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

Re: Comments on Proposal to Identify and Manage Conflicts Involving the Preparation and Distribution of Debt Research Reports (FINRA Regulatory Notice 12-09)

Dear Ms. Asquith:

As a member of the Small Firm Advisory Board (any opinions expressed here are my own and not those of the Board itself) I have had the opportunity to closely monitor the progression of this proposal over the past year. I have witnessed firsthand the rulemaking process and the toil and efforts of FINRA staff to craft a rule that adequately addresses potential conflicts in Debt Research. This rule proposal is much improved from earlier iterations, and I believe that these improvements are largely attributable to FINRA's openness and consideration of comments from a variety of perspectives: member firms, industry groups and associations, and the general public. This is greatly appreciated.

However, I write today with concerns about the rule proposal and specifically its impact on FINRA member Small Firms. I believe that this rule, while well intended, is broad in its scope, at times unnecessarily complex, and as written unduly burdensome on the Small Firm. To this last point, I would argue that it is impossible for many Small Firms to comply with the rule now or at any point in the future, without some type of Small Firm exemption. However, I do think the most current proposal, which gives certain relief to members with Limited Investment Banking Activity provides an excellent starting point.

Before delving into reasons why, let me first comment that I believe the essence and intent of the rule is best captured on page 6 of Regulatory Notice 12-09. It contemplates:

"... policies and procedures reasonably designed to promote objective and reliable research that reflects the truly held opinions of debt research analysts and prevent the use of debt research reports or debt analysts to manipulate or condition the market in favor of the interest of the firm or current or prospective customers or class of customers."

This is well written and I believe any member firm, large or small, that puts its clients first and makes protection of the public investor a priority will resoundingly agree.

It then continues in the next paragraph:

“Those policies and procedures must limit the supervision of debt research analysts to persons not engaged in investment banking, sales and trading or principal trading activities. They further require information barriers or other institutional safeguards to ensure debt analysts are insulated from the review, oversight or pressure from persons engaged in investment banking or principal trading activities or others who might be biased in their judgment or supervision.”

This is where the rule becomes problematic, particularly for small firms. Our firm has approximately \$1 billion in assets under management and twenty employees, but essentially one person wears the debt analyst/sales and trading hat and is also a member of senior management of the firm. How does one erect an information barrier in such a circumstance? Moreover, how does one construct a practical and effective barrier (and then supervise it) even when these roles are spread out amongst several people in an office of 5,000 square feet? I believe that there are many small boutique firms (perhaps in the hundreds) that are caught in this crossfire. Moreover, I also posit that many firms may not even realize so because they may mistakenly believe that the definition of “debt research” under the rule applies to selling or publishing research, not realizing the broader context of any communiqués they may have with their clients in the process of selling a bond are considered research.

In attempting to limit the interaction between debt research analysts and those outside the research department to preserve independent research, the rule becomes complex, and in my opinion at least, even overreaching. For example, the rule contemplates the determination of research budgets and compensation. While FINRA has given this topic much consideration and has further streamlined the process from prior versions, the rule prohibits certain types of compensation and permits others, calls for the formation of a committee “to annually review and approve of a debt analyst’s compensation” taking into account certain named considerations, states who can (by restricting who cannot) be on the committee, AND determines who can and cannot give input in the evaluation process. I am all for truly independent research and preventing undue influence, but from a practical standpoint I’ve got to believe that this has even Senior Executives and Compliance Officers of Large Firm members scratching their heads. But more to the point of this comment letter, this is again problematic from the perspective of the Small Firms who can’t possibly form an independent committee to review the actions of the debt research analysts and sales and trading personnel that would inevitably have to sit on it.

There are many excellent points in the rule. For example, the rule prohibits a research analyst (or a firm through its proprietary trading account) from trading in a manner inconsistent with a debt research analyst’s most recently published recommendation. Again, any firm that puts its clients first would unequivocally support this position. At the beginning of the millennium we witnessed rampant abuses where firms shamelessly issued debt research reports and traded (or at the very least commented) the other way, in order to get in good standing with issuers and win subsequent investment banking relationships. If one believes as I do, that this was the very essence behind the genesis of equity research rules and now its debt research counterpart, then I believe that if a firm does no fixed income

investment banking business or some *de minimis* amount is a great starting point for a Small Firm carve out of certain aspects of the rule. FINRA's revised proposal "exempts from certain provisions regarding supervision and compensation of debt research analysts those firms that over the previous three years, on average per year, have participated in 10 or fewer investment banking services transactions as manager or co-manager and generated \$5 million or less in gross investment banking revenues from those transactions." I wish to comment that this is an excellent starting point for an exemption, and while prior iterations of the rule proposal did not consider such relief (to my knowledge at any rate), it is greatly appreciated that FINRA recognizes potential burdens on Small Firms and is incorporating language into the rule to deal with such hazards. I would add however that because the impact to the Small Firm could be so burdensome, in its attempt to get the exemption right while balancing the integrity and effectiveness of the rule FINRA may wish to perform some type of impact study on small firms just over this exemption metrics implied herein, or at the very least actively identify and encourage further comment from firms on this bubble.

Regulatory Notice 12-09 is not clearly on exactly which provisions Small Firms would actually be exempted, and this must be considered moving forward. I have therefore taken the liberty of sharing a few of my own thoughts. In my opinion, at the very least the carve out should give Small Firms the relief from erecting information barriers or constraints of how compensation is determined and certain other provisions that are simply not practical from a Small Firm standpoint (and from a FINRA perspective probably difficult to enforce as such). However, I would also envision that it would not exempt Small Firms from what I call the "core" provisions of the rule (proprietary and personal trading provisions for example which are ethical standards that can be maintained regardless of firm size). Because Small Firms would not be exempted from these provisions, the public would still be protected even with this carve out. Moreover, I would argue that an additional safety net already is in place for the public, as there are already ample rules on the books (Rules of Fair Dealing, etc.) that could be enforced as a fallback position.

Thank you for the opportunity to comment on Regulatory Notice to Members 12-09.

Sincerely,



Joseph R.V. Romano

President

FINRA Small Firm Advisory Board Member

Additional Points of Comment:

1. The rule often references principal and proprietary trading, but I believe a distinction can and should be made for members at large. As an industry wide practice, many firms (in my estimation the majority of firms) run customer fixed income transactions essentially contemporaneously through their principal trading account with a reasonable markup. I think

this customary practice should be distinguished from proprietary trading where a firm seeks to profit from a change in market value of an underlying security. This latter practice is more subject to potential abuse because without disclosure clients would not know if a firm holds a position and therefore if it in so doing it conflicts with published debt research issued from the firm. On the other hand, this is not as much an issue on trades almost contemporaneously run through the principal side as firms will have a hard time selling fixed income positions run through their principal trading account to clients if they are issuing research, presumably to those same clients, which state a contra position.

2. As a further footnote, while municipal securities are not addressed in the scope and definitions in this rule presumably because they are covered by the MSRB, it is likely that the MSRB will mirror this rule on its books. Therefore, it is imperative to Small Firms that the rule gets written correctly the first time. Also, I believe anecdotally at least, that if municipal securities fall under the rule via an MSRB interpretation, the number of Small Firms affected mushrooms, as Small Firms are less likely to actively to underwrite corporate securities (a Large Firm market), but are often very active in municipal underwriting particular in the local and State arenas. This is problematic and bears great consideration.