



May 31, 2017

BY ELECTRONIC MAIL

Ms. Jennifer Piorko Mitchell
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-1506

**Re: Desk Commentary Safe Harbor from FINRA Equity and Debt Research Rules
(Regulatory Notice 17-16)**

Dear Ms. Mitchell:

The Securities Industry and Financial Markets Association¹ (“SIFMA”) appreciates the opportunity to comment on proposed amendments by the Financial Industry Regulatory Authority (“FINRA”) to FINRA Rule 2241 (Research Analysts and Research Reports) and FINRA Rule 2242 (Debt Research Analysts and Debt Research Reports) to create a limited safe harbor for certain written analysis that comes from sales and trading or principal trading personnel, but that may rise to the level of a “research report” under those rules (“desk commentary”).²

SIFMA welcomes FINRA’s recognition that, more commonly, desk commentary does not meet the definition of a research report due to either insufficient analysis or because the communication falls into a specified exception to that definition.³ SIFMA also appreciates FINRA’s recognition that, to the extent desk commentary technically falls within the research report definition, it should not be subject to the same restrictions and requirements that apply to communications prepared by research department personnel. Accordingly, SIFMA supports FINRA’s general objective of providing relief for desk commentary that may technically be considered a research report. In particular, SIFMA supports FINRA’s proposal: to implement a general, not specific, “health warning” disclosure requirement; not to impose a Series 86/87 registration requirement for sales and trading personnel who author eligible desk commentary; and not to require affirmative consent from

¹ SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over \$2.5 trillion for businesses and municipalities in the U.S., serving clients with over \$18.5 trillion in assets and managing more than \$67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

² These amendments are discussed in FINRA Regulatory Notice 17-16 (April 2017) [hereinafter “Regulatory Notice 17-16”].

³ See *id.* at 3.

recipients of eligible desk commentary. We believe these aspects of the proposal are appropriate given (i) the sophisticated nature of recipients of desk commentary, (ii) the fact that, unlike materials produced by research department personnel, desk commentary is typically not market moving nor considered material, and (iii) the fact that it is widely understood that sales and trading personnel are not independent of a firm's sales and trading or principal trading activities and, by virtue of this role, have potential conflicts of interest that research department personnel may not possess.⁴

However, for the reasons set forth below, certain critical modifications are necessary for the proposed safe harbor to provide meaningful relief and be workable for member firms. In particular, SIFMA believes that the description of desk commentary content that is eligible for the proposed safe harbor should be modified because, as currently drafted, "eligible content" under the proposed safe harbor is limited to communications that, today, would not meet the definition of research report. We also believe that certain "conflict management" provisions relating to investment banking should be eliminated and modified because these provisions, as currently contemplated, would preclude sales and trading personnel who author eligible desk commentary from engaging in many ordinary course activities. These restrictions may be particularly onerous for smaller firms that have limited resources and are less likely to have dedicated investment banking personnel with certain structuring expertise that exists in sales and trading. Finally, SIFMA believes that FINRA should provide certain clarifications to ensure firms are clear on the availability and applicability of the proposed safe harbor, as well as the prohibitions associated with reliance on the proposed safe harbor. We discuss our views more fully below.

While we provide substantive and constructive comments to the proposal below, we are not aware of any substantial investor concerns that have arisen from historical or existing desk commentary content or perceived conflicts of interest. We believe that most desk commentary does not risk technically being considered a research report. From our perspective, most desk commentary lacks analysis and to the extent desk commentary contains analysis, it would not be sufficient to make an investment decision. We, however, appreciate FINRA's efforts to consider a framework that addresses its investor protection concerns while recognizing that certain sales and trading activities are essential for member firms to serve investor and issuer clients.

DISCUSSION

I. FINRA SHOULD MODIFY THE DESCRIPTION OF ELIGIBLE CONTENT TO INCLUDE COMMENTARY THAT MAY MEET THE DEFINITION OF RESEARCH REPORT.

The description of content that is eligible to qualify for the desk commentary safe harbor should be modified to make clear that this content includes communications that may technically fall within the definition of research report. As currently drafted, the proposed safe harbor appears to capture communications that *would not* fall within the definition of research report under any circumstances. To this point, the key elements of the definition of research report are not referenced in the description of eligible content. The description of eligible content also does not exclude

⁴ To this point, it is well recognized that the views of sales and trading personnel who author desk commentary may not be consistent with the views of research department personnel and that such sales and trading personnel may share their views with sophisticated institutional clients.

materials that currently fall under an exception to the definition of research report in Rule 2241(a)(11) or 2242(a)(3).

The stated objective of the safe harbor is to provide relief for desk commentary that “may technically fall within the research report definition, even where it falls well short of the type of fundamental research that originally gave rise to the research conflict of interest rules.”⁵ Given FINRA’s stated objective, the description of eligible content should be modified to make clear that it intends to capture communications that may technically fall within the research report definition. As the description is currently drafted, this does not appear to be the case.

Based on SIFMA member firms’ experience with a diverse range of equity and fixed income desk commentary, we believe the following description of eligible content (which may be sent to fifteen or more persons outside a firm) would meaningfully capture desk commentary that falls well short of the type of fundamental research that prompted the research conflict of interest rules.⁶

Commentary that (i) includes a brief analysis of one or more securities or issuers (not including a formal long-term rating, formal price target or earnings estimate of the author) that may be reasonably sufficient upon which to base an investment decision, and (ii) may contain discussions of:

- *recent, current, or near term expected trading activity;*
- *trading ideas, recommendations, or opportunities;*
- *market conditions, current events (including political or regulatory developments), economic statistics or company results;*
- *a recent research recommendation or research report; and/or*
- *a sector that includes recommendations of transactions or strategies in ETFs that are based on broad-based indices representing that sector.*

SIFMA believes the proposed safe harbor should include the above description of eligible content because this description not only captures typical desk commentary authored by sales and trading personnel, but it also is consistent with the objective of excluding communications that resemble the type of fundamental research that led to the adoption of Rules 2241 and 2242. Consistent with FINRA’s desire to carve out fundamental research, under the above proposed standard, desk commentary would not contain formal long-term ratings or price targets of the sales and trading personnel authoring the communication. The author could, however, include views on short-term price movements or ranges as well as views on exit ranges (*i.e.*, the price or point at which one should unwind a position), which are typical views expressed in desk commentary and are not intended to be formal price targets. Also, it is important that the “brief” qualifier applies to the analysis, not the entire piece. To this point, desk commentary may provide lengthy discussions of general market or other information, but contain only a limited discussion or analysis of a particular issuer or security.

⁵ Regulatory Notice 17-16, *supra* note 2, at 3.

⁶ Commentary that is sent to fewer than fifteen persons outside a firm would be excepted from the definition of “research report” under FINRA Rules 2241(a)(11)(B)(i) and 2242(a)(3)(B)(ii).

SIFMA's proposed modifications to the description of eligible content are essential because, as currently drafted, the proposed safe harbor appears to apply only to communications that currently do not fall within the definition of research report (and, thus, would not necessitate reliance on the safe harbor).⁷ Such an application would prevent FINRA from achieving its stated objective of providing relief for communications that "may technically fall within the research report definition."⁸

II. FINRA SHOULD MODIFY AND ELIMINATE CERTAIN CONFLICT MANAGEMENT PROVISIONS TO PERMIT ORDINARY COURSE ACTIVITIES OF SALES AND TRADING PERSONNEL.

A. Certain of FINRA's Proposed Prohibitions Would Impair Ordinary Course Activities.

In Regulatory Notice 17-16, FINRA requested comment on, among other things, whether there are ordinary course activities conducted by sales and trading personnel related to investment banking transactions that would be precluded by reliance upon the proposed safe harbor. In response, SIFMA identifies below certain prohibitions that would undermine such ordinary course activities:

1. The prohibition on participating in pitches and other solicitations of investment banking services transactions.
2. The prohibition on participation in road shows and other marketing on behalf of an issuer related to an investment banking services transaction.
3. The prohibition on investment banking department personnel directly or indirectly: (i) directing sales and trading personnel who author desk commentary to engage in sales or marketing efforts related to an investment banking services transaction; and (ii) directing sales and trading personnel who author desk commentary to engage in any communication with a current or prospective customer about an investment banking services transaction.
4. The prohibition on sales and trading personnel who author desk commentary from engaging in any communication with a current or prospective customer in the presence of investment banking department personnel or company management about an investment banking services transaction.

The above prohibitions are unmanageable given the essential role that sales and trading personnel play in marketing investment banking transactions, communicating with clients regarding these transactions, and serving as a resource to issuers regarding general market conditions and financing or refinancing considerations.⁹ In addition to creating the various limitations to critical

⁷ For example, as currently contemplated, the proposed safe harbor would cover communications that are already specifically excepted from the definition of "research report" in FINRA Rules 2241(a)(11) and 2242(a)(3), such as commentaries on economic or market conditions.

⁸ Regulatory Notice 17-16, *supra* note 2, at 3.

⁹ We note that the Rule 2242 exemption for institutional debt research is difficult for debt sales and trading personnel to utilize because of the same conflict of interest prohibitions. *See* Rule 2242(j)(2) which requires users of the institutional debt research exemption to comply with the prohibitions set out in Rule 2242(b)(2)(L) and (M).

functions that would affect firms of all sizes, these prohibitions are particularly onerous for smaller firms where there may be fewer personnel with expertise (*e.g.*, where a derivatives expert or other specialist may be more likely to support certain investment banking activities).¹⁰ Below is a more detailed discussion of how these ordinary course activities of sales and trading personnel would be impaired by these prohibitions.

As a general matter, the primary function of sales and trading personnel is to establish and maintain client relationships, in part by serving as the point of contact for clients in connection with securities transactions and services, including investment banking transactions. For example, sales and trading personnel, including sales and trading personnel who may author desk commentary, serve as the central point of contact for clients about roadshows and customarily coordinate meetings between clients and issuers. They also attend road shows and may provide introductory remarks during meetings between issuers and investor clients regarding an investment banking transaction. Similarly, as the primary point of contact for clients, they play an integral role in bringing investment banking transactions to the attention of clients and, consequently, communicate with current and prospective clients about such transactions. This activity may take place at the direction of or in the presence of investment banking department personnel. Thus, sales and trading personnel who may author desk commentary presently engage in ordinary course activities related to investment banking transactions that would conflict with the proposed prohibitions in items 2-4, raising serious concerns about the feasibility of the proposed safe harbor.

There are also serious concerns about the prohibition in item 1. Many firms have equity sector specialists who provide expertise regarding a particular sector or the market generally and may attend meetings with issuers and investment bankers. On the fixed income side, debt sales and trading personnel may meet with issuers and investment banking personnel to discuss financing and refinancing opportunities or to provide certain structuring expertise. They also may respond to “requests for proposals” from issuers regarding potential debt refinancing projects and other investment banking transactions or contact issuers regarding potential bond sales in response to a reverse inquiry from an institutional client seeking bonds that meet the issuer’s profile. Additionally, in connection with a banking pitch, sales and trading personnel may work with investment banking personnel to provide input to issuers related to interest rate and foreign exchange hedging or optimization, as well as structuring aspects of convertible bonds, call features and pricing considerations, and investor demand among various maturity profiles.

B. FINRA Should Consider Certain Modifications to the Proposed Prohibitions.

Given the above concerns raised by the proposed prohibitions, SIFMA urges FINRA to consider certain important modifications to the conflicts management requirements. As discussed below, these modifications are appropriately tailored to allow sales and trading personnel to continue to perform ordinary functions that are essential to their roles without implicating investor protection concerns or raising the types of conflict concerns that Rules 2241 and 2242 are designed to address.

1. “Concurrent” Prohibition: The proposed safe harbor should make clear that the prohibitions on participation in pitches, solicitations, roadshows, and marketing relating to a particular

¹⁰ For these same reasons, the proposed prohibitions on supervision and control, budget restrictions, and compensation restrictions for equity desk commentary will be extremely difficult to implement for small firms with flatter reporting structures and more limited personnel.

issuer or investment banking transaction (“subject issuer/transaction”) apply only if the sales and trading personnel who author the desk commentary are *concurrently* disseminating desk commentary on the subject issuer/transaction. Limiting such prohibitions to instances where the sales and trading personnel authoring desk commentary are concurrently disseminating desk commentary on the subject issuer/transaction would significantly enhance the workability of the proposed safe harbor. It also would appropriately manage any conflict of interest concerns because sales and trading would not be permitted to disseminate desk commentary on an issuer or transaction if they are currently engaged in certain activities in connection with the subject issuer/transaction.

Moreover, this temporal prohibition is appropriate from an investor protection perspective because: (i) the purpose of the prohibitions on research analysts’ participation in pitches, solicitations, roadshows, and other marketing in Rules 2241 and 2242 is not relevant in the context of sales and trading personnel for the reasons set forth below; and (ii) there are already a number of proposed prohibitions that would adequately address concerns regarding improper desk commentary, such as a prohibition on the use of desk commentary to manipulate the market and the prohibition on promises of favorable desk commentary in return for business or compensation.

More specifically, with regard to (i), the prohibitions on pitches, solicitations, roadshows, and other marketing in Rules 2241 and 2242 were intended to address concerns that research analysts – whose research content or statements may be material and who are expected to provide objective coverage of issuers and investment recommendations – may be improperly incentivized to provide overly favorable research (which could impact the market) if they engage in certain activities. In contrast, sales and trading personnel are, by definition, not independent of a firm’s securities activities and, by virtue of this role, are widely understood to have potential conflicts of interest that research department personnel do not possess. Thus, investors – particularly those sophisticated institutional investors who would be eligible to receive desk commentary – would not expect sales and trading personnel to observe the same standards of objectivity that research department personnel observe, and desk commentary is unlikely to be material or market moving. Imposing the same conflict of interest standards on them that apply to research analysts, therefore, would be unnecessary and not consistent with their role.

2. Attendance at Road Shows: As a related matter, FINRA should permit sales and trading personnel who author desk commentary to attend road shows in person as long as they do not concurrently disseminate desk commentary on the subject issuer/transaction. The current proposal provides that the prohibition on participation in road shows would permit “sales and trading and principal trading personnel who publish desk commentary pursuant to the safe harbor [to] listen to or view a live webcast of a transaction-related road show”¹¹ However, we believe that the potential conflict of interest concerns of in-person attendance for research analysts are not present with respect to sales and trading personnel. In adopting the road show provisions in former NASD Rule 2711, FINRA noted that this provision was intended to “remove any suggestion to investors in attendance at a road show that the analyst will give positive coverage to the issuer or that the analyst endorses all of the views expressed by the company or investment banking department personnel.”¹² These concerns are not relevant in the context of sales and trading personnel, who do not “cover” issuers and who (as noted above) are widely understood not to be independent of a firm’s securities business.

¹¹ See Regulatory Notice 17-16, *supra* note 2, at n.10.

¹² NASD Notice to Members 05-34 at 2 (May 2005).

Additionally, road shows serve as an important education source for sales and trading personnel to in turn pass information to investors, and limitations on access will create inefficiencies and delays in the marketing process. Lastly, road shows for debt offerings do not typically provide for teleconference participation, which limits the opportunity to participate from afar.

3. Elimination of Certain Prohibitions: Finally, FINRA should eliminate the prohibitions on (i) investment banking department personnel directing the actions of sales and trading personnel who author desk commentary, and (ii) communications between sales and trading personnel who author desk commentary and clients in the presence of investment banking department personnel. As noted above in Section II.A, these prohibitions are unworkable given the core functions that sales and trading personnel perform. Moreover, these prohibitions are unnecessary in light of the proposed limitations on participation in road shows and other marketing (with the critical modifications discussed above).

III. FINRA SHOULD PROVIDE ADDITIONAL CLARIFICATIONS TO ENSURE THE WORKABILITY OF THE PROPOSED SAFE HARBOR.

As a general matter, SIFMA believes the proposed safe harbor, if modified as discussed above, would maintain the information flow from sales and trading desks that is valued by institutional investors. To further enhance the value of the safe harbor and ensure its workability, SIFMA believes that FINRA should consider the following additional clarifications.

First, regarding application of the proposed safe harbor, SIFMA appreciates and agrees with FINRA's intention to provide a non-exclusive safe harbor and for the content limitation not to define such communications as research reports for the purposes of the proposed safe harbor.¹³ To minimize the potential for confusion as to FINRA's intent, however, we request that FINRA provide the following clarifications in the text of the forthcoming rule proposal:

- FINRA should explicitly confirm that the use of the safe harbor does not create a presumption that the desk commentary contains an analysis of a security or issuer and provides information that is reasonably sufficient to make an investment decision (*i.e.*, does not necessarily constitute a research report). This clarification is particularly important because firms may choose to apply safe harbor policies and practices to more desk commentary than necessary (*i.e.*, even if firms believe that the commentary would not meet the definition of research report). SIFMA urges FINRA not to discourage such prudent practices by implicitly creating a presumption that such communications automatically are subject to the prohibitions applicable to desk commentary.
- FINRA should make clear in the text of the rule proposal that reliance on the safe harbor is not required, as the safe harbor is non-exclusive. To this end, FINRA should clarify that firms may still prepare commentary that may be covered by the proposed safe harbor's "eligible content" description and would not be required to rely on the proposed safe harbor if they can determine that (i) the commentary is not a "research report" because there is not "an analysis of a security or issuer that may provide information reasonably sufficient upon which to base an investment decision," or (ii) the commentary falls under an exception from the definition of "research report" in Rule 2241(a) or 2242(a).

¹³ See Regulatory Notice 17-16, *supra* note 2, at 3-4.

Second, for purposes of the information barrier or institutional safeguard requirement, FINRA should make clear in the text of the rule proposal that the “pressure” prohibitions are intended to address personnel who “overtly pressure a person who produces desk commentary to express a particular view.”¹⁴

Third, FINRA should define or clarify the meaning of certain terms:

- FINRA should define persons relying on the safe harbor as something other than “research analysts” (*e.g.*, “desk personnel”) and their content as something other than “research reports” (*e.g.*, “safe harbor commentary”). We believe these definitions will avoid confusion that would be caused by calling such persons “research analysts” and their materials “research reports.” To this point, many firms that will rely on the safe harbor have research department personnel who are referred to as “research analysts” in policies and procedures. Also, there are requirements that may apply to true research personnel (*e.g.*, the Global Research Settlement). We understand that FINRA may have used the terms “research analyst” and “research report” in the Regulatory Notice as a matter of simplicity, but suggest that greater specificity would resolve the issue.
- For purposes of understanding the scope of permitted and prohibited activities, FINRA should define “investment banking services” to make clear that it does not include deal-related sales and trading activities such as marketing investment banking transactions or soliciting indications of interest/investor feedback.

SIFMA believes that the above-noted clarifications would greatly assist firms in applying and implementing the proposed safe harbor.

CONCLUSION

SIFMA appreciates FINRA’s continued engagement with our members concerning the distribution of sales and/or trading desk commentary as a general matter. We reiterate our concern, however, that the current formulation of the proposed safe harbor would not provide meaningful relief or be workable for all firms. We urge FINRA, in the following proposal, to modify the description of “eligible content,” modify and eliminate certain conflict management prohibitions, and make certain clarifications related to the availability and applicability of the proposed safe harbor as well as the prohibitions associated with the proposed safe harbor. With these changes, SIFMA believes FINRA may achieve its stated goals. Without the changes suggested above, SIFMA is not supportive of the proposed safe harbor in its current form because it would not permit sales and trading expertise to be used effectively and as necessary to bring issuers’ securities to the market. In the absence of such changes, we recommend FINRA reconsider how best to provide guidance to market participants on the use of desk commentary.

¹⁴ Regulatory Notice 17-16, *supra* note 2, at n.9.

We would welcome the opportunity to discuss the concept release and our comments in further detail. Separately, SIFMA will provide suggestions on changes to current Rules 2241 and 2242 in connection with its comment letter on FINRA's rules and programs governing the capital raising process and their effects on capital formation. Should you have any questions, please do not hesitate to contact the undersigned at 212.313.1118 or Stephanie Nicolas, SIFMA's outside counsel, at Wilmer Cutler Pickering Hale and Dorr LLP, at 202.663.6000.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Sean Davy", with a stylized flourish at the end.

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