April 29, 2011

Exclusively via e-mail to pubcom@finra.org

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

Re: **Comments Regarding FINRA's Concept Proposal to Identify and Manage Conflicts Involving the Preparation and Distribution of Debt Research Reports (FINRA Regulatory Notice 11-11)**

Dear Ms. Asquith:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is submitting this letter to the Financial Industry Regulatory Authority, Inc. ("FINRA") in response to FINRA's request for comments regarding a concept proposal to apply objectivity standards and disclosure requirements to the publication and distribution of debt research reports, as set forth in FINRA Regulatory Notice 11-11 ("Concept Proposal"). SIFMA welcomes the opportunity to respond to FINRA's Concept Proposal.

I. Introduction

As an initial matter, SIFMA appreciates the time that FINRA has spent talking with buy-side and sell-side firms in formulating the Concept Proposal and FINRA's recognition that the debt markets (and, therefore, debt research) are different from the equities markets. With respect to this last point, SIFMA endorses FINRA's efforts to tailor certain proposed concepts in recognition that the debt markets operate differently. SIFMA agrees with FINRA that it is important for investor protection purposes to apply standards of conduct and other requirements to debt research. Currently, debt research is subject to the Securities and Exchange

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

Commission's ("SEC") Regulation Analyst Certification requirements and FINRA rules for communications with customers. Like the Concept Proposal, which would adopt a bifurcated approach for retail and institutional research, the current FINRA rules recognize a tiered approach for "institutional" versus "retail" sales material.[2] For almost a decade, FINRA's content standards have meant that institutional research and retail research for debt securities are subject to basic content standards, with additional requirements applying to retail research. FINRA's proposed bifurcated approach, then, is consistent with this tradition of applying additional requirements to materials that are provided to retail customers.

While FINRA's content standards have worked well over the years, both SIFMA and, before SIFMA, The Bond Market Association ("TBMA") have been active in advocating additional standards for debt research. To this end, TBMA issued Guiding Principles to Promote the Integrity of Fixed Income Research ("Guiding Principles") in 2004. In fact, many of the provisions in the Concept Proposal are similar to the Guiding Principles endorsed by TBMA, and we similarly endorse them here.[3] SIFMA, however, has concerns about certain aspects of the Concept Proposal – especially the provisions that go beyond the restrictions in FINRA's current rules for equity research analysts – which could, if adopted, have the negative effects of both (i) isolating debt research from other areas of firms and important sources of information, and (ii) hindering the ability of debt research analysts to provide the most timely and relevant research to customers. Given the other measures and safeguards that FINRA is proposing, the cost of certain proposed measures greatly outweighs any incremental investor protection benefit that they may have.[4]

II. **<u>Background Regarding Debt Research</u>**

Before discussing our specific concerns and responding to FINRA's requests for comments, we believe it is important to provide some background regarding the role that debt research analysts play at firms, the need for interaction between research analysts and sales and trading personnel, and the unique nature of debt research coverage. Debt research analysts play a key role at firms. They provide their core constituencies (customers, sales personnel, and traders) with information and views about fixed income securities that are not provided by any other source. Salespersons, traders, and customers all rely on the experience of research

---

[2] *See* NASD Rules 2210(a), 2210(a)(4), and 2211(a)(2). The terms "sales literature" and "institutional sales material" would include fixed income research reports that are sent to retail and institutional investors, respectively.

[3] *See e.g.*, Guiding Principles 4.1.1 (Prohibition on Promising Favorable Fixed Income Research), 4.1.2 (Prohibition on Retaliation), 4.3.2 (Restrictions on Review or Approval of Draft Research Reports), 4.7.1 (Prohibition on Soliciting Investment Banking Business), and 4.7.2. (Prohibition on Directed Participation in Investment-Banking Sponsored Marketing Efforts).

[4] In particular, and as described more fully below, SIFMA is concerned about the Concept Proposal's prohibitions on allowing key constituents, such as sales or trading personnel, to have input into budget and evaluations for retail research – even though there will be safeguards in place to ensure that such decisions are made and determined by research management, not other constituencies of firms. SIFMA also is concerned by the proposed prohibitions on certain important interactions between research and sales/trading and/or firm customers that do not raise investor protection concerns (such as the ability of fixed income research to discuss trading transactions that are specific to those personnel and/or customers and not inconsistent with published research).

analysts to understand bond structures, the yield/risk characteristics of bonds, and the prospects for particular issuers and the industries and sectors in which they operate. In particular, analysts assist salespeople and traders in the following ways:

- *Salespeople*. In assessing the correct type of bond to meet a particular investor's needs, salespeople need to understand the promised coupon or yield of the specific instrument and risk factors (*e.g.,* vulnerability to macroeconomic factors such as changes in interest rates) and unique structural characteristics (*e.g.,* the nature of the indentures) in the context of the customer's portfolio and/or benchmark securities. By utilizing knowledge gained through discussions with research, sales personnel help customers make informed investment and trading decisions, and are better able to serve customer interests. The ability of salespersons to assist customers in making informed decisions about investments in fixed income securities may be hampered if analysts are unable to provide information and insights about these securities to sales personnel. The end result may be that customers are deprived of important information regarding these products.

- *Traders*. To better manage risk and trading and position limits, traders utilize the services of debt research analysts to understand the risks represented by issuers, instruments, sectors, and markets. This interaction is important because the nature of the debt markets requires firms to act in a principal capacity to facilitate customers' trading. Firms with significant debt franchises are required to carry on their books debt securities or instruments representing many issuers and classes of securities in order to facilitate ordinary customer trading flows. To assist them in better managing risk and firm positions and facilitating customer transactions, traders will often talk to research analysts to more fully understand an issuer's debt capital structure and how macroeconomic and market factors may affect the issuer's different classes of bonds. For example, the same issuer may have several bond issues that have different interest rates, redemption dates, claims on company assets, indenture provisions, change in control provisions, and/or call provisions. These differences necessarily will affect the way the bond trades and responds to market events, both in the short and long term. This is the same type of information that an analyst would discuss with an investing customer.

It is also critical from the research analyst's perspective for debt analysts to be able to interact with sales and trading personnel. As noted in the Concept Proposal, the "staff understands that the uniqueness of the debt market as compared to equities (*e.g.,* limited last sale transparency information) necessitates communication between analysts and traders in certain fundamental regards."[5] Because there are thousands of bonds, only a fraction of which can actually be discussed in written research given resource constraints, research analysts need input from all constituencies to identify and write about securities that are most relevant to the firm's customers. Also, because the value and pricing of debt securities are typically determined in part by macroeconomic factors and reference to benchmark and peer securities, research analysts

---

[5] Regulatory Notice 11-11, at n.10.

need to interact with salespeople and traders to gather, synthesize and interpret market information to obtain accurate valuations of, and prices for, debt securities. For example, trading personnel may have broad market information about the level of trading activity and/or various spread levels for a particular security, class of securities, or securities within an industry. This information would be difficult for a research analyst to obtain independently. Such information can help provide valuable insight into different classes of securities, or explain differences in spread levels for similar securities within an industry. Additionally, salespeople are in constant contact with customers and therefore may have the best aggregated view of customer interests. Analysts, who also communicate with customers, need to be able to discuss customers' reactions with sales and trading personnel to better serve those customers. Salespersons' and traders' insights assist research analysts in understanding customers' areas of focus and concerns.

Finally, the notion of "coverage" typically is more fluid for debt research, as compared to equity. Because there are thousands of bonds, an individual analyst may write on hundreds of different securities over the course of a year. For many of these securities, the analyst may only publish once on the security and, therefore, would not initiate or maintain formal ongoing "coverage" in the way that an equity analyst typically covers specific equity securities or companies. Also, it would not be unusual for an analyst to have different recommendations for different bonds of the same issuer.

III. **Comments Regarding the Concept Proposal**

With this background in mind, SIFMA responds to specific items for which FINRA has solicited comments, requests clarification regarding certain proposed provisions, and discusses concerns about certain aspects of the Concept Proposal. SIFMA's comments are organized to correspond to the ordering of issues in the Concept Proposal.

A. **Definition of "Debt Security"**

The requirements in the Concept Proposal would apply to any person who prepares a research report on a "debt security." FINRA has proposed to define the phrase "debt security" as "any 'security' other than an 'equity security,' a 'treasury security' or a 'municipal security' (as those terms are defined in the federal securities laws)." SIFMA is concerned that, because this definition is framed in the negative, it inevitably will cover types of securities that should not be considered "debt securities." For example, read literally, this definition could include non-equity securities not traditionally considered debt securities, such as security-based swaps. SIFMA encourages FINRA to either define "debt security" affirmatively, or solicit comments on the types of additional securities that should be excluded from this definition.

SIFMA also asks FINRA to clarify that the reference to the exclusion of "treasury security[ies]," which to our knowledge is not a defined term in the federal securities laws, was meant to reference "government securities" as defined in Section 3(a)(42) of the Securities Exchange Act of 1934, as amended. We believe the rationale for excluding Treasury securities applies equally to other government securities that are backed by the full faith and credit of the

United States (such as Treasuries) or by the full faith and credit of any agency or instrumentality of the United States government. Similarly, we believe government securities (including municipals) issued by non-U.S. industrialized countries that are part of the G-20[6] should be excluded from the definition of debt security. Like U.S. government securities, these securities are obligations of major industrialized nations or their agencies and instrumentalities. Also like government securities research, research on non-U.S. sovereign securities generally is more macroeconomic in nature and is less likely to raise the potential conflicts that FINRA's new proposed concepts are designed to address.[7] Based on these considerations, we request that FINRA exclude U.S. government securities and non-U.S. government and municipal securities issued by G-20 nations from the definition of "debt security."

B. **Standards Applicable to Retail Debt Research: Prohibitions on Input Into Research Budget and Evaluations, and Prohibition on Considering Analysts' Contributions to Sales and Trading Activities**

SIFMA is concerned by the Concept Proposal's prohibitions on allowing key constituents, such as sales and trading personnel, to have any input into budget and evaluations for research analysts who publish retail research. SIFMA also is concerned by the proposal to prohibit compensation committees from considering an analyst's contributions to sales and trading activities. In particular, we believe (i) these prohibitions will diminish the important role that debt analysts play at firms and disassociate research from other customer-facing fixed income departments of the firm (thus, making debt research less relevant and less useful to investors), and (ii) there will be little, if any, incremental investor protection benefit – particularly in light of the other safeguards that FINRA has proposed for debt research.

1. Legitimate and Important Reasons for Allowing Input Into Budget and Evaluations, and Committee Consideration of Sales and Trading Activities

It is important for management of sales and trading areas of the firm – like other constituencies who use the research services of debt analysts – to provide input into the debt research budget. Fixed income research is not self-funded. It relies on funding from other areas of the firm to operate, in particular sales and trading. During the budgeting process, research management must make decisions about allocating analysts and resources across various markets and disciplines based on anticipated areas of customer interest and market growth. The size of a particular research group's budget (*e.g.* mortgage research, high yield research) is necessarily influenced by the size of the respective market and the relevance of that market to the firm's customer base. Decisions regarding the research budget, therefore, must take into account the views of sales and trading management personnel because these personnel not only are

---

6 G-20 means the Group of Twenty Finance Ministers and Central Bank Governors.

7 With respect to the definition of "debt research report," FINRA proposes to largely mirror the definition of "research report" set forth in NASD Rule 2711 and the related exclusions. We encourage FINRA to consider additional exclusions from the definition of debt research report that may be appropriate in light of the unique characteristics of the fixed income markets.

significant users of research resources, but also have direct knowledge of customer interest regarding new products and potential areas of product growth. If firms are not permitted to consider input from sales or trading management, firm management will be making decisions about the research budget in a vacuum, without regard to firm-wide goals, initiatives, or customer-driven priorities. This lack of input inevitably would result in a mismatch between research department funding and customer needs. Further, it could have the unintended consequence of less funding being provided for research.

It is also important for sales and trading personnel – like other constituencies who use the research services of debt analysts – to provide input into the evaluations of debt research analysts. Similarly, it is important for analysts' contributions to sales and trading activities to be considered by research management and compensation committees. Research analysts' ability to offer articulate and insightful analysis to sales and trading is a significant part of their role at firms. As described above, sales personnel and traders rely heavily on debt research and research analysts to help them better understand the terms of and risk factors associated with specific issues so that they are better able to assist customers in making informed investment and trading decisions. Traders and trading management also rely on research analysts to help them manage risk related to firm positions, and facilitate customer trades through market making and counterparty transactions. Sales and trading's assessment of the quality of research, therefore, is an important consideration for research management in assessing the overall performance of research analysts.

Moreover, without input from sales personnel, it would be virtually impossible to understand a debt research analyst's contributions to, and impact on, customers. There is no systematic way to receive direct customer feedback regarding debt research. In this regard, there is no mechanism for retail customers to provide comprehensive views on research, and there is limited ability for institutional customers to provide formalized feedback regarding the quality of any research product. For instance, there are only a small number of surveys and broker votes relevant to fixed income research.[8] In order to truly ascertain the customer impact of analysts, research management must ask the people who work most closely with customers: sales personnel. Sales personnel are in constant contact with customers and are uniquely positioned to provide research management with clients' perspectives regarding the quality of an analyst's published content and the quality of such analyst's service to customers. As such, sales personnel are a critical proxy for a firm's customers and can provide important feedback regarding customers' views to assist management with evaluation and compensation decisions.

[8] Even for equity research, the amount of detailed information contained in broker votes varies widely among customers, with many providing limited feedback and others providing no broker votes at all. So, by necessity, broker vote information is only one element considered when assessing the customer impact of equity analysts.

2. <u>Other Safeguards That Are Sufficient to Promote Research Analyst Independence and Research Quality</u>

Putting aside these important and legitimate reasons for allowing sales and trading personnel to provide input into evaluations and budget, and for compensation committees to consider sales and trading activities, we do not see any discernable investor protection benefit in prohibiting such input or consideration. To this end, there are important safeguards that FINRA has proposed for retail research that would promote research analyst independence and quality with respect to compensation, evaluation, and budget considerations. These safeguards, which SIFMA fully supports, include the following:

- Research management shall be responsible for final decisions regarding evaluations and compensation.

- The budget shall be set by firm management and research management shall have the final decision in allocating the research budget.

- Debt research analysts shall not be compensated based on the success or revenues derived from specific sales and trading transactions.

- Investment banking shall not have any input into the evaluation of debt research analysts or into the research budget.

- Research analysts' compensation shall be reviewed and approved by a compensation committee, which will serve as an important safeguard to prevent inappropriate influence of sales and trading personnel into compensation decisions. This committee will consider the quality of the research product.

These are important safeguards that will help assure that decisions relating to research are not inappropriately influenced by other sectors of the firm. To be sure, these safeguards have worked well in the equity context. We are not aware of instances or examples that would justify a complete prohibition on (i) input into evaluations and budget by sales and trading personnel, and (ii) compensation committees from generally considering sales and trading activities. For the reasons set forth above, any measurable investor protection benefit derived from these prohibitions would be greatly outweighed by the costs of prohibiting important constituencies from providing feedback regarding research.

C. **Standards Applicable to Retail Debt Research: Personal Trading Restrictions and Disclosures**

SIFMA agrees with FINRA that it is important to provide disclosures regarding conflicts of interest in debt research, and to impose personal trading restrictions on debt analysts that are designed to address conflicts of interest. SIFMA believes, however, that the Concept Proposal's equity-type prohibitions on personal trading and equity-type disclosures for retail research need to be tailored so they are workable in the context of debt research.

1. Proposed Personal Trading Restrictions

As noted above, in many cases, debt research analysts do not "cover" securities in the same way as equity research analysts.[9] Even if there is coverage over some securities, analysts often issue trade ideas and trading strategies that are episodic and market-driven. Also, analysts are more likely to write in response to market events and only in cases where the relevant bond is available with sufficient liquidity. Indeed, certain asset classes (in particular, mortgage and asset backed securities) and series of corporate bonds may not trade for extended periods. Accordingly, even where a research analyst formally initiates coverage on a set of bonds, he or she may also write about – but not formally "cover" – other bonds that have similar interest and payment characteristics to those bonds the analyst covers. Further complicating the notion of "coverage" in the debt context, because the characteristics of different bonds issued by the same issuer may be quite different, an analyst may "cover" a particular issuer but have a different outlook or rating for the different bonds of that issuer. In this regard, a debt issuer may issue a variety of different types of debt securities (*e.g.,* secured, unsecured), each with its own structural dynamics and the prices of which are likely to respond differently to interest rate-related or credit-related information. An analyst could, therefore, have different recommendations for different bonds of the same issuer that he/she covers. In addition, analysts may recommend trades for specific bonds on an ad-hoc basis.

Given the different types of research product (*e.g.*, two-legged trade ideas and relative value analyses), the market-driven and episodic nature of research, and the fact that "coverage" is a very fluid concept, it would be significantly more difficult to mirror certain equity-type restrictions in the debt research context. For example, it may be difficult to determine what kind of trading would be inconsistent with an analyst's recommendation because an analyst may have different views on different bonds for the same issuer. For these reasons, a wholesale application of the equity personal trading restrictions is not tenable in the debt context. Instead, SIFMA encourages FINRA to adopt a formulation for personal trading that is similar to that proposed for analysts in Regulatory Notice 08-55, which would require firms to implement appropriate policies and procedures to prevent conflicts of interest with respect to analysts' personal trading. Specifically, SIFMA supports the adoption of the following standard for personal trading:

---

[9] We note that some retail firms provide more formal coverage, similar to the equity markets.

> *Firms should be required to establish policies and procedures reasonably designed to help ensure that analysts and others with the ability to influence the content of research reports do not benefit in their trading from the knowledge of the 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 report.*

We believe that this standard would allow firms to better tailor their personal trading policies to capture conflicts of interest that may arise based on their unique fixed income research models.

2. Proposed Disclosures

SIFMA appreciates FINRA's acknowledgement that disclosures used in the equity research regulatory regime need to be modified in light of the unique nature of the fixed income market. As with the personal trading restrictions, disclosure requirements tied to equity concepts of "subject company" of "research reports" are very difficult to implement, given the number of debt securities, the variety of debt research products, and the fluid nature of debt research "coverage." Where analysts do not have a predetermined set of companies they cover, firms would have to establish systems to track compensation received from, and relationships with, the entire universe of possible issuers of debt securities – including corporates and agencies. Those systems would need to be designed to identify and aggregate such compensation or relationship information on little notice since the subjects of debt research often are determined in reaction to market events. For these reasons, a wholesale application of the equity-type disclosures is not tenable for debt research. SIFMA, therefore, encourages FINRA to apply the disclosure requirements to only those securities with respect to which the analyst has initiated formal coverage and assigned a rating.

Additionally, it is unclear what information relating to ownership interest would need to be disclosed in debt research reports. For equity research, NASD Rule 2711 requires disclosure if the firm owns 1% or more of the subject company's common equity securities. Implementing the disclosure of position information in equities securities was manageable, given that most firms had existing systems to track equity ownership for §13(d) purposes. In contrast, building a database and system that can identify, across an entire firm, the aggregated net proprietary ownership in a debt security "immediately prior to" the issuance of a research report will be very difficult to implement because (i) firms do not have systems established to capture this information with regard to debt securities, and (ii) it may be impossible to determine all of the debt securities that a particular issuer has outstanding (which, in turn, makes it very difficult to ascertain whether a firm has a specific ownership interest in such issuer's debt). Moreover, given the complexity and multitude of securities and derivatives for any individual issuer, the fact that there may be long and short positions in different bonds of the same issuer, and the fact that positions are changing on a minute-by-minute basis, it would extremely difficult to have real-time disclosure regarding the firm's credit exposure to an issuer at any given point in time. For these reasons, we urge FINRA to adopt a standard that permits firms to determine, based on their own reasonable standards, what types of investments need to be disclosed as a material conflict of interest (*e.g.*, when holdings in fixed income securities of a subject company are material for a particular firm, such that disclosure may be appropriate).

D. **<u>Standards Applicable to Institutional Debt Research</u>: Proposed Institutional Research Disclosure**

SIFMA agrees that there should be a "health warning" disclosure for institutional research to alert recipients that the material is intended for institutional investors only and not subject to all of the retail research safeguards. SIFMA asks FINRA to confirm, however, that the disclosure that institutional research "may not be independent of the firm's proprietary interests" is only required "if applicable," and is not necessary for all research that is produced in reliance on the institutional investor exemption.[10] In this regard, different firms have adopted different models for producing research. For example, some firms may elect to structure their institutional research departments in an independent manner and have adopted policies and controls to promote the independence of research from proprietary trading interests. In these cases, the proposed statement regarding non-independence would be incorrect and unnecessary. SIFMA, therefore, believes that firms should be required to disclose that "research is not independent of the firm's proprietary trading interests" only if applicable, based on their respective models and policies and procedures. We ask that FINRA confirm this view.

E. **<u>Standards Applicable to Institutional Debt Research</u>: Definition of "Institutional Investor" and Eligibility for the Institutional Research Framework**

SIFMA supports the tiered framework of "institutional" and "retail" research proposed by FINRA, and agrees with FINRA that many aspects of the debt market are largely institutional. SIFMA also supports the Concept Proposal's definition of "institutional investor," which is consistent with the definition that is relevant for the NASD's institutional sales literature material rule, Rule 2211. SIFMA asks FINRA to confirm that firms may continue to rely on the standards set forth in NASD Rule 2211 in qualifying for the institutional framework. Specifically, these standards require firms to implement policies reasonably designed to identify institutional investors and ensure that institutional research is only made available to those investors. Under these standards, if a communication is forwarded to a retail investor (for example, by a firm's institutional customer) despite the firm's disclosures that the communication should not be so forwarded, the firm could still rely on the institutional framework, so long as it adopted reasonably designed policies and procedures to prevent retail customers from receiving this information. As noted, this existing structure has worked well and provides firms with an existing regulatory framework to consult when implementing these new provisions.

---

[10] Specifically, the Concept Proposal requires firms to include a statement "if applicable" that "the research may not be independent of the firm's proprietary trading interests."

F. **<u>Standards Applicable to All Debt Research</u>: Conflicts of Interest Relating to Investment Banking**

1. <u>Coverage Decisions</u>

The Concept Proposal would prohibit investment banking personnel from having input into research coverage decisions. Acknowledging that research management exercises final discretion over coverage decisions, we ask that FINRA clarify that the proposed prohibition on investment banking personnel's input into coverage decisions will prohibit investment banking from having input into specific company coverage decisions, but still allow input into category-by-category coverage decisions (*e.g.*, a given sector, all issuers underwritten by the firm, companies meeting a certain market capitalization threshold).

Such clarification would be consistent with the Global Research Settlement and would recognize that there are important and legitimate reasons for allowing category-by-category input. For example, when a new fixed income security is introduced by investment banking, customers rely on fixed income research analysts to provide them with independent analysis of these securities once they begin trading in the secondary markets. As these new products are introduced, it is important for investment banking to provide research management with its input regarding category-by-category coverage decisions because such input permits research management to better deploy its resources in order to meet customers' desires for analyses of these new products. Also, it is extremely important for research management to understand the broad areas of underwriting (*e.g.*, by product, sector, or region) anticipated by the capital markets area of the firm so that debt research is appropriately staffed to deal with anticipated vetting requests and with related investor education efforts.[11]

2. <u>Prohibitions on Certain "Three-Way" Communications</u>

The Concept Proposal would prohibit certain "three-way" communications among debt analysts, customers, and either (i) investment banking personnel, or (ii) issuer management. The prohibition relating to institutional research qualifies this prohibition, making clear that the prohibition only applies to "*communications about an investment banking services transaction*." This formulation is consistent with the prohibitions in the equity research rule, NASD Rule 2711. The prohibition relating to retail research, however, contains no such qualification. We assume that this omission was not intentional, and therefore ask that FINRA clarify that the prohibitions on certain "three-way" communications involving retail debt research analysts, customers, bankers, and issuer management would be interpreted consistently with Rule 2711 and the institutional research provision.

---

[11] Debt analysts play the same risk mitigation and customer protection role that equity analysts play in the equity offering context by participating in vetting and screening processes during debt offerings – a role that the regulators recognized as valuable when granting exceptions to the Global Research Settlement regarding equity underwritings.

We also ask that FINRA clarify what it means by "other marketing" in its proposed prohibition on research analyst involvement in "pitches, road shows, and other marketing." In this regard, we ask that, consistent with Rule 2711, FINRA clarify that this prohibition is only intended to cover deal-related road shows and investment banking solicitations (or pitches).

Finally, we ask that FINRA clarify that debt research analysts may passively attend company-sponsored road shows where the presence of the analysts is not announced to other participants. SIFMA believes such passive attendance does not raise the concerns the proposed concepts are designed to prevent. The ability of debt analysts to hear information from company management is particularly important in debt offerings because debt offerings often move very quickly and there may be few opportunities for analysts to hear from company management during the truncated offering process. Such passive participation is consistent with TBMA Guiding Principles.

G. Standards Applicable to All Debt Research: Proposed Firewalls

SIFMA agrees that there should be separation between debt research department personnel and sales and trading personnel, in order to promote the independence of debt research department personnel and to manage conflicts of interest. SIFMA, however, has a number of requests for clarification relating to the proposed firewalls for retail and institutional research and some specific concerns. In this regard, SIFMA is concerned that certain language in the Concept Proposal might be read to prohibit important interactions between research and sales and trading personnel and/or firm customers and, thus, could weaken the critical role that debt research analysts serve. These interactions do not raise investor protection concerns, and we ask that FINRA provide clarification, as discussed below.

1. Consistency with NASD Rule 2711

First, SIFMA requests that FINRA clarify that the communication "firewalls" operate consistently with the approach taken in NASD Rule 2711, and that communications between debt research analysts and sales and trading personnel are permissible unless they are specifically prohibited.

2. Prohibition on Identifying or Recommending Specific Potential Transactions

Second, SIFMA is concerned by the Concept Proposal's statement that debt research analysts would be prohibited from "*identifying or recommending specific potential trading transactions to sales/trading personnel that are not contained in the research analyst's currently published reports*." We are concerned that this provision, as currently drafted, would prevent research analysts from performing the important role that they play, as described above, in assisting sales and trading personnel and customers with understanding transactions that are tailored to a particular customer or trader's interests and helping the firm manage its risk. As currently drafted, this provision also appears to be inconsistent with footnote 12 in the Concept

Proposal, which recognizes that an "*analyst's communications with sales and trading personnel would not be deemed 'inconsistent' with the analyst's published research where the investment objectives or time horizons being discussed differ from those underlying the analyst's published views*."

If a salesperson wants to discuss specific bonds with a research analyst that a customer is interested in, this provision, as currently drafted, could be read to prevent the analyst from discussing those bonds or any possible transaction in those bonds unless the analyst has written about those specific bonds or the specific possible transaction in a research report, which would curtail the discussions research analysts could have with customers and sales personnel. As stated earlier, because of the large universe of bonds, combined with practical resource constraints, research analysts only write about a fraction of the bonds that are trading at any particular point in time; since many issuers have dozens of bonds outstanding, it is not feasible for an analyst to publish a view on each one. Also, based on this provision, analysts would be prohibited from discussing a short-term trade idea with a salesperson in response to a specific customer request if the trade idea varies from the analyst's long-term view but addresses the customer's specific desire for a short-term position. This seems contrary to the concept expressed in footnote 12 of the Concept Proposal, which allows discussions "inconsistent" with the analyst's published research where the time horizons discussed differ from those underlying the analyst's published views.

The above-noted provision, as currently drafted, is also problematic for trading personnel. Trading personnel frequently request risk assessments regarding particular bonds from analysts prior to taking on positions. These communications serve important risk management purposes for customer facilitation trading desks and should not be prohibited. Given that trading personnel also need to discuss different bonds and trade ideas with research analysts for purposes of market making, risk management, and managing firm positions to facilitate customer trades, this provision is equally problematic when applied to communications between traders and research analysts.

For all of the above reasons, we ask that FINRA modify this proposed provision, so that it is consistent with footnote 12 in the Concept Proposal. In particular, the provision should focus more precisely on preventing selective dissemination of recommendations intended to be published in a research report to certain customers or trading personnel, in advance of a broader dissemination of those recommendations. For example, we would support a provision that would prohibit a debt analyst from recommending an actionable trade idea to sales or trading personnel in advance of publishing such idea in a research report. We also would note that fixed income research department analysts already are subject to the safeguards in FINRA Rule 5280, which restricts information flow between research department personnel and trading department personnel.

3. Prohibition on Communications "For the Purpose of Determining the Profile of a Customer"

The Concept Proposal contains a prohibition on debt analysts "*otherwise having any communication for the purpose of determining the profile of a customer to whom research should be directed.*" SIFMA is concerned by the ambiguity and breadth of this provision, as currently drafted, and requests that FINRA clarify which communications it intends to prohibit. While we understand and agree that research analysts should not write research reports solely for the purpose of benefiting the trading positions of a specific customer, analysts must be permitted to communicate with sales and/or trading personnel to determine which bonds, issuers, or sectors are of the most relevance to the firms' customers. In fact, some research analysts may provide specific or customized analyses for individual customers. For these reasons, the proposed prohibition needs to be refined to address the specific types of activities that FINRA deems problematic. We would support a prohibition, for example, that is focused on research analysts who publish research reports solely to benefit a customer's position. This type of prohibition is appropriately limited considering other existing regulations such as Regulation AC, which requires analysts to attest that all of their views expressed in their research reports accurately reflect their personal views.

4. Prohibition on Attempting to Influence Opinions or Views

The Concept Proposal contains a general prohibition on "*attempting to influence a debt analyst's opinions or views for the purpose of benefiting the trading position of the firm, a customer, or a class of customers*." As currently drafted, it is not clear what types of activities this prohibition is intended to address. There are many appropriate conversations that occur among research analysts and sales and trading personnel, which we would expect that FINRA does not intend to prohibit with this provision. For example, it is appropriate for sales and trading personnel to communicate with analysts regarding which sectors, companies, or asset classes are of interest to customers based on their extensive day-to-day contact with customers. Analysts may respond by drafting trade ideas or research reports that are of interest to these customers. These types of interactions with sales and trading personnel and customers should not be prohibited. For these reasons, we ask FINRA to clarify that this provision is intended to prevent sales and trading from attempting to *inappropriately* influence a debt analyst's opinions or views in a research report for the purpose of benefiting the trading position of the firm, a particular customer, or class of customers. This provision, as clarified, would complement other proposed and existing regulations including the requirements for research personnel to have final authority over the content of any research publication, for each analyst to include a Regulation AC certification attesting the contents of a report accurately reflect the analyst's personal views, and for research departments to restrict access by sales and trading to unpublished research reports.

H. **<u>Proposed Opt-in/Opt-Out Requirement for Institutional Research</u>**

SIFMA believes that the proposed opt-in/opt-out requirement for institutional research is unnecessary, unworkable, and should be eliminated. As stated above, for almost a decade, FINRA has relied on a bifurcated framework with respect to retail and institutional sales material (which would include debt research) under NASD Rules 2210 and 2211. This framework has worked well, even though there has been no "opt-out" provision for institutional investors who want to be treated like retail investors. We encourage FINRA to take the same approach for debt research that it has adopted for institutional sales literature – specifically, any communications that are sent to "institutional investors" should meet the definition of "institutional research" and not be subject to all of the requirements for retail communications. The protections afforded by the existing framework, coupled with new safeguards for institutional research in the Concept Proposal, should provide ample safeguards for institutional research.

Moreover, the opt-in/opt-out selection would be extremely expensive and burdensome for firms to implement and would be difficult from a planning perspective. This proposal would require firms to determine which, if any, of their customers satisfy the institutional customer definition and which, if any, have elected to opt in to the retail framework. These determinations would have to be updated and changed if a customer opts to receive retail protections at a later date. Based on these determinations, firms that do not currently provide retail research would be required to amass a retail research function, or elect not to provide retail research at all, if a single institutional investor elects to receive the retail protections. It would be extremely burdensome and expensive for firms to establish two different research businesses, which may result in separate but unequal research products.

We also ask that FINRA allow institutional customers who do not meet the monetary thresholds in FINRA's definition of "institutional investor" to receive institutional research if they (i) satisfy the monetary thresholds required for "accredited investors,"[12] and (ii) request such research with the understanding that the institutional framework applies. The ability of these types of institutions to receive institutional research is important, particularly where a firm does not have a retail product offering.

I. **<u>Effect on Retail Debt Research</u>**

The provisions in the Concept Proposal applicable to retail debt research may result in a retail offering that is limited in both scope and depth. As noted, the restrictions on analysts' communications with important and legitimate constituencies, such as sales and trading personnel, may result in a less meaningful product for investors and/or lead to reports about securities that are not of interest to investors. The result may be that retail customers no longer have access to a broad range of relevant debt research and the research provided to them may be

[12] *See* Rule 501 of the Securities Act of 1933, as amended.

less comprehensive. Based on these concerns, we urge FINRA to adopt the modifications to the proposed retail debt research concepts requested in this comment letter.

* * * *

We appreciate the opportunity to submit this letter to you. We would be pleased to discuss this matter further with you and to provide you with any additional information you believe would be helpful in connection with your consideration of this matter. Please feel free to direct any questions you may have in this regard to the undersigned at (202) 962-7386 or jmchale@sifma.org, or Yoon-Young Lee or Stephanie Nicolas of Wilmer Cutler Pickering Hale and Dorr LLP at (202) 663-6720 and (202) 663-6825, respectively.

Sincerely,

James T. McHale
Managing Director and Associate General Counsel
SIFMA

cc: Mr. Marc Menchel
Mr. Philip Shaikun
Ms. Racquel Russell