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April 10, 2012

Via Email

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

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

Dear Ms. Asquith:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Sincerely yours,



Amy Natanson Kroll

cc: Mr. Marc Menchel, Executive Vice President and General Counsel for
Regulation, FINRA
Mr. Philip Shaikun, Associate Vice President, Office of General Counsel, FINRA
Ms. Racquel Russell, Assistant General Counsel, Office of General Counsel,
FINRA