

THE ALLIANCE IN SUPPORT OF INDEPENDENT RESEARCH

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Marcia E. Asquith  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20006-1506

Re: Regulatory Notice 12-09- Debt Research Reports

Dear Ms. Asquith:

This letter is submitted on behalf of the Alliance in Support of Independent Research in response to FINRA's request for comments regarding the above-referenced Regulatory Notice.

Members of the Alliance share a common interest in fostering a favorable regulatory environment in which research services and products may be furnished to the money management community, and in preserving the umbrella of protection Section 28(e) of the Securities Exchange Act of 1934 provides to fiduciaries who receive all forms of investment research.

The leading members of the Alliance in Support of Independent Research include the following broker-dealers:

BNY ConvergeX Group, LLC  
John D. Meserve, Executive Managing Director

Capital Institutional Services, Inc.  
Kristi P. Wetherington, President and CEO

Knight Capital Group, Inc.  
Thomas M. Merritt, Esq., Senior Managing Director and Deputy General Counsel  
Kevin M. Donohue, Managing Director  
Paul Wagenbach, Esq., Vice President, Assistant General Counsel

The Interstate Group Division of Morgan Keegan & Co., Inc.  
Grady G. Thomas, Jr., President  
Jay Thomas, Chief Operating Officer

Our members are involved in a significant portion of the arrangements under which fiduciaries such as mutual funds, investment advisers, banks and other money managers are provided with independent research services and products for the benefit of their managed accounts.

### **Application of the Proposal to Independent Third-Party Research**

The Alliance's comments are primarily addressed to those aspects of the Regulatory Notice which would impact the provision of third-party debt research by FINRA members to institutional asset managers through client commission arrangements structured to comply with the safe harbor under Section 28(e) of the Securities Exchange Act of 1934. In this regard, we note that in a typical third-party client commission arrangement, at the request of an asset manager, an independent third-party research preparer delivers its research product directly to an asset manager. The "providing" broker-dealer pays the research preparer directly, leaving no opportunity or rationale for the research product to be reviewed by the broker-dealer.<sup>1</sup>

Regulatory Notice 12-09 recognizes that the debt research report rule should generally not apply to independent third-party research, stating:

The revised proposal also sets out the requirements for the review and distribution of third-party research. It generally incorporates the current standards for third-party equity research, including the distinction between independent and non-independent third-party research with respect to the review and disclosure requirements. In short, a firm need not review independent third-party debt research prior to distribution and may not have to include certain otherwise applicable disclosures depending on whether the research is "distributed" or made available."<sup>2</sup>

Notwithstanding this language from the Regulatory Notice, the actual text of the proposed rule leaves some question as to the responsibilities of broker-dealers who make available independent third-party debt research.<sup>3</sup>

The requirements applicable to the distribution of third-party research reports are contained in paragraph (h)(1) through (h)(5) of the proposed rule. Paragraph (h)(3) of the proposed rule exempts third-party debt research reports from the review requirements of

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<sup>1</sup> See, e.g., SEC Rel. No. 34-54165, 71 Fed. Reg. 41978, 41992 (July 24, 2006). According to the SEC, to satisfy the "provided by" element of Section 28(e), the broker-dealer would either be legally obligated to the research preparer to pay for the research, or would satisfy the element by: 1) paying the research preparer directly; 2) reviewing a description of the services to be paid for for red flags that indicate the services are not within Section 28(e) and agreeing with the Manager to use commissions only to pay for services within the safe harbor; 3) developing procedures so that research payments are documented and paid for promptly. *Id.* at 41994-95.

<sup>2</sup> Regulatory Notice 12-09, at 13.

<sup>3</sup> An independent third-party debt research report is a third-party research report in respect of which the person producing the report: (A) has no affiliation or business or contractual relationship with the distributing member or the member's affiliates reasonably likely to influence the content of the report; and, (B) makes content determinations without any input from the member or a member's affiliates.

(h)(1)(C).<sup>4</sup> Paragraph (h)(4) exempts independent debt research reports “made available” (rather than “distributed to”) customers by a broker-dealer from the provisions of paragraph (h)(2)<sup>5</sup> and (h)(1)(B).<sup>6</sup> There does not, however, appear to be any exemption for independent third-party research from the requirements of paragraph (h)(1)(A) or (h)(5) of the proposed rule.

Paragraph (h)(1)(A) requires a broker-dealer who distributes independent third-party research to establish, maintain and enforce policies and procedures reasonably designed to ensure that any third-party debt research report it distributes is “reliable and objective.” A broker-dealer who makes available independent debt research reports upon request through a client commission arrangement is not in a position to determine the reliability or objectivity of a report, nor would it necessarily have the capacity to do so, as the research report would typically be selected by the broker-dealer’s institutional client and delivered directly to the client by the independent third-party author.

A similar issue is raised by paragraph (h)(5) of the proposed rule, which requires a member to “ensure that a third-party debt research report is clearly labeled as such and that there is no confusion on the part of the recipient as to the person or entity that prepared the debt research report.” There are several issues with imposing this obligation on broker-dealers who provide independent third-party research upon request. First, as discussed above, such research is typically selected by, and delivered directly to, a member’s institutional client, and is not subject to review by the member. Second, by definition, a member is not in a position to influence or determine the content of independent third-party research, including presumably the labeling of such research as an “independent third-party debt research report.”

The Alliance therefore requests that FINRA amend paragraph (h)(4) of the proposed rule to indicate that a member who “makes available” independent debt research will not be considered to have distributed such research for purposes of paragraph (h)(1) and (h)(2) and amend paragraph (h)(3) to extend the exemption contained therein to paragraph (h)(5) in addition to paragraph (h)(1)(C).

### **Application of the Proposal to Institutional Investors**

The Alliance notes that FINRA has proposed that many of the requirements applicable to debt research reports would not apply to reports distributed only to “institutional investors,” provided that such institutions have affirmatively notified each broker-dealer in writing that they wish to forego the protection of the rule. This is a change from FINRA’s original proposal, which would have automatically excluded institutional

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<sup>4</sup> Paragraph (h)(1)(C) requires a member to establish, maintain and enforce procedures designed to ensure that any third-party debt research report it distributes contains no untrue statement of material fact and is otherwise not false or misleading.

<sup>5</sup> Paragraph (h)(2) requires a member to accompany a third-party debt research report with certain disclosures.

<sup>6</sup> This is so because (h)(1)(B) requires a member firm to put in place procedures reasonably designed to ensure that third-party debt research reports contain the disclosures required by (h)(2). Accordingly, a member exempt from making disclosures under (h)(2) would presumably be exempt from drafting procedures to ensure that such disclosures are made.

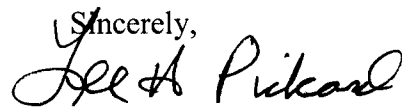
investors from most of the provisions of the rule, unless the institutions “opted-in” to protections available to retail investors. We believe FINRA’s original approach, permitting institutions to “opt-in” rather than requiring them to “opt-out” is more appropriate. The default of excluding institutions from most provisions of the debt research report rule is consistent with the general notion under U.S. securities laws and regulations (including FINRA’s own suitability rule) that institutions are typically sophisticated investors who are able to independently assess investment opportunities. We also note that the “opt-out” proposal would impose an administrative burden on the back-offices of both member firms and institutions that would likely result in its rare use.

**Application of the Proposal to Contacts Between  
Debt Research Analysts and Trading Staff**

Similar to Rule 2711, FINRA’s rule governing equity research reports, the debt research report rule would generally restrict contact between debt research analysts and a member’s investment banking department. The Alliance supports these provisions. The proposed rule, however, goes far beyond Rule 2711 by additionally restricting many contacts between debt research analysts and a member’s sales and trading personnel and principal trading personnel. It is not clear why more onerous regulatory obligations should apply to debt research reports than apply to equity research reports. The disparate application of the debt research report rule and Rule 2711 would impose administrative and compliance burdens on member firms that are not justified by any identified investor protection concerns. Accordingly, the Alliance suggests that if the debt research report proposal is adopted, its coverage be harmonized with Rule 2711.

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The Alliance in Support of Independent Research appreciates the opportunity to comment on these rule changes. If you have any questions, please do not hesitate to contact Lee A. Pickard or William D. Edick at 202-223-4418.

Sincerely,  


Lee A. Pickard  
William D. Edick  
Pickard and Djinis LLP  
Counsel to the Alliance in Support of  
Independent Research