FINRA Should Clarify that the Structural and Procedural Safeguards Contemplated by Proposed Rule 2242(b) Are Consistent with Those Contemplated by Current FINRA Rule 5280.

In the Rule Filing, FINRA noted that "separation between investment banking and debt research, and between sales and trading and principal trading and debt research, is of particular importance" and that while physical separation is not mandated, "FINRA would expect such physical separation except in extraordinary circumstances where the costs are unreasonable due to a firm's size and resource limitations," as a component of the policies and procedures required by paragraphs (b)(1) and (b)(2) of the Proposed Rule.[10] At the same time, the Proposed Rule contains provisions, such as Supplementary Material .03(b), which recognize the existence and importance of discussions that sales and trading and principal trading personnel have on a regular basis with debt research analysts.

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[9] The Rule Filing contains many references to individuals "engaged in" specified activities, including sales, trading, and investment banking. The Firms believe that in determining the universe of individuals engaged in specified activities, member firms should not conclude that simply because an individual might, *e.g.*, occasionally speak to a customer or have persons from sales reporting to him or her, the individual must be classified as sales personnel or as someone "engaged in" sales. Rather, an individual should be classified as, *e.g.*, sales, when he or she is primarily responsible for performing such functions or directly supervising individuals performing such functions.

[10] Rule Filing, *supra* note 1, at 69910 n.38.

Pursuant to FINRA Rule 5280(b), member firms are required to have policies and procedures reasonably designed to restrict or limit the information flow between research department personnel and other persons with knowledge of the content and timing of research reports, 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 firm or any other person. Like paragraphs (b)(1) and (b)(2) of the Proposed Rule, Rule 5280 seeks to control the flow of information between persons inside the research department (or others with appropriate knowledge of the substance and timing of research reports) and persons who might improperly act upon advance knowledge of the substance or timing of research; however, Rule 5280 does not impose a strict physical separation requirement.

Accordingly, the Firms ask FINRA to clarify that members that have developed policies and procedures consistent with those required by Rule 5280 would also be in compliance with Proposed Rule 2242(b)'s expectation of structural and procedural safeguards.

C. Proposed Rule 2242(b)(2) Should Be Modified To Clarify That Compliance with All of the Prohibitions, Prescriptions, and Restrictions in that Provision May Be Sufficient To Satisfy that Provision.

Proposed Rule 2242(b)(2) contains detailed prohibitions, prescriptions, and restrictions regarding the written policies and procedures that member firms must adopt "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 member or a current or prospective customer or class of customers." These requirements build on and significantly expand the prohibitions and restrictions currently in NASD Rule 2711 with respect to equity research reports.[11] However, unlike in NASD Rule 2711, these requirements are identified as "the minimum" policies and procedures that member firms must adopt.[12] While the Firms understand that they would be subject to each of the requirements listed in Proposed Rule 2242(b)(2) and that there may be circumstances that may necessitate additional requirements, they respectfully request that FINRA eliminate the "at a minimum" language in this provision because it is not clear what additional policies and procedures this language would require in every situation–particularly in light of the detailed and extensive nature of the requirements in Proposed Rule 2242(b)(2).

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[11] For example, the Proposed Rule includes several prohibitions relating to sales and trading and principal trading that go beyond the requirements outlined with respect to equity securities in NASD Rule 2711 or Section 15D of the Securities Exchange Act of 1934 ("Exchange Act"), which focus primarily on the activities of, and prohibitions related to, investment banking personnel. *See* Proposed Rule 2242(b)(1)(C) (requiring policies and procedures to identify and manage conflicts of interest related to the interaction between research analysts and sales and trading and principal trading personnel); and Proposed Rule 2242(b)(2)(H) (requiring policies and procedures to establish information barriers or other institutional safeguards to ensure that research analysts are insulated from pressure by persons engaged in sales and trading and principal trading).

[12] *See* Proposed Rule 2242(b)(2) (stating that "Such policies and procedures *must at a minimum*...") (emphasis added).

The Firms also do not believe that this language is necessary, given not only the extensive prohibitions, restrictions, and prescriptions in Proposed Rule 2242(b)(2), but also the broad principles-based language that serves as an overlay in Proposed Rule 2242(b)(1). To this point, Proposed Rule 2242(b)(1) contains a broad principles-based requirement that member firms establish, maintain, and enforce written policies and procedures to "identify and manage conflicts of interest" relating to (i) the preparation, content, and distribution of debt research reports, (ii) debt research analysts' public appearances, and (iii) the interaction between debt research analysts and those outside the research department, including investment banking personnel, sales and trading personnel, principal trading personnel, subject companies, and customers.

For the above reasons, the elimination of the phrase "at a minimum" would provide clarity regarding the applicability of existing rules, but would not diminish investor protection given the broad principles-based requirements in paragraphs (b)(1) and (b)(2) of the Proposed Rule.

D. Proposed Rule 2242(b)(2)(C) Should Be Clarified by Eliminating a Redundant or Unclear Term.

As currently drafted, Proposed Rule 2242(b)(2)(C) permits non-research personnel to have input into research coverage, so long as research management "independently makes all final decisions regarding the research coverage plan."

The Firms ask FINRA to eliminate the term "independently" because that term appears to be redundant with the notion of research management "making final decisions." If FINRA does not believe the term "independently" is redundant, it is unclear what is contemplated here because non-research personnel may, in fact, have input into research coverage under the terms of the Proposed Rule. Thus, if FINRA declines to eliminate this term, the Firms ask FINRA to confirm that member firms would satisfy the "independent" standard in Rule 2242(b)(2)(C) as long as research management makes the final determination regarding coverage decisions.[13]

E. FINRA Should Permit Principal Trading Personnel To Provide Input to Debt Research Management in Order To Convey Customer Feedback.

Proposed Rule 2242(b)(2)(G) would prohibit principal trading personnel from providing input to debt research management with respect to the evaluation of debt research analysts even for the purpose of conveying customer feedback. Given the broad nature of principal trading in the debt markets, and the potentially broad application of the terms "principal trading activities," "principal trading personnel," and "persons engaged in principal trading activities" in the Proposed Rule, this prohibition would deprive research management of important feedback about

[13] This request is consistent with the following general description of the requirement in the Rule Filing: "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." *See* Rule Filing, *supra* note 1, at 69910.

the performance of debt research analysts.[14] Accordingly, the Firms urge FINRA to revise this prohibition to allow principal trading personnel to provide limited input in order to reflect customer feedback. Contrary to FINRA's view in the Rule Filing,[15] the Firms believe that input from principal trading is essential to reflecting customer feedback to research management, and that this input may not be adequately conveyed by other personnel.

At the same time, amending this provision would not undermine investor protection because member firms would need to establish reasonably designed policies, procedures, and processes to ensure that any input from principal trading personnel reflects customer feedback, that analyst compensation is not based upon specific trading transactions, and that analyst compensation determinations are made by research management and reviewed and approved in accordance with other safeguards provided for by the Proposed Rule.

As discussed above, investors frequently interact directly with principal trading personnel and, in some cases, without the involvement of any sales personnel. In the fixed income market, it is also more difficult for research management to receive comprehensive feedback from clients because clients provide more limited aggregated rankings or data on debt research analysts than they do in the equity market. Principal traders are frequently in touch with many people at many clients and so are well positioned to aggregate feedback on research analyst performance. Such broad feedback from clients is immensely helpful to research management in assessing the impact of debt research on the markets and the value that clients attribute to it.

While the Firms appreciate the risk of conflicts of interest with respect to input from principal traders who may hold inventory in the securities covered by an analyst, they believe that these potential conflicts can be adequately mitigated by reasonably designed policies, procedures, and controls. For example, in order to comply with rules established by the CFTC Rules 1.71 and 23.605, some member firms already have in place supervisory policies and procedures and training programs designed to allow principal traders to communicate client feedback and sentiment to research management.

F. Proposed Rule 2242(b)(2)(H) Should Be Clarified and Modified To Be Consistent with FINRA's General Supervisory Requirement that Firms Have "Reasonably Designed" Policies and Procedures.

As currently drafted, Proposed Rule 2242(b)(2)(H) requires member firms to "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

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[14] If FINRA chooses to adopt the definitions of "principal trading activities," "principal trading personnel," and "persons engaged in principal trading activities" suggested above in section II.A.2, the comment in this section II.E would be unnecessary.

[15] *See* Rule Filing, *supra* note 1, at 69924 ("FINRA believes, in part based on discussions with research management personnel, that input from sales and trading personnel provides an effective proxy for customer feedback.")

services; principal trading or sales and trading activities; and other persons who might be biased in their judgment or supervision."

The Firms appreciate that this language has been clarified to permit member firms to establish "other institutional safeguards" (and not only "information barriers"), but ask FINRA to consider additional important modifications that are necessary (i) to provide clarity regarding certain requirements of this provision, and (ii) to conform this provision to FINRA's well-established "reasonably designed" standard for policies and procedures.

With respect to (i), the following changes are necessary to provide greater clarity:

- First, the term "review" in Proposed Rule 2242(b)(2)(H) should be eliminated because it appears to be redundant with the term "oversight." Moreover, the reason for including this provision relates to the oversight of research activities. As noted in FINRA's rule filing regarding a comparable provision in the proposed equity research rule: "FINRA is including the provision to emphasize that the conflicts management must extend to persons other than investment banking personnel, including sales and trading department personnel, who may be placed in a position to supervise or influence the content of research reports or public appearances."[16] If FINRA does not agree that the terms "review" and "oversight" are redundant, FINRA should clarify what the term "review" would require that is not already captured by the other provisions in Proposed Rule 2242. For example, Proposed Rule 2242(b)(2) already includes provisions that impose limits and prohibitions on certain input into analysts' compensatory evaluations and prepublication reviews of research reports by certain non-research personnel.

- Second, the Firms ask FINRA to clarify that the "information barriers or institutional safeguards" required by Proposed Rule 2242(b)(2)(H) are not intended to prohibit or limit activities that would otherwise be permitted under other provisions of Proposed Rule 2242.

- Finally, the Firms ask FINRA to clarify that "bias" and "pressure" for purposes of this provision are intended to address "persons who may try to improperly influence research views." The Firms appreciate that these terms may appear in certain provisions of the Sarbanes-Oxley Act of 2002 relating to equity research,[17] but that fact should not prevent FINRA from providing clarifying guidance regarding their meaning for purposes of the Proposed Rule, particularly because these terms appear broad and ambiguous on their face.[18] For example, if a debt research analyst is

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[16] *See* Equity Research Rule Filing, *supra* note 1, at 69943.

[17] *See* Section 501 Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745 (2002).

[18] For example, the term "bias" has been defined broadly as "a tendency to believe that some people, ideas, etc., are better than others that usually results in treating some people unfairly." *Bias Definition*, Merriam-Webster.com, http://www.merriam-webster.com/dictionary/bias (last visited Dec. 16, 2014).

pressured to change the format of a debt research report to comply with the department's standard procedures or the firm's technology specifications, it is not clear whether the firm would have to determine whether the person applying the pressure had some sort of bias against the analyst.

Additionally, with respect to (ii), the Firms ask FINRA to modify Proposed Rule 2242(b)(2)(H) to conform to paragraphs (b)(1) and (b)(2) of the Proposed Rule by imposing a "reasonably designed" standard on the policies and procedures that member firms must adopt. The "reasonably designed" standard is also the legal standard that has historically been required by FINRA's general supervision rule and which is required by FINRA's new supervision rule, Rule 3110.

G. FINRA Should Eliminate the Prohibition on In-Person Attendance at Road Shows by Debt Research Analysts.

Proposed Rule 2242(b)(2)(L) would require member firms to prohibit debt research analyst attendance at road shows. In the Rule Filing, FINRA stated that debt research analysts may only listen in to issuer presentations, similar to the way equity research analysts may listen to road shows under NASD Rule 2711.[19]

While the Firms recognize the critical importance of prohibiting analysts from participating in road shows and other marketing activities for investment banking services transactions on behalf of an issuer or investment banking personnel, the Firms urge FINRA to permit debt analysts to attend road shows in person, provided that (i) their participation is limited to the same manner as an investor, and (ii) they may not participate or attend on behalf of the issuer or investment banking personnel. Because debt research coverage is broader than in the equity markets and may include more issuers than equity research, debt research analysts are often not as familiar as equity analysts are with issuer management. Debt research analysts are rarely afforded the kind of access to issuer management that is available to equity analysts, and given the comparatively rapid pace of many debt offerings, debt analysts often do not participate in vetting or due diligence in the same way that an equity analyst would in connection with an equity offering. Thus, attending road shows in person in the same posture as an investor is most often the only opportunity for debt research analysts to meet issuer leadership, assess the quality of management, hear an issuer's story, and ask questions prior to an offering. This opportunity is particularly valuable where the issuer is not a public filer (which is often the case in the debt market) and has no prior record of operational or financial performance.

The Firms believe that allowing debt analysts to attend road shows in the same posture as investors (*i.e.*, they would simply be part of the audience and not presenting or otherwise marketing the deal) would not compromise investor protection. In fact, this approach would be beneficial to investors because it would place debt analysts in a better position to advise investor clients.

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[19] *See* Rule Filing, *supra* note 1, at 69923.

H. FINRA Should Amend the Preamble to Proposed Rule 2242(b)(2)(L) To Eliminate Redundancy.

In contrast to the other provisions in the Proposed Rule, such as those in paragraphs (A)-(K), (M) and (N) of Proposed Rule 2242(b)(2), Proposed Rule 2242(b)(2)(L) has a broad preamble that requires member firms to establish, maintain, and enforce policies and procedures that would "restrict or limit activities by research analysts that can reasonably be expected to compromise their objectivity" before identifying specific prohibited activities related to investment banking services transactions. As noted above, Proposed Rule 2242(b)(1) sets out a broad principles-based requirement that member firms establish, maintain, and enforce written policies and procedures reasonably designed to identify and effectively manage conflicts of interest, and Proposed Rule 2242(b)(2) would further require those policies and procedures to be reasonably designed to promote objective and reliable debt research. In light of these general requirements, it is unclear what additional requirements are intended to flow from the preamble in Proposed Rule 2242(b)(2)(L) or why it is necessary to require an additional principles-based requirement in this provision.

Accordingly, for the sake of clarity, the Firms ask FINRA to revise the preamble to Proposed Rule 2242(b)(2)(L) to state simply that member firms' policies and procedures must: "prohibit debt research analysts' participation in pitches and other solicitations of investment banking services transactions, and their participation in road shows and other marketing on behalf of an issuer related to an investment banking services transaction."

I. Certain New Disclosure Requirements in Proposed Rule 2242(c) Will Impose Significant Burdens and Costs on Firms, and Should Be Reconsidered.

Proposed Rule 2242(c) contains new disclosure requirements, which will result in significant burdens and costs for member firms that the Firms believe would outweigh any possible investor protection benefits. For these reasons and as described more fully below, the Firms ask FINRA to reconsider these provisions.

1. Summaries and Historical Displays of Ratings Distributions

Paragraphs (c)(2) and (c)(3) of the Proposed Rule would require member firms to provide certain summaries and historical displays of ratings distributions in debt research reports, which are similar to the disclosures required for equity research reports by NASD Rule 2711. Specifically:

- Proposed Rule 2242(c)(2)(A) would require a firm to include in each debt research report that includes a rating, the percentage of all debt securities rated by the firm to which the firm would assign a "buy," "hold," or "sell" rating;

- Proposed Rule 2242(c)(2)(B) would require a firm to disclose in each debt research report, the percentage of subject companies within each of the "buy," "hold," and

"sell" categories for which the firm has provided investment banking services within the previous twelve months; and

- Proposed Rule 2242(c)(3) would require debt research reports containing a rating for a subject company's debt security, where the firm has assigned a rating to such debt security for at least one year, to show each date on which the firm has assigned a rating and the rating assigned on that date. This information must be provided for the shorter of either the period that the member has assigned any rating, or for three years.

The Firms ask FINRA to consider eliminating the above-described buy/hold/sell and historical distribution disclosure requirements for debt research reports in paragraphs (c)(2) and (c)(3) of the Proposed Rule. While these types of disclosures may be very useful in the equity context, they are impracticable for debt research because of the number of bonds issued by companies and followed by analysts, and they would provide little benefit to investors because they would not allow for helpful comparisons across debt securities or subject companies.

With respect to the distribution of ratings required by Proposed Rule 2242(c)(2), analysts often rate numerous bonds of the same company and may have different ratings on those bonds based on, for example, expected spreads and yields. In some cases, analysts may have issuer ratings where the rating applies to all of the individual bonds of a company. As a result, some companies will be over-represented in the calculation of the distribution of ratings, with the result that the information provided to investors could be confusing or misconstrued, especially as it relates to the percentage of companies for which the member has provided investment banking services within the previous twelve months.

In addition, the burden of tracking the individual ratings on numerous bonds of the same company is significant as members would be required to create a tracking system for each individual bond to capture the rating over time. These complexities are exacerbated by new issues and maturing issues that would have to be tracked and added or removed. The practice of publishing debt research on "on-the-run" series of bonds (where the rated bonds change to reflect the most recent series of bonds issued) poses additional difficulties regarding how to capture these rating for inclusion in the disclosure.

Because of the complications discussed above, the Firms do not believe it is feasible to produce a distribution of ratings table that would provide investors with meaningful and accurate disclosure. Moreover, with all of the other, more important disclosures regarding issuer relationships with member firms, it is unclear what additional benefit this type of ratings analysis would provide investors.

With respect to the three year history of ratings for securities assigned a debt rating for at least one year required by Proposed Rule 2242(c)(3), the Firms ask that FINRA eliminate this requirement because of the number of issues covered and the cost and expense of tracking the ratings of so many bonds over a three year period. Even if it were practical to disclose the

ratings history for debt securities, it is possible that the ratings history of very few bonds would be tracked because issuers continually retire, redeem, or replace outstanding bonds, which results in analysts dropping coverage of an old bond and initiating coverage on the new replacement bond. This is even more acute when firms provide coverage of "on-the run" bonds, where the covered bond may change frequently. In addition, because the ratings history does not include any pricing reference, it is likely that the ratings history would be of little use to investors.

If despite these issues, FINRA believes that the history of ratings disclosure provides some value, the Firms urge FINRA to revise this provision to require disclosure of the history of debt ratings only over the prior twelve-month period (rather than a three-year "look back" period). Unlike stock ratings designed for more long-term investors, member firms' bonds ratings are primarily designed for institutions that engage in short-term trading.[20] As such, providing the ratings history three years back would not only be difficult and costly to do and unwieldy to display, but it also would not be meaningful to most debt investors.

2. Expanded "Catch-all" Disclosure

Proposed Rule 2242(c)(4)(H) would significantly expand upon the "catch-all" disclosure in NASD Rule 2711(h)(1)(C), which currently requires the disclosure of "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 of publication of the research report or at the time of the public appearance." Under the proposed expanded disclosures, member firms would be required to also disclose any other material conflict of interest of the research analyst or the member firm that "an associated person of the member with the ability to influence the content of a debt research report knows or has reason to know...."

While the Firms understand that FINRA is proposing this expansion to address some perceived "gap" in the disclosure requirements,[21] they respectfully submit that there has been no evidence presented of any gap or undisclosed conflicts that would require such an expansion. In contrast, the burdens and logistical difficulties of imposing this expanded disclosure would be very real and exceed any potential benefit. To this point, the expanded disclosure would create a logistical quagmire. It would slow down the research dissemination process and make it difficult to issue reports in a timely and efficient manner because it would require member firms to canvass all of research management, research supervisors, supervisory analysts, and legal and compliance personnel who might have the authority to review a research report before publishing it in order to determine if they are aware of a material conflict of interest that the research analyst – who is the author of the report – does not know or have reason to know.

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[20] For example, at least one Firm's rating scale provides for a three-month time frame.

[21] This expanded "catch-all" disclosure is also included in the equity research rule proposal and discussed in the Equity Research Rule Filing, which states: "This provision would close a gap that exists whereby persons who oversee research and research analysts could influence the recommendation or conclusions in a research report without disclosing their own material conflicts of interest or those of the member of which only they, and not the research analyst, know or have reason to know." Equity Research Rule Filing, *supra* note 1, at 69951.

An expansion of the "catch-all" disclosure also would create significant issues because such persons (especially legal and compliance personnel) may possess confidential information that could be captured by this expanded "catch-all," and would not fall under the narrow exception in Proposed Rule 2242(c)(5) for disclosure of material nonpublic information regarding specific potential future investment banking transactions of the subject company (the "MNPI exception"). For example, legal and compliance personnel typically have access to a firm's systems that contain information about *all* of a firm's proposed *and* on-going activities. Because the "catch-all" is designed to capture "conflicts that should reasonably be discovered by those persons *in the ordinary course of discharging their functions*,"[22] this prohibition could be read to require the disclosure of material nonpublic information learned by legal and compliance personnel, through the ordinary course, that is unrelated to investment banking transactions of the subject company. Additionally, a research supervisor who has been brought across the wall (as well as legal and compliance personnel) may be aware that the member firm is advising a merger between two of the company's competitors; such information would not fall within the MNPI exception because the proposed transaction is not an investment banking transaction "of the subject company."

Moreover, the proposed expanded "catch-all" disclosure is not necessary given the following significant protections and safeguards:

- All of the conflict of interest disclosures that would be required under the Proposed Rule;
- The additional information barriers, safeguards, policies and procedures that member firms must implement under paragraphs (b)(1) and (2) of the Proposed Rule that must be reasonably designed to "identify and manage" conflicts of interest and "promote objective and reliable research"; and
- The safeguards provided by Regulation Analyst Certification, which assure that any views and opinions expressed in a research report reflect those of the primary research analyst, even if such report has been amended to reflect any comments or review by supervisory analysts, research management, or others.

J. FINRA Should Permit Members To Provide Web-Based Debt Research Disclosures.

Like NASD Rule 2711 and Proposed Rule 2241, Proposed Rule 2242(c)(4) would require member firms to provide disclosures with respect to certain potential conflicts of interest, including, for example, debt analyst financial holdings, debt analyst compensation, firm investment banking activities, and firm principal trading in the debt of the covered issuer. Proposed Rule 2242(c)(4) would require that these disclosures be made in a debt research report

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[22] *Id.* at 69947 (emphasis added).

at the time of publication or distribution. Proposed Rule 2242(c)(6) would allow these disclosures to be provided by hyperlink for electronic debt research reports.

The Firms ask FINRA to allow member firms to provide a hyperlink or web-address to web-based disclosures in all debt research reports. While the Firms understand that the SEC interprets Section 15D(b) of the Exchange Act to require disclosure in each equity research report, this Exchange Act provision applies only to equity research and does not extend to debt research. Web-based disclosures for debt research would provide investors with the same access to these disclosures, while facilitating the efficient production and publication of research reports. In fact, FINRA acknowledged its support for the use of web-based disclosures in the equity research rule proposal.[23]

If FINRA does not allow member firms to provide a hyperlink or web-address to web-based disclosures in all debt research reports, the Firms request confirmation that member firms may, under Proposed Rule 2242(c)(6), rely on hyperlinked disclosures for debt research reports that are delivered electronically, even if these reports may be subsequently "printed out" by customers, thereby being converted to hard copy format.

K. Firms Should Not Be Required To Disclose Whether an Alternative Research Product or Service Does in Fact Contain a Contrary Recommendation.

Proposed Rule 2242(f) and Supplementary Material .06 would allow member firms to provide different research products and services to different classes of customers, so long as they: (i) are not differentiated with respect to timing of receipt of recommendations, ratings, or other potentially market moving information; (ii) are not labeled so as to provide different customers with essentially the same products and services at different times; and (iii) are accompanied by appropriate disclosures that different products and services may reach different conclusions. In the Rule Filing, FINRA noted that it "will read with interest comments as to whether a member should be required to disclose to its other customers when an alternative research product or service does, in fact, contain a recommendation contrary to the research product or service that those customers receive." In response to this request, the Firms submit that the proposed disclosure requirement in Supplementary Material .06 is appropriate, and that requiring disclosure of specific instances of contrary recommendations would be unworkable and not justified in light of the costs.

Complying with a requirement to disclose each such instance would require extremely close tracking and coordination of the content of each and every product or service in order to identify when a recommendation is being made and to determine the extent to which each such recommendation might be deemed "contrary" to the current recommendations in all other products and services. This is particularly difficult because a single firm may publish tens of thousands of research reports each year and employ hundreds of analysts across various

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[23] *See id.* ("FINRA believes that a web-based disclosure approach would be at least as effective and a more efficient means to inform investors of conflicts of interests").

disciplines. As such, neither a research analyst responsible for a particular report nor a supervisory analyst responsible for reviewing such report could reasonably be expected to be aware of all other research products or services that may contain differing views. It is also challenging because different research products and services may focus on different types of analyses or time horizons, such as technical versus fundamental research, or long-term versus short-term research, further complicating the determination of when recommendations are contrary. Where a research product or service does not have formal ratings applied, such as a relative-value or paired trade analysis, the mere determination of what constitutes a recommendation would be time-consuming and challenging.

The Firms believe the burdens associated with implementing this complicated system to track and analyze all recommendations in different research products and services would outweigh any related benefits. As recognized in the Proposed Rule, different audiences for research have different concerns and objectives, so recommendations that may appear contrary in different research products may simply be appropriately tailored to the interests or objectives of their respective audiences.[24]

L. FINRA Should Confirm that in Applying the Institutional Debt Research Framework in Proposed Rule 2242(j) to Non-U.S. Institutional Customers, Firms Can Rely on QIB-Equivalent Status in the Home Jurisdictions of Those Customers.

Proposed Rule 2242(j) would create a more streamlined set of requirements for debt research reports provided to institutional investors. Proposed Rule 2242(j)(1)(A) provides that "institutional investors" include "qualified institutional buyers" ("QIBs"), which Proposed Rule 2242(a) defines in the same manner as Rule 144A of the Securities Act of 1933.[25] The Firms ask FINRA to confirm that, in distributing debt research reports under the institutional debt research framework in Proposed Rule 2242(j) to certain non-U.S. institutional investors who are customers of a member firm's non-U.S. broker-dealer affiliate, the member firm may rely on similar classifications in the non-U.S. institutional investors' home jurisdictions.

This clarification is necessary because some global firms distribute their debt research reports to non-U.S. institutional investors who are not active trading customers of the member firm, so these entities may not have been vetted as QIBs by the member firm. Also, in some instances, these non-U.S. institutional investors may trade with the member firm, but may not have been vetted as QIBs because they have not participated in a Rule 144A offering. To the extent that the home jurisdiction of these non-U.S. institutional investors recognizes a customer classification that is comparable to a QIB and a non-U.S. broker-dealer assumes sole or shared

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[24] *See* Rule Filing, *supra* note 1, at 66916.

[25] The Firms assume that, in determining QIB status, a member firm may use reasonable due diligence, which may include but is not limited to receipt of a QIB certificate or reliance on public financial filings, consistent with Rule 144A(d)(1).

responsibility for that customer,[26] the Firms ask FINRA to confirm that, in distributing debt research reports under the institutional debt research framework in Proposed Rule 2242(j), member firms may treat these similar classifications as the equivalent of a QIB.

M. FINRA Should Clarify the Application of the Institutional Debt Research Framework in Proposed Rule 2242(j) to Desk Analysts.

Proposed Rule 2242(j)(2) would require member firms to establish, maintain, and enforce policies and procedures reasonably designed to, among other things, insulate research analysts writing research reports distributed to institutional investors from pressure by persons engaged in investment banking services, principal trading, sales and trading activities, or any other persons who might be biased in their judgment (pursuant to Proposed Rule 2242(b)(2)(H), with respect to pressuring). Similarly, Proposed Rule 2242(j)(2) would require member firms to establish, maintain, and enforce policies and procedures reasonably designed to, among other things, restrict or limit activities by debt research analysts that can reasonably be expected to compromise their objectivity (pursuant to Proposed Rule 2242(b)(2)(L)).

In the context of desk analysts or other personnel who are part of the trading desk (and are not "research department" personnel), but are publishing debt research reports in reliance on the institutional research exemption,[27] it is not clear how member firms would implement the above-noted provisions. For example, a trader who writes desk commentary that falls within the Proposed Rule's definition of a debt research report has an inherent conflict of interest, and although member firms will disclose this conflict of interest in the research report, member firms cannot be expected to restrict the trader's ability to conduct his day-to-day trading activities. As such, the Firms ask FINRA to clarify that when sales and trading personnel or principal trading personnel publish debt research reports in reliance on the institutional research exemption, paragraphs (b)(2)(H) and (b)(2)(L) of the Proposed Rule would not apply to their activities.

N. Supplementary Material

1. The Firms Request Guidance on Policies and Procedures Prohibiting "Attempts" To Improperly Influence Analysts' Views.

Proposed Supplementary Material .03(a)(1) would require member firms 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

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[26] For example, under the MiFID directive as implemented in the UK's Conduct of Business (COB) rules, a firm carrying out a regulated activity must classify each client as retail, professional, or eligible counterparty in order to determine the firm's regulatory obligations to that client. The QIB-equivalent would be any client classified as either a professional (essentially institutional investors, defined in COB Rule 3.5) or eligible counterparty (defined in COB Rule 3.6 – covers sophisticated investors which are not institutions as such, *e.g.* central banks or other governmental organizations).

[27] *See* Rule Filing, *supra* note 1, at 69919 (noting that "some well-regarded debt research is produced by analysts that are part of the trading desk").

opinion or views for the purpose of benefiting the trading position of the firm, a customer, or a class of customers.

The Firms ask FINRA to either eliminate the word "attempting" or provide guidance on the application of this provision with respect to "attempts." While member firms can readily establish and enforce a policy prohibiting non-research personnel from improperly influencing research personnel, it is unclear how member firms should *enforce* a prohibition on "attempting" to influence, since doing so would entail, in effect, policing the intent and knowledge underlying any particular interaction between debt research analysts and sales and trading or principal trading personnel. As an alternative to eliminating the word "attempting," the Firms ask that FINRA provide clarification regarding the requirement to enforce prohibitions on "attempts" by non-research personnel because it is not clear how member firms would do so.

2. FINRA Should Amend Proposed Supplementary Material .03(b)(2) To Clarify that Communications May Not Be Inconsistent with Pending Publications of Debt Research Reports.

Under Proposed Supplementary Material .03(b)(2), debt research analysts may provide customized analysis, recommendations, or trade ideas to sales and trading and principal trading personnel, or to customers, provided that any such communications are not inconsistent with analysts' currently published or pending debt research, and that any subsequently published debt research is not for the purpose of benefiting the trading position of the firm, a customer, or a class of customers.

The Firms are concerned that the term "pending" is vague in this context, and could be read to imply that discussions with clients consistent with published research views could be viewed in hindsight as inappropriate if an analyst changes his or her views in a subsequent publication. The Firms believe that the appropriate standard should be that analysts should neither disavow their published research views nor preview unpublished changes to those research views when speaking with customers. A requirement that member firms ensure that discussions are also consistent with analysts' "pending" research raises uncertainty as to what communications would be permissible. Accordingly, the Firms respectfully request that FINRA delete the words "or pending" in Supplementary Material .03(b)(2). In the alternative, the Firms ask FINRA to confirm that "pending" means the imminent publication of a debt research report.

3. The Standard in Supplementary Material .03(b)(3) for Assessing Consistency with a Research Analyst's Views Should Be Applied Throughout the Proposed Rule.

As noted above, the Firms appreciate FINRA's clarification that, in determining what is consistent with a debt research analyst's published debt research for the purposes of sharing certain views with sales and trading and principal trading personnel, member firms may consider the context, including that the investment objectives or time horizons being discussed may differ from those underlying the debt analyst's published views. The Firms ask FINRA to clarify that

this standard may be applied wherever consistency with a debt research analyst's views must be assessed under Proposed Rule 2242, such as with respect to debt research analyst account trading, pursuant to Proposed Rule 2242(b)(2)(J)(ii), or providing customized analysis, recommendations, or trade ideas to sales and trading, principal trading, and customers, pursuant to Proposed Supplementary Material .03(b)(2).

4. FINRA Should Eliminate the Provision Specifying that Failure To Comply with Policies and Procedures Amounts to a Violation of the Rule.

Proposed Supplementary Material .08 states that the failure of an associated person to comply with a firm's written policies and procedures "shall constitute a violation of this Rule." The Firms appreciate the fundamental point that member firm personnel should comply with a firm's policies and procedures and that member firms need to enforce these policies and procedures. The Firms are concerned, however, that this statement may create a perverse incentive for some member firms to implement policies and procedures that are the "bare minimum" necessary to comply with the Proposed Rule by punishing firms that adopt policies and procedures that exceed the Proposed Rule. For example, if a member firm is considering adopting policies and procedures that are more restrictive than required by the Proposed Rule or that cover research activities that are not addressed by the Proposed Rule, that firm should not be discouraged from doing so out of concern that a violation by an employee of those policies and procedures would be the equivalent of a violation of FINRA rules and trigger all the consequences of such violations.

The Firms are also concerned about the unprecedented nature of this statement. To that point, no other FINRA rule contains a statement that a violation of a member firm's policies and procedures established pursuant to that rule – regardless of whether those policies and procedures exceed the rule's requirements – constitutes a separate and independent FINRA rule violation. It is also unclear how this provision would intersect with other FINRA rules.

For these reasons, the Firms respectfully request that FINRA eliminate the statement in Proposed Supplementary Material .08 that "[f]ailure of an associated person to comply with such policies and procedures shall constitute a violation of this Rule." The Firms do not believe that eliminating this statement will diminish the effectiveness of the other provisions of Supplementary Material .08, which clarify that an associated person who engages in the restricted or prohibited conduct covered by the Proposed Rule will be deemed to have violated the Proposed Rule regardless of the member firm's policies and procedures.

O. FINRA Should Amend FINRA Rule 2210(c)(7) To Exclude Debt Research Reports on Certain Issuers from the Rule 2210(c)(3) Filing Requirements.

FINRA recently amended Rule 2210(c)(7) to exclude from the filing requirements in Rule 2210(c)(3) research reports as defined in NASD Rule 2711 that concern only securities that are listed on a national securities exchange, other than research reports required to be filed with

the SEC pursuant to Section 24(b) of the Investment Company Act. This exclusion extends to, for example, equity research on exchange-listed master limited partnerships.

Commenters on this rulemaking asked FINRA to extend the exclusion to debt research reports, if and when a debt research rule is proposed and approved.[28] FINRA declined to extend the exclusion to debt research reports ahead of the filing of a debt research rule, but noted that it would be appropriate to consider the exclusion when a debt research rule is filed with the SEC and approved.[29]

In light of the filing of Proposed Rule 2242, FINRA should consider a similar exclusion for debt research reports from the Rule 2210(c)(3) filing requirement. After Proposed Rule 2242 is effective, these research reports will be subject to controls intended to protect investors in the same manner as NASD Rule 2711 (and Proposed Rule 2241).

P. FINRA Should Provide a One-Year Implementation Period.

The Firms greatly appreciate FINRA's agreement to provide sufficient time for implementation of the Proposed Rule and FINRA's recognition that required systems changes often take time. In that regard, the Firms request 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 date of implementation to fully incorporate policies, procedures, and processes to meet the various new disclosure and other requirements.

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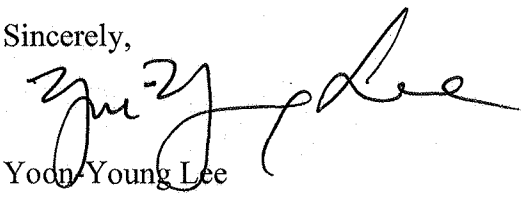
The Firms appreciate the opportunity to comment on the Proposed Rule. We would be pleased to discuss any of these comments further and provide any additional information you believe would be helpful. Please feel free to contact me if you have any questions at (202) 663-6720 or Stephanie Nicolas at (202) 663-6825.

Sincerely,



Yoon-Young Lee

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[28] *See* Order Approving Filing of a Proposed Rule Change To Amend FINRA Rules 2210 (Communications with the Public) and 2214 (Requirements for the Use of Investment Analysis Tools), Release No. 34-72480, 79 Fed. Reg. 37796, 37797 (Jul. 2, 2014).

[29] *Id.*

cc: Stephen Luparello, Director, Division of Trading and Markets, SEC
Robert L.D. Colby, Chief Legal Officer, FINRA
Philip Shaikun, Vice President and Associate General Counsel, FINRA