trade through the PBBO. With respect to trading halts, the Exchange believes that proposed Rule 7.18P would promote price discovery and liquidity on the primary listing market for re-opening auctions following a halt, suspension, or trading pause, thereby supporting competition. The proposed non-substantive differences would be to use new Pillar terminology, which would promote consistent use of terminology to support the Pillar trading platform making the Exchange's rules easier to navigate.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

No written comments were solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the **Federal Register** or up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve or disapprove the proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/sro.shtml*); or
- Send an email to *rule-comments@sec.gov*. Please include File Number SR–NYSEARCA–2015–58 on the subject line.

Paper Comments

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090.

All submissions should refer to File Number SR–NYSEARCA–2015–58. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/sro.shtml*). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing will also be available for inspection and copying at the NYSE's principal office and on its Internet Web site at *www.nyse.com.* All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–NYSEARCA–2015–58 and should be submitted on or before August 12, 2015.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[53]

Robert W. Errett,

Deputy Secretary.

[FR Doc. 2015–17895 Filed 7–21–15; 8:45 am]

BILLING CODE 8011–01–P

[53] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–75472; File No. SR–FINRA–2014–048]

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change, as Modified by Amendment No. 1 Thereto, To Adopt FINRA Rule 2242 (Debt Research Analysts and Debt Research Reports)

July 16, 2015.

I. Introduction

On November 14, 2014, Financial Industry Regulatory Authority, Inc. (''FINRA'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission''), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'' or ''Exchange Act'')[1] and Rule 19b–4 thereunder,[2] a proposed rule to adopt new FINRA Rule 2242 (Debt Research Analysts and Debt Research Reports) to address conflicts of interest relating to the publication and distribution of debt research reports. The proposal was published for comment in the **Federal Register** on November 24, 2014.[3] The Commission received five comments on the proposal.[4] On February 19, 2015, FINRA filed Amendment No. 1 responding to the comments received to the proposal as well as to propose amendments in response to these comments. The proposal, as amended by Amendment No. 1, was published for comment in the **Federal Register** on March 18, 2015.[5] On February 20, 2015, the Commission issued an order instituting proceedings pursuant to section 19(b)(2)(B) of the Act[6] to determine whether to approve or disapprove the proposal. The order was published for comment in the **Federal Register** on February 26, 2015.[7] The Commission received a further four comments regarding the proceedings or in response

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Exchange Act Release No. 73623 (Nov. 18, 2014); 79 FR 69905 (Nov. 24, 2014) (''Notice''). On January 6, 2015, FINRA consented to extending the time period for the Commission to either approve or disapprove the proposed rule change, or to institute proceedings to determine whether to approve or disapprove the proposed rule change, to February 20, 2015.

[4] *See* Letter from Kevin Zambrowicz, Associate General Counsel & Managing Director and Sean Davy, Managing Director, SIFMA, dated Dec. 15, 2014 (''SIFMA''), Letter from Hugh D. Berkson, President-Elect, Public Investors Arbitration Bar Association, dated Dec. 15, 2014 (''PIABA Debt''), Letter from Yoon-Young Lee, WilmerHale, dated Dec. 16, 2014 (''WilmerHale Debt One''), Letter from William Beatty, President and Washington (State) Securities Administrator, North American Securities Administrators Association, Inc., dated Dec. 19, 2014 (''NASAA Debt One''), and Letter from Kurt N. Schacht, CFA, Managing Director, Standards and Financial Market Integrity and Linda L. Rittenhouse, Director, Capital Markets Policy, CFA Institute, dated Feb. 9, 2015 (''CFA Institute One'').

[5] Exchange Act Release No. 74490 (Mar. 12, 2015); 80 FR 14198 (Mar. 18, 2015) (''Amendment Notice'').

[6] 15 U.S.C. 78s(b)(2)(B).

[7] Exchange Act Release No. 74340 (Feb. 20, 2015); 80 FR 10538 (Feb. 26, 2015). Specifically, the Commission instituted proceedings to allow for additional analysis of the proposed rule change's consistency with section 15A(b)(9) of the Act, which requires that FINRA's rules be designed to, among other things, promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. *See id.*

to Amendment No. 1,[8] to which FINRA responded via letter on May 5, 2015.[9]

This order approves the proposed rule change.

II. Description of the Proposed Rule Change

As described more fully in the Notice, FINRA proposed to adopt FINRA Rule 2242 to address conflicts of interest relating to the publication and distribution of debt research reports. Proposed FINRA Rule 2242 would adopt a tiered approach that FINRA believed, in general, would provide retail debt research recipients with extensive protections similar to those provided to recipients of equity research under current and proposed FINRA rules,[10] with modifications to reflect differences in the trading of debt securities.

As stated above, the Commission received five comments on the proposal. All of the relevant commenters expressed general support for the proposal. Of the four comments received in regards to the proceedings or Amendment No. 1, one was supportive of the proposal as amended by Amendment No. 1 with certain specific comments,[11] one stated that Amendment No. 1 addressed their specific comments,[12] one reiterated prior concerns regarding the principles-based nature of the proposal,[13] and one did not seem to be related to the proposed rule change.[14]

A. Definitions

FINRA represented that most of the defined terms closely follow the defined terms for equity research in NASD Rule 2711, as amended by the equity research filing, with minor changes to reflect their application to debt research. The proposed definitions are set forth below.

Under the proposed rule change, the term ''debt research analyst'' would mean an associated person who is primarily responsible for, and any associated person who reports directly or indirectly to a debt research analyst in connection with, the preparation of the substance of a debt research report, whether or not any such person has the job title of ''research analyst.'' [15] The term ''debt research analyst account'' would mean any account in which a debt research analyst or member of the debt research analyst's household has a financial interest, or over which such analyst has discretion or control. It would not, however, include an investment company registered under the Investment Company Act of 1940 over which the debt research analyst or a member of the debt research analyst's household has discretion or control, provided that the debt research analyst or member of a debt research analyst's household has no financial interest in such investment company, other than a performance or management fee. The term also would not include a ''blind trust'' account that is controlled by a person other than the debt research analyst or member of the debt research analyst's household where neither the debt research analyst nor a member of the debt research analyst's household knows of the account's investments or investment transactions.[16]

The proposed rule change would define the term ''debt research report'' as any written (including electronic) communication that includes an analysis of a debt security or an issuer of a debt security and that provides information reasonably sufficient upon which to base an investment decision, excluding communications that solely constitute an equity research report as defined in proposed Rule 2241(a)(11).[17] The proposed definition and exceptions noted below would, in FINRA's view, generally align with the definition of ''research report'' in NASD Rule 2711, while incorporating aspects of the Regulation AC definition of ''research report.'' [18]

Communications that constitute statutory prospectuses that are filed as part of the registration statement would not be included in the definition of a debt research report. Further, communications that constitute private placement memoranda and comparable offering-related documents, other than those that purport to be research, would not be included in the definition of a debt research report. In general, the term debt research report also would not include communications that are limited to the following, if they do not include an analysis of, or recommend or rate, individual debt securities or issuers:

- Discussions of broad-based indices;
- Commentaries on economic, political, or market conditions;
- Commentaries on or analyses of particular types of debt securities or characteristics of debt securities;
- Technical analyses concerning the demand and supply for a sector, index, or industry based on trading volume and price;
- Recommendations regarding increasing or decreasing holdings in particular industries or sectors or types of debt securities; or
- Notices of ratings or price target changes, provided that the member simultaneously directs the readers of the notice to the most recent debt research report on the subject company that includes all current applicable disclosures required by the rule and that such debt research report does not contain materially misleading disclosures, including disclosures that are outdated or no longer applicable.

The term debt research report also, in general, would not include the following communications, even if they include an analysis of an individual debt security or issuer and information

[8] Letter from Stephanie R. Nicholas, WilmerHale, dated Apr. 6, 2015 (''WilmerHale Debt Two''), Letter from Kurt N. Schacht, Managing Director, Standards and Financial Market Integrity, and Linda L. Rittenhouse, Director, Capital Markets Policy, CFA Institute, to Brent J. Fields, Secretary, SEC, dated Apr. 7, 2015 (''CFA Institute Two''), an anonymous comment dated Apr. 8, 2015 (''Anonymous''), and Letter from William Beatty, President and Washington (State) Securities Administrator, North American Securities Administrators Association, Inc., dated Apr. 17, 2015 (''NASAA Debt Two'').

[9] Letter from Philip Shaikun, Vice President and Associate General Counsel, FINRA, dated May 5, 2015 (''FINRA Response'').

[10] *See* Exchange Act Release No. 73622 (Nov. 18, 2014); 79 FR 69939 (Nov. 24, 2014) (SR–FINRA–2014–047) (proposing amendments to current SRO rules relating to equity research).

[11] WilmerHale Debt Two.

[12] CFA Institute Two.

[13] NASAA Debt Two.

[14] Anonymous. The comment, in total, was: ''[I]s this a due diligence report where numbers amounts are fabricated? Is a qualified professional 'valuing' as a way of adjusting the amounts[?] I believe individuals should be leery of using 'debt' excessively when processing accounting matters. Especially with the prevalence of automated software and attitude of today[']s workers.'' *Id.* Neither we nor FINRA see any issues raised by this comment relevant to the proposed rule change. *See* FINRA Response.

[15] *See* proposed FINRA Rule 2242(a)(1).

[16] *See* proposed FINRA Rule 2242(a)(2). The exclusion for a registered investment company over which a research analyst has discretion or control in the proposed definition mirrors proposed changes to the definition of ''research analyst account'' in the equity research rules.

[17] *See* proposed FINRA Rule 2242(a)(3). FINRA explained that the proposed rule change did not need to, similar to the equity proposal, explicitly exclude communications concerning open-end registered investment companies that are not listed or traded on an exchange (''mutual funds'') from the proposed rule as they would not be captured by the rule in the first place. *See* proposed FINRA Rule 2242(a)(4) (defining ''debt securities'' as not including ''equity securities'' as defined in the Act). *See also* Exchange Act Release No. 74488 (Mar. 12, 2015); 80 FR 14174 (Mar. 18, 2015) (explaining the equity proposal as amended).

[18] In aligning the proposed definition with the Regulation AC definition of research report, FINRA pointed out that the proposed definition differs in minor respects from the definition of ''research report'' in NASD Rule 2711. For example, the proposed definition of ''debt research report'' would apply to a communication that includes an analysis of a debt security or an issuer of a debt security, while the definition of ''research report'' in NASD Rule 2711 applies to an analysis of equity securities of individual companies or industries.

reasonably sufficient upon which to base an investment decision:

- Statistical summaries of multiple companies' financial data, including listings of current ratings that do not include an analysis of individual companies' data;
- An analysis prepared for a specific person or a limited group of fewer than 15 persons;
- Periodic reports or other communications prepared for investment company shareholders or discretionary investment account clients that discuss individual debt securities in the context of a fund's or account's past performance or the basis for previously made discretionary investment decisions; or
- Internal communications that are not given to current or prospective customers.

The proposed rule change would define the term ''debt security'' as any ''security'' as defined in section 3(a)(10) of the Exchange Act,[19] except for any ''equity security'' as defined in section 3(a)(11) of the Exchange Act,[20] any ''municipal security'' as defined in section 3(a)(29) of the Exchange Act,[21] any ''security-based swap'' as defined in section 3(a)(68) of the Exchange Act,[22] and any ''U.S. Treasury Security'' as defined in paragraph (p) of FINRA Rule 6710.[23]

The proposed rule change would define the term ''debt trader'' as a person, with respect to transactions in debt securities, who is engaged in proprietary trading or the execution of transactions on an agency basis.[24]

The proposed rule change would provide that the term ''independent third-party debt research report'' means a third-party debt research report, in which the person producing the report both (1) has no affiliation or business or contractual relationship with the distributing member or that member's affiliates that is reasonably likely to inform the content of its research reports, and (2) makes content determinations without any input from the distributing member or that member's affiliates.[25]

The proposed rule change would define the term ''investment banking department'' as any department or division, whether or not identified as such, that performs any investment banking service on behalf of a member.[26] The term ''investment banking services'' would include, without limitation, acting as an underwriter, participating in a selling group in an offering for the issuer or otherwise acting in furtherance of a public offering of the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital or equity lines of credit or serving as placement agent for the issuer or otherwise acting in furtherance of a private offering of the issuer.[27]

The proposed rule change would define the term ''member of a debt research analyst's household'' as any individual whose principal residence is the same as the debt research analyst's principal residence.[28]

The proposed rule change would define ''public appearance'' as any participation in a conference call, seminar, forum (including an interactive electronic forum) or other public speaking activity before fifteen or more persons or before one or more representatives of the media, a radio, television or print media interview, or the writing of a print media article, in which a debt research analyst makes a recommendation or offers an opinion concerning a debt security or an issuer of a debt security.[29]

Under the proposed rule change the term ''qualified institutional buyer'' has the same meaning as under Rule 144A of the Securities Act.[30]

The proposed rule change would define ''research department'' as any department or division, whether or not identified as such, that is principally responsible for preparing the substance of a debt research report on behalf of a member.[31] The proposed rule change would define the term ''subject company'' as the issuer whose debt securities are the subject of a debt research report or a public appearance.[32] Finally, the proposed rule change would define the term ''third-party debt research report'' as a debt research report that is produced by a person or entity other than the member.[33]

B. Identifying and Managing Conflicts of Interest

Similar to the proposed equity research rule, the proposed rule change contains an overarching provision that would require members to establish, maintain, and enforce written policies and procedures reasonably designed to identify and effectively manage conflicts of interest related to the preparation, content, and distribution of debt research reports; public appearances by debt research analysts; and the interaction between debt research analysts and persons outside of the research department, including investment banking, sales and trading and principal trading personnel, subject companies, and customers.[34]

The written policies and procedures would be required to be reasonably designed to promote objective and reliable debt research that reflects the truly held opinions of debt research analysts and to prevent the use of debt research reports or debt research analysts to manipulate or condition the market or favor the interests of the firm or current or prospective customers or class of customers.[35]

The proposed rule change would introduce a distinction between sales and trading personnel and persons engaged in principal trading activities, where, in FINRA's opinion, the conflicts addressed by the proposal are of most concern.

1. Prepublication Review

FINRA proposed that the required policies and procedures would be required to prohibit prepublication review, clearance or approval of debt research by persons involved in investment banking, sales and trading, or principal trading, and either restrict or prohibit such review, clearance, and approval by other non-research personnel other than legal and compliance.[36] The policies and procedures also would be required to prohibit prepublication review of a debt research report by a subject company, other than for verification of facts.[37] The proposed rule change would allow sections of a draft debt research report to be provided to non-investment banking personnel, non-principal trading personnel, non-sales and trading personnel, or to the subject company for factual review, so long as: (1) The sections of the draft debt research report submitted do not contain the research summary, recommendation or rating; (2) A complete draft of the debt research report is provided to legal or compliance personnel before sections of the report are submitted to non-investment banking personnel, non-

[19] 15 U.S.C. 78c(a)(10).
[20] 15 U.S.C. 78c(a)(11).
[21] 15 U.S.C. 78c(a)(29).
[22] 15 U.S.C. 78c(a)(68).
[23] *See* proposed FINRA Rule 2242(a)(4).
[24] *See* proposed FINRA Rule 2242(a)(5).
[25] *See* proposed FINRA Rule 2242(a)(6).
[26] *See* proposed FINRA Rule 2242(a)(8).
[27] *See* proposed FINRA Rule 2242(a)(9).
[28] *See* proposed FINRA Rule 2242(a)(10).
[29] *See* proposed FINRA Rule 2242(a)(11).
[30] *See* proposed FINRA Rule 2242(a)(12).
[31] *See* proposed FINRA Rule 2242(a)(14).
[32] *See* proposed FINRA Rule 2242(a)(15).
[33] *See* proposed FINRA Rule 2242(a)(16).
[34] *See* proposed FINRA Rule 2242(b)(1).
[35] *See* proposed FINRA Rule 2242(b)(2).
[36] *See* proposed FINRA Rule 2242(b)(2)(A) and (B).
[37] *See* proposed FINRA Rule 2242(b)(2)(N).

principal trading personnel, non-sales and trading personnel or the subject company; and (3) If, after submitting sections of the draft debt research report to non-investment banking personnel, non-principal trading personnel, non-sales and trading personnel or the subject company, the research department intends to change the proposed rating or recommendation, it would be required to first provide written justification to, and receive written authorization from, legal or compliance personnel for the change. The member would be required to retain copies of any draft and the final version of such debt research report for three years after publication. [38]

2. Coverage Decisions

With respect to coverage decisions, a member's written policies and procedures would be required under the proposal to restrict or limit input by investment banking, sales and trading and principal trading personnel to ensure that research management independently makes all final decisions regarding the research coverage plan.[39] However, the provision would not preclude personnel from these or any other department from conveying customer interests and coverage needs, so long as final decisions regarding the coverage plan are made by research management.

3. Solicitation and Marketing of Investment Banking Transactions

A member's written policies and procedures also would be required under the proposal to restrict or limit activities by debt research analysts that can reasonably be expected to compromise their objectivity.[40] This would include prohibiting participation in pitches and other solicitations of investment banking services transactions and road shows and other marketing on behalf of issuers related to such transactions. The proposed rule change would adopt Supplementary Material that incorporates an existing FINRA interpretation for the equity research rules that prohibits in pitch materials any information about a member's debt research capacity in a manner that suggests, directly or indirectly, that the member might provide favorable debt research coverage.[41] By way of example, the Supplementary Material explains that FINRA would consider the publication in a pitch book or related materials of an analyst's industry ranking to imply the potential outcome of future research because of the manner in which such rankings are compiled. The Supplementary Material further notes that a member would be permitted to include in the pitch materials the fact of coverage and the name of the debt research analyst, since that information alone does not imply favorable coverage.

The proposed rule change also would prohibit investment banking personnel from directing debt research analysts to engage in sales or marketing efforts related to an investment banking services transaction or any communication with a current or prospective customer about an investment banking services transaction.[42] In addition, the proposed rule change would adopt Supplementary Material to provide that, consistent with this requirement, no debt research analyst may engage 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.[43]

4. Supervision

A member's written policies and procedures would be required under the proposal to limit the supervision of debt research analysts to persons not engaged in investment banking, sales and trading or principal trading activities.[44] In addition, the member would further be required under the proposal to establish information barriers or other institutional safeguards reasonably designed to ensure that debt research analysts are insulated from the review, pressure or oversight by persons engaged in investment banking services, principal trading or sales and trading activities or others who might be biased in their judgment or supervision.[45]

5. Budget and Compensation

A member's written policies and procedures also would be required under the proposal to limit the determination of a firm's debt research department budget to senior management, excluding senior management engaged in investment banking or principal trading activities, and without regard to specific revenues or results derived from investment banking.[46] However, the proposed rule change would expressly permit all persons to provide input to senior management regarding the demand for and quality of debt research, including product trends and customer interests. It further would allow consideration by senior management of a firm's overall revenues and results in determining the debt research budget and allocation of expenses.

With respect to compensation determinations, a member's written policies and procedures would be required under the proposal to prohibit compensation based on specific investment banking services or trading transactions or contributions to a firm's investment banking or principal trading activities and prohibit investment banking and principal trading personnel from input into the compensation of debt research analysts.[47] Further, the firm's written policies and procedures would be required under the proposal to require that the compensation of a debt research analyst who is primarily responsible for the substance of a research report be reviewed and approved at least annually by a committee that reports to a member's board of directors or, if the member has no board of directors, a senior executive officer of the member.[48] This committee would be required under the proposal to not have representation from investment banking personnel or persons engaged in principal trading activities and would be required to consider certain factors when reviewing a debt research analyst's compensation. Specifically, the proposal would require that the committee consider the debt research analyst's individual performance, including the analyst's productivity and the quality of the debt research analyst's research as well as the overall ratings received from customers and peers (independent of the member's investment banking department and persons engaged in principal trading activities) and other independent ratings services.

Neither investment banking personnel nor persons engaged in principal trading activities would be required under the proposal to give input with respect to the compensation determination for debt research analysts. However, sales and trading personnel would be permitted to give input to debt research management as part of the evaluation process in order to convey customer

[38] *See* proposed FINRA Rule 2242.05 (Submission of Sections of a Draft Research Report for Factual Review).

[39] *See* proposed FINRA Rule 2242(b)(2)(C).

[40] *See* proposed FINRA Rule 2242(b)(2)(L).

[41] *See* proposed FINRA Rule 2242.01 (Efforts to Solicit Investment Banking Business).

[42] *See* proposed FINRA Rule 2242(b)(2)(M).

[43] *See* proposed FINRA Rule 2242.02(a) (Restrictions on Communications with Customers and Internal Personnel).

[44] *See* proposed FINRA Rule 2242(b)(2)(D).

[45] *See* proposed FINRA Rule 2242(b)(2)(H).

[46] *See* proposed FINRA Rule 2242(b)(2)(E).

[47] *See* proposed FINRA Rule 2242(b)(2)(D) and (F).

[48] *See* proposed FINRA Rule 2242(b)(2)(G).

feedback, provided that final compensation determinations are made by research management, subject to review and approval by the compensation committee.[49] The committee, which would not be permitted to have representation from investment banking or persons engaged in principal trading activities, would be required to document the basis for each debt research analyst's compensation, including any input from sales and trading personnel.

6. Personal Trading Restrictions

Under the proposed rule change, a member's written policies and procedures would be required to restrict or limit trading by a ''debt research analyst account'' in securities, derivatives and funds whose performance is materially dependent upon the performance of securities covered by the debt research analyst.[50] The procedures would be required under the proposal to ensure that those accounts, supervisors of debt research analysts, and associated persons with the ability to influence the content of debt research reports do not benefit in their trading from knowledge of the content or timing of debt research reports before the intended recipients of such research have had a reasonable opportunity to act on the information in the report.[51] Furthermore, the procedures would be required under the proposal to generally prohibit a debt research analyst account from purchasing or selling any security or any option or derivative of such security in a manner inconsistent with the debt research analyst's most recently published recommendation, except that the procedures would be permitted to define circumstances of financial hardship (*e.g.,* unanticipated significant change in the personal financial circumstances of the beneficial owner of the research analyst account) in which the firm would permit a debt research analyst account to trade contrary to that recommendation. In determining whether a particular trade is contrary to an existing recommendation, firms would be permitted to take into account the context of a given trade, including the extent of coverage of the subject security. While the proposed rule change does not include a recordkeeping requirement, FINRA stated it expects members to evidence compliance with their policies and procedures and retain any related documentation in accordance with FINRA Rule 4511.

The proposed rule change includes Supplementary Material .10, which would provide that FINRA would not consider a research analyst account to have traded in a manner inconsistent with a research analyst's recommendation where a member has instituted a policy that prohibits any research analyst from holding securities, or options on or derivatives of such securities, of the companies in the research analyst's coverage universe, provided that the member establishes a reasonable plan to liquidate such holdings consistent with the principles in paragraph (b)(2)(J)(i) and such plan is approved by the member's legal or compliance department.[52]

7. Retaliation and Promises of Favorable Research

A member's written policies and procedures would be required to prohibit direct or indirect retaliation or threat of retaliation against debt research analysts by any employee of the firm for publishing research or making a public appearance that may adversely affect the member's current or prospective business interests.[53] The policies and procedures would also be required to prohibit explicit or implicit promises of favorable debt research, specific research content or a specific rating or recommendation as inducement for the receipt of business or compensation.[54]

8. Joint Due Diligence with Investment Banking Personnel

The proposed rule change would establish limitations regarding joint due diligence activities—*i.e.,* due diligence by the debt research analyst in the presence of investment banking department personnel—during a specified time period. Specifically, the proposed rule change states that FINRA would interpret the overarching principle which would, under the proposal, require members to, among other things, establish, maintain, and enforce written policies and procedures that address the interaction between debt research analysts and those outside the research department, including investment banking department personnel, sales and trading personnel, principal trading personnel, subject companies, and customers,[55] to prohibit the performance of joint due diligence prior to the selection of underwriters for the investment banking services transaction.[56]

9. Communications Between Debt Research Analysts and Trading Personnel

The proposed rule change delineates what would be the prohibited and permissible interactions between debt research analysts and sales and trading and principal trading personnel. The proposed rule change would require members to establish, maintain and enforce written policies and procedures reasonably designed to prohibit sales and trading and principal trading personnel from attempting to influence a debt research analyst's opinions or views for the purpose of benefiting the trading position of the firm, a customer or a class of customers.[57] It would further prohibit debt research analysts from identifying or recommending specific potential trading transactions to sales and trading or principal trading personnel that are inconsistent with such debt research analyst's currently published debt research reports or from disclosing the timing of, or material investment conclusions in, a pending debt research report.[58]

The proposed rule change would permit sales and trading and principal trading personnel to communicate customers' interests to a debt research analyst, so long as the debt research analyst does not respond by publishing debt research for the purpose of benefiting the trading position of the firm, a customer or a class of customers.[59] In addition, debt research analysts would be permitted to provide customized analysis, recommendations or trade ideas to sales and trading and principal trading personnel and customers, provided that any such communications are not inconsistent with the analyst's currently published or pending debt research, and that any subsequently published debt research is not for the purpose of benefiting the trading position of the firm, a customer or a class of customers.[60]

The proposed rule change also would permit sales and trading and principal

[49] *See* proposed FINRA Rule 2242(b)(2)(D) and (G).

[50] *See* proposed FINRA Rule 2242(b)(2)(J).

[51] *See* proposed FINRA Rule 2242.07 (Ability to Influence the Content of a Research Report).

[52] *See* proposed FINRA Rule 2242.10.

[53] *See* proposed FINRA Rule 2242(b)(2)(I).

[54] *See* proposed FINRA Rule 2242(b)(2)(K).

[55] *See* proposed FINRA Rule 2242(b)(1)(C).

[56] *See* proposed FINRA Rule 2242.09 (Joint Due Diligence).

[57] *See* proposed FINRA Rule 2242.03(a)(1) (Information Barriers between Research Analysts and Trading Desk Personnel).

[58] *See* proposed FINRA Rule 2242.03(a)(2) (Information Barriers between Research Analysts and Trading Desk Personnel).

[59] *See* proposed FINRA Rule 2242.03(b)(1) (Information Barriers between Research Analysts and Trading Desk Personnel).

[60] *See* proposed FINRA Rule 2242.03(b)(2) (Information Barriers between Research Analysts and Trading Desk Personnel).

trading personnel to seek the views of debt research analysts regarding the creditworthiness of the issuer of a debt security and other information regarding an issuer of a debt security that is reasonably related to the price or performance of the debt security, so long as, with respect to any covered issuer, such information is consistent with the debt research analyst's published debt research report and consistent in nature with the types of communications that a debt research analyst might have with customers. In determining what is consistent with the debt research analyst's published debt research, FINRA stated that a member would be permitted to consider the context, including that the investment objectives or time horizons being discussed differ from those underlying the debt research analyst's published views.[61] Finally, FINRA also stated that debt research analysts would be permitted to seek information from sales and trading and principal trading personnel regarding a particular debt instrument, current prices, spreads, liquidity, and similar market information relevant to the debt research analyst's valuation of a particular debt security.[62]

The proposed rule change clarifies that communications between debt research analysts and sales and trading or principal trading personnel that are not related to sales and trading, principal trading or debt research activities would be permitted to take place without restriction, unless otherwise prohibited.[63]

10. Restrictions on Communications With Customers and Internal Sales Personnel

The proposed rule change would apply standards to communications with customers and internal sales personnel. Any written or oral communication by a debt research analyst with a current or prospective customer or internal personnel related to an investment banking services transaction would be required to be fair, balanced and not misleading, taking into consideration the overall context in which the communication is made.[64]

Consistent with the proposed prohibition on investment banking department personnel directly or indirectly directing a debt research analyst to engage in sales or marketing efforts related to an investment banking services transaction or directing a debt research analyst to engage in any communication with a current or prospective customer about an investment banking services transaction, no debt research analyst would be permitted to engage 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.

C. Content and Disclosure in Debt Research Reports

The proposed rule change would, in general, adopt the disclosures in the equity research rule for debt research, with modifications to reflect the different characteristics of the debt market. The proposed rule change would require members to establish, maintain and enforce written policies and procedures reasonably designed to ensure that purported facts in their debt research reports are based on reliable information.[65] In addition, the policies and procedures would be required to be reasonably designed to ensure that any recommendation or rating has a reasonable basis and is accompanied by a clear explanation of any valuation method used and a fair presentation of the risks that may impede achievement of the recommendation or rating.[66] While there would be no obligation to employ a rating system under the proposed rule, members that choose to employ a rating system would be required to clearly define in each debt research report the meaning of each rating in the system, including the time horizon and any benchmarks on which a rating is based. In addition, the definition of each rating would be required to be consistent with its plain meaning.[67]

Consistent with the equity rules, irrespective of the rating system a member employs, a member would be required to include in each debt research report limited to the analysis of an issuer of a debt security that includes a rating of the subject company the percentage of all subject companies rated by the member to which the member would assign a ''buy,'' ''hold'' or ''sell'' rating.[68] In addition, a member would be required to disclose in each debt research report the percentage of subject companies within each of the ''buy,'' ''hold,'' and ''sell'' categories for which the member has provided investment banking services within the previous 12 months.[69] All such information would be required to be current as of the end of the most recent calendar quarter or the second most recent calendar quarter if the publication date of the debt research report is less than 15 calendar days after the most recent calendar quarter.[70]

If a debt research report limited to the analysis of an issuer of a debt security contains a rating for the subject company and the member has assigned a rating to such subject company for at least one year, the debt research report would be required to show each date on which a member has assigned a rating to the debt security and the rating assigned on such date. This information would be required for the period that the member has assigned any rating to the debt security or for a three-year period, whichever is shorter.[71] Unlike the equity research rules, the proposed rule change would not require those ratings to be plotted on a price chart because of limits on price transparency, including daily closing price information, with respect to many debt securities.

The proposed rule change would require a member to disclose in any debt research report at the time of publication or distribution of the report:[72]

- If the debt research analyst or a member of the debt research analyst's household has a financial interest in the debt or equity securities of the subject company (including, without limitation, any option, right, warrant, future, long or short position), and the nature of such interest;
- If the debt research analyst has received compensation based upon (among other factors) the member's investment banking, sales and trading or principal trading revenues;
- If the member or any of its affiliates managed or co-managed a public offering of securities for the subject company in the past 12 months, received compensation for investment banking services from the subject company in the past 12 months, or expects to receive or intends to seek compensation for investment banking

[61] *See* proposed FINRA Rule 2242.03(b)(3) (Information Barriers between Research Analysts and Trading Desk Personnel).

[62] *See* proposed FINRA Rule 2242.03(b)(4) (Information Barriers between Research Analysts and Trading Desk Personnel).

[63] *See* proposed FINRA Rule 2242.03(c) (Information Barriers between Research Analysts and Trading Desk Personnel).

[64] *See* proposed FINRA Rule 2242.02(b) (Restrictions on Communications with Customers and Internal Personnel).

[65] *See* proposed FINRA Rule 2242(c)(1)(A).

[66] *See* proposed FINRA Rule 2242(c)(1)(B).

[67] *See* proposed FINRA Rule 2242(c)(2).

[68] *See* proposed FINRA Rule 2242(c)(2)(A).

[69] *See* proposed FINRA Rule 2242(c)(2)(B).

[70] *See* proposed FINRA Rule 2242(c)(2)(C).

[71] *See* proposed FINRA Rule 2242(c)(3).

[72] *See* proposed FINRA Rule 2242(c)(4).

services from the subject company in the next three months;

• If, as of the end of the month immediately preceding the date of publication or distribution of a debt research report (or the end of the second most recent month if the publication date is less than 30 calendar days after the end of the most recent month), the member or its affiliates have received from the subject company any compensation for products or services other than investment banking services in the previous 12 months; [73]

• If the subject company is, or over the 12-month period preceding the date of publication or distribution of the debt research report has been, a client of the member, and if so, the types of services provided to the issuer. Such services, if applicable, shall be identified as either investment banking services, non-investment banking securities-related services or non-securities services;

• If the member trades or may trade as principal in the debt securities (or in related derivatives) that are the subject of the debt research report;

• If the debt research analyst received any compensation from the subject company in the previous 12 months; and

• Any other material conflict of interest of the debt research analyst or member that the debt research analyst or an associated person of the member with the ability to influence the content of a debt research report knows or has reason to know at the time of the publication or distribution of a debt research report.

The proposed rule change would incorporate a proposed amendment to the corresponding provision in the equity research rules that expands the existing ''catch all'' disclosure to require disclosure of material conflicts known not only by the research analyst, but also by any ''associated person of the member with the ability to influence the content of a research report.'' The proposed rule change defines a person with the ''ability to influence the content of a research report'' as an associated person who is required to review the content of the debt research report or has exercised authority to review or change the debt research report prior to publication or distribution. This term would not include legal or compliance personnel who may review a debt research report for compliance purposes but are not authorized to dictate a particular recommendation or rating.[74] The ''reason to know'' standard in the provision would not impose a duty of inquiry on the debt research analyst or others who can influence the content of a debt research report. Rather, it would cover disclosure of those conflicts that should reasonably be discovered by those persons in the ordinary course of discharging their functions.

The proposed rule change would mandate disclosure of firm ownership of debt securities in research reports or a public appearance to the extent those holdings constitute a material conflict of interest.[75]

The proposed rule change would adopt an exception for disclosure that would reveal material non-public information regarding specific potential future investment banking transactions.[76] Similar to the equity research rules, the proposed rule change would require that disclosures be presented on the front page of debt research reports or the front page must refer to the page on which the disclosures are found. Electronic debt research reports, however, would be permitted to provide a hyperlink directly to the required disclosures. All disclosures and references to disclosures required by the proposed rule would need to be clear, comprehensive and prominent.[77]

Like the equity research rule, the proposed rule change would permit a member that distributes a debt research report covering six or more companies (compendium report) to direct the reader in a clear manner to the applicable disclosures. Electronic compendium reports would be required to include a hyperlink to the required disclosures. Paper-based compendium reports would be required to provide either a toll-free number or a postal address to request the required disclosures and also may include a web address of the member where the disclosures can be found.[78]

D. Disclosure of Compensation Received by Affiliates

The proposed rule change would provide that a member would not be required to disclose receipt of non-investment banking services compensation by an affiliate if it has implemented written policies and procedures reasonably designed to prevent the debt research analyst and associated persons of the member with the ability to influence the content of debt research reports from directly or indirectly receiving information from the affiliate as to whether the affiliate received such compensation.[79] In addition, a member would be permitted to satisfy the disclosure requirement with respect to the receipt of investment banking compensation from a foreign sovereign by a non-U.S. affiliate of the member by implementing written policies and procedures reasonably designed to prevent the debt research analyst and associated persons of the member with the ability to influence the content of debt research reports from directly or indirectly receiving information from the non-U.S. affiliate as to whether such non-U.S. affiliate received or expects to receive such compensation from the foreign sovereign. However, a member would be required to disclose receipt of compensation by its affiliates from the subject company (including any foreign sovereign) in the past 12 months when the debt research analyst or an associated person with the ability to influence the content of a debt research report has actual knowledge that an affiliate received such compensation during that time period.

E. Disclosure in Public Appearances

The proposed rule change closely parallels the equity research rules with respect to disclosure in public appearances. Under the proposed rule, a debt research analyst would be required to disclose in public appearances: [80]

• If the debt research analyst or a member of the debt research analyst's household has a financial interest in the debt or equity securities of the subject company (including, without limitation, whether it consists of any option, right, warrant, future, long or short position), and the nature of such interest;

• If, to the extent the debt research analyst knows or has reason to know, the member or any affiliate received any compensation from the subject company in the previous 12 months;

• If the debt research analyst received any compensation from the subject company in the previous 12 months;

• If, to the extent the debt research analyst knows or has reason to know, the subject company currently is, or during the 12-month period preceding the date of publication or distribution of the debt research report, was, a client of the member. In such cases, the debt research analyst also must disclose the

[73] *See also* discussion of proposed FINRA Rule 2242.04 (Disclosure of Compensation Received by Affiliates) below.

[74] *See* proposed FINRA Rule 2242.07.

[75] *See* proposed FINRA Rules 2242(c)(4)(H) and (d)(1)(E).

[76] *See* proposed FINRA Rule 2242(c)(5).

[77] *See* proposed FINRA Rule 2242(c)(6).

[78] *See* proposed FINRA Rule 2242(c)(7).

[79] *See* proposed FINRA Rule 2242.04 (Disclosure of Compensation Received by Affiliates).

[80] *See* proposed FINRA Rule 2242(d)(1).

types of services provided to the subject company, if known by the debt research analyst; or

• Any other material conflict of interest of the debt research analyst or member that the debt research analyst knows or has reason to know at the time of the public appearance.

However, a member or debt research analyst would not be required to make any such disclosure to the extent it would reveal material non-public information regarding specific potential future investment banking transactions.[81] Unlike in debt research reports, the ''catch-all'' disclosure requirement in public appearances would apply only to a conflict of interest of the debt research analyst or member that the analyst knows or has reason to know at the time of the public appearance. FINRA stated it understands that supervisors or legal and compliance personnel, who otherwise might be captured by the definition of an associated person ''with the ability to influence,'' typically do not have the opportunity to review and insist on changes to public appearances, many of which are extemporaneous in nature.

The proposed rule change would require members to maintain records of public appearances by debt research analysts sufficient to demonstrate compliance by those debt research analysts with the applicable disclosure requirements for public appearances. Such records would be required to be maintained for at least three years from the date of the public appearance.[82]

F. Disclosure Required by Other Provisions

With respect to both research reports and public appearances, the proposed rule change would require that, in addition to the disclosures required under the proposed rule, members and debt research analysts comply with all applicable disclosure provisions of FINRA Rule 2210 (Communications with the Public) and the federal securities laws.[83]

G. Distribution of Member Research Reports

The proposed rule change would require firms to establish, maintain and enforce written policies and procedures reasonably designed to ensure that a debt research report is not distributed selectively to internal trading personnel or a particular customer or class of customers in advance of other customers that the member has previously determined are entitled to receive the debt research report.[84] The proposed rule change includes further guidance to explain that firms would be permitted to provide different debt research products and services to different classes of customers, provided the products are not differentiated based on the timing of receipt of potentially market moving information and the firm discloses its research dissemination practices to all customers that receive a research product.[85]

In addition, a member that provides different debt research products and services for certain customers would be required to inform its other customers that its alternative debt research products and services may reach different conclusions or recommendations that could impact the price of the debt security.[86]

H. Distribution of Third-party Debt Research Reports

FINRA proposed to apply the supervisory review and disclosure obligations applicable to the distribution of third-party equity research similarly to third-party retail debt research. Moreover, the proposed rule change would incorporate 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 addition, the proposed rule change would adopt an expanded requirement in the proposed equity research rules that requires members to disclose any other material conflict of interest that can reasonably be expected to have influenced the member's choice of a third-party research provider or the subject company of a third-party research report.

The proposed rule change would prohibit a member from distributing third-party debt research if it knows or has reason to know that such research is not objective or reliable.[87] A member would satisfy the standard based on its actual knowledge and reasonable diligence. However, there would be no duty of inquiry to definitively establish that the third-party research is, in fact, objective and reliable.

In addition, the proposed rule change would require a member to establish, maintain, and enforce written policies and procedures reasonably 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.[88] For the purpose of this requirement, a member's obligation to review a third-party debt research report would extend to any untrue statement of material fact or any false or misleading information that should be known from reading the debt research report or is known based on information otherwise possessed by the member.

The proposed rule change would require that a member accompany any third-party debt research report it distributes with, or provide a web address that directs a recipient to, disclosure of any material conflict of interest that can reasonably be expected to have influenced the choice of a third-party debt research report provider or the subject company of a third-party debt research report, including:

• If the member or any of its affiliates managed or co-managed a public offering of securities for the subject company in the past 12 months, received compensation for investment banking services from the subject company in the past 12 months, or expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months;

• If the member trades or may trade as principal in the debt securities (or in related derivatives) that are the subject of the debt research report; and

• Any other material conflict of interest of the debt research analyst or member that the debt research analyst or an associated person of the member with the ability to influence the content of a debt research report knows or has reason to know at the time of the publication or distribution of a debt research report.[89]

The proposed rule change would not require members to review a third-party debt research report prior to distribution if such debt research report is an independent third-party debt research report.[90] For the purposes of the disclosure requirements for third-party research reports, a member would not be considered to have distributed a third-party debt research report where the research is an independent third-party debt research report and made available by a member upon request, through a member-maintained Web site, or to a customer in connection with a solicited order in which the registered representative has informed the

[81] *See* proposed FINRA Rule 2242(d)(2).

[82] *See* proposed FINRA Rule 2242(d)(3).

[83] *See* proposed FINRA Rule 2242(e).

[84] *See* proposed FINRA Rule 2242(f).

[85] *See* proposed FINRA Rule 2242.06 (Distribution of Member Research Products).

[86] *See id.*

[87] *See* proposed FINRA Rule 2242(g)(1).

[88] *See* proposed FINRA Rule 2242(g)(2).

[89] *See* proposed FINRA Rule 2242(g)(3).

[90] *See* proposed FINRA Rule 2242(g)(4).

customer, during the solicitation, of the availability of independent debt research on the solicited debt security and the customer requests such independent debt research.[91]

The proposed rule would require that members ensure that third-party debt research reports are 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 reports.[92]

I. Obligations of Persons Associated With a Member

The proposed rule change would clarify the obligations of each associated person under those provisions of the proposed rule that require a member to restrict or prohibit certain conduct by establishing, maintaining, and enforcing particular policies and procedures. Specifically, the proposed rule change provides that, consistent with FINRA Rule 0140, persons associated with a member would be required to comply with such member's written policies and procedures as established pursuant to the proposed rule. In addition, consistent with Rule 0140, the proposed rule states in Supplementary Material .08 that it would be a violation of proposed Rule 2242 for an associated person to engage in the restricted or prohibited conduct to be addressed through the establishment, maintenance, and enforcement of written policies and procedures required by provisions of FINRA Rule 2242, including applicable supplementary material.

J. Exemption for Members With Limited Investment Banking Activity

Similar to the equity research rule, the proposed rule change would exempt from certain provisions regarding supervision and compensation of debt research analysts those members that over the previous three years, on average per year, have participated in ten 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.[93] Specifically, members that meet those thresholds would be exempt from the requirement to establish, maintain, and enforce policies and procedures that (1) prohibit prepublication review of debt research reports by investment banking personnel or other persons not directly responsible for the preparation, content, or distribution of debt research reports (but not principal trading or sales and trading personnel, unless the member also qualifies for the limited principal trading activity exemption); (2) restrict or limit investment banking personnel from input into coverage decisions; (3) limit supervision of debt research analysts to persons not engaged in investment banking; (4) limit determination of the research department budget to senior management, excluding senior management engaged in investment banking activities; (5) require that compensation of a debt research analyst be approved by a compensation committee that may not have representation from investment banking personnel; and (6) establish information barriers to insulate debt research analysts from the review or oversight by persons engaged in investment banking services or other persons who might be biased in their judgment or supervision.[94] However, the proposed rule would require that members with limited investment banking activity establish information barriers or other institutional safeguards reasonably designed to ensure debt research analysts are insulated from *pressure* by persons engaged in investment banking services activities or other persons, including persons engaged in principal trading or principal sales and trading activities, who might be biased in their judgment or supervision.[95]

While small investment banks may need those who supervise debt research analysts under such circumstances also to be involved in the determination of those analysts' compensation, the proposal would still prohibit these firms from compensating a debt research analyst based upon specific investment banking services transactions or contributions to a member's investment banking services activities. Members that qualify for this exemption would be required to maintain records sufficient to establish eligibility for the exemption and also maintain for at least three years any communication that, but for this exemption, would be subject to all of the requirements of proposed FINRA Rule 2242(b).

K. Exemption for Limited Principal Trading Activity

The proposed rule change includes an exemption from certain provisions regarding supervision and compensation of debt research analysts for members that engage in limited principal trading activity where: (1) In absolute value on an annual basis, the member's trading gains or losses on principal trades in debt securities are $15 million or less over the previous three years, on average per year; and (2) The member employs fewer than 10 debt traders; provided, however, that such members establish information barriers or other institutional safeguards reasonably designed to ensure debt research analysts are insulated from pressure by persons engaged in principal trading or sales and trading activities or other persons who might be biased in their judgment or supervision.[96] Specifically, members that meet those thresholds would be exempt from the requirement to establish, maintain and enforce policies and procedures that: (1) Prohibit prepublication review of debt research reports by principal trading or sales and trading personnel or other persons not directly responsible for the preparation, content or distribution of debt research reports (but not investment banking personnel, unless the firm also qualifies for the limited investment banking activity exemption); (2) Restrict or limit principal trading or sales and trading personnel from input into coverage decisions; (3) Limit supervision of debt research analysts to persons not engaged in sales and trading or principal trading activities, including input into the compensation of debt research analysts; (4) Limit determination of the research department budget to senior management, excluding senior management engaged in principal trading activities; (5) Require that compensation of a debt research analyst be approved by a compensation committee that may not have representation from principal trading personnel; and (6) Establish information barriers to insulate debt research analysts from the review or oversight by persons engaged in principal trading or sales and trading activities or other persons who might be biased in their judgment or supervision.[97]

As with the limited investment banking activity exemption, members

[91] *See* proposed FINRA Rule 2242(g)(5).

[92] *See* proposed FINRA Rule 2242(g)(6). This requirement would codify guidance in *Notice to Members* 04–18 (March 2004) related to equity research reports.

[93] *See* proposed FINRA Rule 2242(h).

[94] *See* proposed FINRA Rule 2242(b)(2)(A)(i), (b)(2)(B), (b)(2)(C) (with respect to investment banking), (b)(2)(D)(i), (b)(2)(E) (with respect to investment banking), (b)(2)(G) and (b)(2)(H)(i) and (iii).

[95] For the purposes of proposed FINRA Rule 2242(h), FINRA clarified that the term ''investment banking services transactions'' includes the underwriting of both corporate debt and equity securities but not municipal securities.

[96] *See* proposed FINRA Rule 2242(i).

[97] *See* proposed FINRA Rule 2242(b)(2)(A)(ii) and (iii), (b)(2)(B), (b)(2)(C) (with respect to sales and trading and principal trading), (b)(2)(D)(ii) and (iii), (b)(2)(E) (with respect to principal trading), (b)(2)(G) and (b)(2)(H)(ii) and (iii).

still would be required to establish information barriers or other institutional safeguards reasonably designed to ensure debt research analysts are insulated from *pressure* by persons engaged in principal trading or sales and trading activities or other persons who might be biased in their judgment or supervision. Members that qualify for this exemption must maintain records sufficient to establish eligibility for the exemption and also maintain for at least three years any communication that, but for this exemption, would be subject to all of the requirements of proposed FINRA Rule 2242(b).

L. Exemption for Debt Research Reports Provided to Institutional Investors

Given the debt market and the needs of its participants, the proposed rule change would exempt debt research distributed solely to eligible institutional investors (''institutional debt research'') from most of the provisions regarding supervision, coverage determinations, budget and compensation determinations, and all of the disclosure requirements applicable to debt research reports distributed to retail investors (''retail debt research'').[98] Under the proposed rule change, the term ''retail investor'' means any person other than an institutional investor.[99]

The proposed rule distinguishes between larger and smaller institutions in the manner in which their opt-in decision is obtained. Larger institutions would be permitted to receive institutional debt research based on negative consent, while smaller institutions would be required to affirmatively consent in writing to receive that research.

Specifically, the proposed rule would allow firms to distribute institutional debt research by negative consent to a person who meets the definition of a qualified institutional buyer (''QIB'') [100] and where, pursuant to FINRA Rule 2111(b): (1) The member or associated person has a reasonable basis to believe that the QIB is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies involving a debt security or debt securities; and (2) The QIB has affirmatively indicated that it is exercising independent judgment in evaluating the member's recommendations pursuant to FINRA Rule 2111 and such affirmation is broad enough to encompass transactions in debt securities. The proposed rule change would require written disclosure to the QIB that the member may provide debt research reports that are intended for institutional investors and are not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors. If the QIB does not contact the member and request to receive only retail debt research reports, the member would be permitted to reasonably conclude that the QIB has consented to receiving institutional debt research reports.[101] FINRA stated that it would interpret this standard to allow an order placer, *e.g.,* a registered investment adviser, for a QIB that satisfies the FINRA Rule 2111 institutional suitability requirements with respect to debt transactions to agree to receive institutional debt research on behalf of the QIB by negative consent should the rule be approved.

Institutional accounts that meet the definition of FINRA Rule 4512(c) but do not satisfy the higher tier requirements described above would still be permitted to affirmatively elect in writing to receive institutional debt research. Specifically, a person that meets the definition of ''institutional account'' in FINRA Rule 4512(c) would be permitted to receive institutional debt research provided that such person, prior to receipt of a debt research report, has affirmatively notified the member in writing that it wishes to receive institutional debt research and forego treatment as a retail investor for the purposes of the proposed rule. Members would not be permitted to allow retail investors to choose to receive institutional debt research.[102]

FINRA stated that, to avoid a disruption in the receipt of institutional debt research, the proposed rule change would allow firms to send institutional debt research to any FINRA Rule 4512(c) account, except a natural person, without affirmative or negative consent for a period of up to one year after Commission approval of the proposed rule change while they obtain the necessary consents. Natural persons that qualify as an institutional account under FINRA Rule 4512(c) would be required to provide affirmative consent to receive institutional debt research during this transition period and thereafter.[103]

The proposed exemption would permit members that distribute institutional debt research to institutional investors to do so without meeting the proposed requirements to have written policies and procedures for this research with respect to: (1) Restricting or prohibiting prepublication review of institutional debt research by principal trading and sales and trading personnel or others outside the research department, other than investment banking personnel; (2) Input by investment banking, principal trading and sales and trading into coverage decisions; (3) Limiting supervision of debt research analysts to persons not engaged in investment banking, principal trading or sales and trading activities; (4) Limiting determination of the debt research department's budget to senior management not engaged in investment banking or principal trading activities and without regard to specific revenues derived from investment banking; (5) Determination of debt research analyst compensation; (6) Restricting or limiting debt research analyst account trading; and (7) Information barriers or other institutional safeguards reasonably designed to ensure debt research analysts are insulated from review or oversight by investment banking, sales and trading or principal trading personnel, among others (but members still must have written policies and procedures to guard against those persons pressuring analysts). The exemption further would apply to all disclosure requirements, including content and disclosure requirements for third-party research.

Notwithstanding the proposed exemption, some provisions of the proposed rule still would apply to institutional debt research, including the prohibition on prepublication review of debt research reports by investment banking personnel and the restrictions on such review by subject companies. While prepublication review by principal trading and sales and trading personnel would not be prohibited pursuant to the exemption, other provisions of the rule would continue to require management of those conflicts, including the requirement to establish information barriers reasonably designed to insulate debt research analysts from pressure by those persons. Furthermore, the requirements in Supplementary

[98] *See* proposed FINRA Rule 2242(j)(1).

[99] *See* proposed FINRA Rule 2242(a)(13).

[100] *See* proposed FINRA Rule 2242(a)(12) under which a QIB has the same meaning as under Rule 144A of the Securities Act.

[101] *See* proposed FINRA Rule 2242(j)(1)(A)(i) and (ii).

[102] *See* proposed FINRA Rule 2242(j)(1)(B).

[103] *See* proposed FINRA Rule 2242.11 (Distribution of Institutional Debt Research During Transition Period).

Material .05 related to submission of sections of a draft debt research report for factual review would apply to any permitted prepublication review by persons not directly responsible for the preparation, content or distribution of debt research reports. In addition, members would be required to prohibit debt research analysts from participating in the solicitation of investment banking services transactions, road shows, and other marketing on behalf of issuers and further prohibit investment banking personnel from directly or indirectly directing a debt research analyst to engage in sales and marketing efforts related to an investment banking deal or to communicate with a current or prospective customer with respect to such transactions. The provisions regarding retaliation against debt research analysts and promises of favorable debt research also would still apply with respect to research distributed to eligible institutional investors.[104]

While the proposed rule change would not require institutional debt research to carry the specific disclosures applicable to retail debt research, it would require that such research carry general disclosures prominently on the first page warning that: (1) The report is intended only for institutional investors and does not carry all of the independence and disclosure standards of retail debt research reports; (2) If applicable, that the views in the report may differ from the views offered in retail debt research reports; and (3) If applicable, that the report may not be independent of the firm's proprietary interests and that the firm trades the securities covered in the report for its own account and on a discretionary basis on behalf of certain customers, and such trading interests may be contrary to the recommendation in the report.[105] FINRA stated that the second and third disclosures described above would be required only if the member produces both retail and institutional debt research reports that sometimes differ in their views or if the member maintains a proprietary trading desk or trades on a discretionary basis on behalf of some customers and those interests sometimes are contrary to recommendations in institutional debt research reports.

The proposed rule change would require members to establish, maintain and enforce written policies and procedures reasonably designed to ensure that institutional debt research is made available only to eligible institutional investors.[106] A member would not be permitted to rely on the proposed exemption with respect to a debt research report that the member has reason to believe will be redistributed to a retail investor. The proposed rule change also states that the proposed exemption would not relieve a member of its obligations to comply with the antifraud provisions of the federal securities laws and FINRA rules.[107]

M. General Exemptive Authority

The proposed rule change would provide FINRA, pursuant to the FINRA Rule 9600 Series, with authority to conditionally or unconditionally grant, in exceptional and unusual circumstances, an exemption from any requirement of the proposed rule for good cause shown, after taking into account all relevant factors and provided that such exemption is consistent with the purposes of the rule, the protection of investors, and the public interest.[108]

III. Summary of Comment Letters, Discussion, and Commission Findings

In response to the proposal as originally proposed by FINRA, the Commission received five comments on the proposal.[109] All of the relevant commenters expressed general support for the proposal.[110] The specifics of these comments were summarized when the Commission instituted proceedings and again when the Commission noticed Amendment No. 1.[111] FINRA filed Amendment No. 1 as a response to these earlier comments as discussed when the amendment was noticed.[112] In the time since Amendment No. 1 was filed the Commission has received four comment letters on the proposal.[113] FINRA submitted a letter in response to these comments.[114]

All five of the commenters to the original proposal,[115] and all three of the relevant commenters to the proposal in connection with instituting proceedings or with regards to Amendment No. 1,[116] expressed general support for the proposal. The Commission notes this support.

A. Comments and Discussion Regarding the Principles-Based Approach of the Proposed Rule Change

The rule proposal as originally proposed would have adopted a policies and procedures approach to identification and management of research-related conflicts of interest and require those policies and procedures to, at a minimum, prohibit or restrict particular conduct. Commenters to the original proposal expressed several concerns with the approach.

Two of these commenters asserted that the mix of a principles-based approach with prescriptive requirements was confusing in places and posed operational challenges. In particular, the commenters recommended eliminating the minimum standards for the policies and procedures.[117] One of those commenters had previously expressed support for the proposed principles-based approach with minimum requirements,[118] but asserted that the proposed rule text requiring procedures to ''at a minimum, be reasonably designed to prohibit'' specified conduct is superfluous or confusing. Another commenter to the original proposal favored utilizing a proscriptive approach similar to the current equity rules and also requiring that firms maintain policies and procedures designed to ensure compliance.[119] Another commenter to the original proposal supported the types of communications between debt research analysts and other persons that may be permitted by a firm's policies and procedures.[120] One commenter to the original proposal questioned the necessity of the ''preamble'' requiring policies and procedures that ''restrict or limit activities by research analysts that can reasonably be expected to compromise their objectivity'' that precedes specific prohibited activities related to investment banking transactions.[121] Finally, some

[104] *See* proposed FINRA Rule 2242(j)(2).

[105] *See* proposed FINRA Rule 2242(j)(3).

[106] *See* proposed FINRA Rule 2242(j)(4).

[107] *See* proposed FINRA Rule 2242(j)(5).

[108] *See* proposed FINRA Rule 2242(k).

[109] *See* note 4, *supra.*

[110] SIFMA, WilmerHale Debt One, PIABA Debt, NASAA Debt One and CFA Institute One.

[111] Exchange Act Release No. 74340 (Feb. 20, 2015); 80 FR 10538 (Feb. 26, 2015) and Amendment Notice.

[112] *Id.*

[113] WilmerHale Debt Two, CFA Institute Two, Anonymous, and NASAA Debt Two.

[114] FINRA Response.

[115] SIFMA, WilmerHale Debt One, PIABA Debt, NASAA Debt One, and CFA Institute One.

[116] WilmerHale Debt Two, CFA Institute Two, and NASAA Debt Two. As noted above the comment from Anonymous did not seem relevant to the proposed rule change as it seemed to be asking about accounting issues, which were not raised by the proposal. *See* note 14, *supra.*

[117] SIFMA and WilmerHale Debt One.

[118] Letter from Amal Aly, Managing Director and Associate General Counsel, SIFMA, to Marcia E. Asquith, Corporate Secretary, FINRA, dated November 14, 2008 regarding *Regulatory Notice* 08–55 (Research Analysts and Research Reports).

[119] NASAA Debt One.

[120] CFA Institute One.

[121] WilmerHale Debt One.

commenters to the original proposal suggested FINRA eliminate language in the supplementary material that provides that the failure of an associated person to comply with the firm's policies and procedures constitutes a violation of the proposed rule itself.[122] These commenters argued that because members may establish policies and procedures that go beyond the requirements set forth in the rule, the provision may have the unintended consequence of discouraging firms from creating standards in their policies and procedures that extend beyond the rule. One of those commenters suggested that the remaining language in the supplementary material adequately holds individuals responsible for engaging in restricted or prohibited conduct covered by the proposals.[123]

FINRA, in response, stated it believes the framework will maintain the same level of investor protection in the current equity rules (which also would largely apply to retail debt research) while providing both some flexibility for firms to align their compliance systems with their business model and philosophy and imposing additional obligations to proactively identify and manage emerging conflicts. According to FINRA the proposal, even under a policies and procedures approach, ''would effectively maintain, with some modifications, the key proscriptions in the current rules'' [124] (*e.g.,* prohibitions on prepublication review, supervision of research analysts by investment banking and participation in pitches and road shows). FINRA disagreed that the ''preamble'' to some of those prohibitions is unnecessary. As with the more general overarching principles-based requirement to identify and manage conflicts of interest, the introductory principle that requires written policies and procedures to restrict or limit activities by research analysts that can reasonably be expected to compromise their objectivity recognizes that FINRA cannot identify every conflict related to research at every firm and therefore requires proactive monitoring and management of those conflicts. FINRA did not believe this ''preamble'' language is redundant with the broader overarching principle because it applies more specifically to the activities of research analysts and, unlike the broader principle, would preclude the use of disclosure as a means of conflict management for those activities.

In light of the overarching principle that requires firms to establish, maintain, and enforce written policies and procedures reasonably designed to identify and effectively manage research-related conflicts, FINRA clarified that the ''at a minimum'' language was meant to convey that additional conflicts management policies and procedures may be needed to address emerging conflicts that may arise as the result of business changes, such as new research products, affiliations or distribution methods at a particular firm. As discussed in the Notice, FINRA stated that it intends for firms to proactively identify and manage those conflicts with appropriately designed policies and procedures. FINRA clarified that their inclusion of the ''at a minimum'' language was not, in their opinion, intended to suggest that firms' written policies and procedures must go beyond the specified prohibitions and restrictions in the proposal where no new conflicts have been identified. However, FINRA stated it believes the overarching requirement for policies and procedures reasonably designed to identify and effectively manage research-related conflicts suffices to achieve the intended regulatory objective, and therefore to eliminate any confusion, FINRA proposed to amend the proposals to delete the ''at a minimum'' language in Amendment No. 1. One of the commenters that raised this issue noted their approval of this change in their second letter.[125]

FINRA stated that it appreciates the commenters' concerns with respect to language in the supplementary material that would make a violation of a firm's policies a violation of the underlying rule. They further stated that the supplementary material was intended to hold individuals responsible for engaging in the conduct that the policies and procedures effectively restrict or prohibit. FINRA agreed that purpose is achieved with the language in the supplementary material that states that, consistent with FINRA Rule 0140, ''it shall be a violation of [the Rule] for an associated person to engage in the restricted or prohibited conduct to be addressed through the establishment, maintenance and enforcement of policies and procedures required by [the Rule] or related Supplementary Material.'' Therefore, FINRA proposed, in Amendment No. 1, to amend the proposals to delete the language stating that a violation of a firm's policies and procedures shall constitute a violation of the rule itself. One of the commenters that raised this issue noted their approval of this change in their second letter.[126]

Another of the original commenters, in a second letter, repeated their concerns about utilizing a principles-based method in a rule in this area, noting that a proscriptive approach is known to be generally effective at addressing the types of conflicts of interest that the proposal is designed to address and repeated violations by industry of the current proscriptive equity research rule.[127] FINRA disagreed with the commenter noting that the proposed rule change would establish for debt research reports, ''with a few modifications,'' the key requirements of the current equity rules as mandated policies and procedures members must establish.[128]

B. Comments and Discussion Regarding the Definitions and Terms Used in the Proposed Rule Change

One commenter to the original proposal requested that the proposal define the term ''sales and trading personnel'' as ''persons who are primarily responsible for performing sales and trading activities, or exercising direct supervisory authority over such persons.'' [129] The commenter's proposed definition was intended to clarify that the proposed restrictions on sales and trading personnel activities should not extend to senior management who do not directly supervise those activities but have a reporting line from such personnel or persons who occasionally function in a sales and trading capacity. FINRA stated that it intends for the sales and trading personnel conflict management provisions to apply to individuals who perform sales and trading functions, irrespective of their job title or the frequency of engaging in the activities. As such, FINRA stated it did not intend for the rule to capture as sales and trading personnel senior management, such as the chief executive officer, who do not engage in or supervise day-to-day sales and trading activities. However, FINRA stated it believes the applicable provisions should apply to individuals who may occasionally perform or directly supervise sales and trading activities. Otherwise, FINRA believes, investors could be put at risk with respect to the research or transactions involved when those individuals are

[122] SIFMA and WilmerHale Debt One.

[123] WilmerHale Debt One.

[124] Presumably FINRA means the current equity research rules that would be carried over to debt research reports under the proposal.

[125] WilmerHale Debt Two.

[126] WilmerHale Debt Two.

[127] NASAA Debt Two.

[128] FINRA Response.

[129] WilmerHale Debt One.

functioning in those capacities because the conflict management procedures and proscriptions and required disclosures would not apply. Therefore, FINRA proposed to amend the rule as part of Amendment No. 1 to define sales and trading personnel to include ''persons in any department or division, whether or not identified as such, who perform any sales or trading service on behalf of a member.'' FINRA noted that this proposed definition is more consistent with the definition of ''investment banking department'' in the proposed rule change.

One commenter to the original proposal asked FINRA to include an exclusion from the definition of ''debt research report'' for private placement memoranda and similar offering-related documents prepared in connection with investment banking services transactions.[130] The commenter noted that such offering-related documents typically are prepared by investment banking personnel or non-research personnel on behalf of investment banking personnel. The commenter asserted that absent an express exception, the proposals could turn investment banking personnel into research analysts and make the rule unworkable. The commenter noted that NASD Rule 2711(a) excludes communications that constitute statutory prospectuses that are filed as part of a registration statement and contended that the basis for that exception should apply equally to private placement memoranda and similar offering-related documents.

As FINRA had noted with respect to the definition of ''research report'' in the equity research filing, they also noted that a ''debt research report'' is generally understood not to include such offering-related documents prepared in connection with investment banking services transactions. In the course of administering the filing review programs under FINRA Rules 2210 (Communications with the Public), 5110 (Corporate Financing Rule), 5122 (Member Private Offerings) and 5123 (Private Placements of Securities), FINRA stated it had not received any inquiries or addressed any issues that indicate there is confusion regarding the scope of the research analyst rules as applied to offering-related documents prepared in connection with investment banking activities. Regardless, to provide firms with greater clarity as to the status of such offering-related documents under the proposals, FINRA proposed to amend the proposed rule as part of Amendment No. 1 to exclude private placement memoranda and similar offering-related documents prepared in connection with investment banking services transactions other than those that purport to be research from the definition of ''debt research report.'' In their second comment letter, the commenter expressed support for this change.[131]

One commenter to the original proposal asked FINRA to refrain from using the concept of ''reliable'' research in the proposal as it may inappropriately connote accuracy in the context of a research analyst's opinions.[132] FINRA stated it believes that the term ''reliable'' is commonly understood and notes that the term is used in certain research-related provisions in the Sarbanes–Oxley Act of 2002 (''Sarbanes-Oxley'') without definition. FINRA further stated it does not believe the term connotes accuracy of opinions.

One commenter to the original proposal asked FINRA to eliminate as redundant the term ''independently'' from the provisions permitting non-research personnel to have input into research coverage, so long as research management ''independently makes all final decisions regarding the research coverage plan.'' [133] The commenter asserted that inclusion of ''independently'' is confusing since the proposal would permit input from non-research personnel into coverage decisions. FINRA stated it had included ''independently'' to make clear that research management alone is vested with making final coverage decisions. Thus, for example, a firm could not have a committee that includes a majority of research management personnel but also other individuals make final coverage decisions by a vote. As such, FINRA declined to eliminate the term as suggested.

One commenter to the original proposal requested that the proposal define the terms ''principal trading activities,'' ''principal trading personnel,'' and ''persons engaged in principal trading activities'' to exclude traders who are primarily involved in customer accommodation or customer facilitation trading, such as market makers that trade on a principal basis.[134] The commenter stated that the exclusion is necessary to allow those traders to provide feedback from clients for the purposes of evaluating debt research analysts for compensation determination. More directly to that point, the same commenter and an additional commenter to the original proposal asserted that the proposal should not prohibit those engaged in principal trading activities from providing customer feedback as part of the evaluation and compensation process for a debt research analyst.[135] They contended that the fixed income markets operate primarily on a principal basis and prohibiting such input would have a broad impact on research management's ability to appropriately evaluate and compensate debt research analysts.

The proposal would allow sales and trading personnel, but not personnel engaged in principal trading activities, to provide input to debt research management into the evaluation of debt research analysts. As discussed in detail in the Notice in response to the similar comment raised to earlier iterations of the debt proposal,[136] given the importance of principal trading operations to the revenues of many firms, FINRA stated it believes there is increased risk that a principal trader could improperly pressure or influence debt research if he or she has a say concerning analyst compensation or can selectively relay customer feedback. FINRA also stated it believes the risk to retail investors—the compensation evaluation restrictions would not apply to institutional debt research—outweighs the benefit of an additional data point for research management to assess the quality of research produced by those that they oversee. FINRA also noted that the proposal would allow sales and trading personnel to provide customer feedback. For these reasons, FINRA declined to define the terms as the commenter suggested. One of the commenters, in their second letter, expressed disappointment in this decision, but noted their acceptance that FINRA has already considered the issue a number of times and did not reiterate the comment.[137]

Another commenter to the original proposal asked for clarification of the term ''principal trading'' because it believes the term ''sales and trading'' already encompasses all agency, principal and proprietary trading activities.[138] FINRA clarified in response to this comment that the debt proposal imposes greater restrictions on interaction between debt research analysts and principal trading personnel than between debt research analysts and sales and trading personnel because the

[130] WilmerHale Debt One.

[131] WilmerHale Debt Two.

[132] SIFMA.

[133] WilmerHale Debt One.

[134] *Id.*

[135] SIFMA and WilmerHale Debt One.

[136] 79 FR 69905, 69924.

[137] WilmerHale Debt Two.

[138] SIFMA.

magnitude of the conflict is greater with respect to the former. According to FINRA, this structure evolved based on extensive consultation and feedback from the industry. Based on those communications, FINRA stated it understands and intends for the term ''sales and trading'' to exclude principal and proprietary trading activities. FINRA further stated it will consider providing guidance where it is unclear whether a particular job function or activity falls within ''sales and trading'' or ''principal trading'' activities.

One commenter to the original proposal suggested that FINRA revise the definition of ''subject company'' to specify that the term means the ''*issuer* (rather than the ''company'') whose debt securities are the subject of a debt research report or a public appearance.'' [139] The commenter noted that, among other things, the proposal would cover debt issued by persons other than corporate entities, such as foreign sovereigns or special purpose vehicles. FINRA agreed that the change is appropriate and proposed to amend the definition accordingly in Amendment No. 1.

C. Comments and Discussion Regarding Information Barriers

The proposed rule would require written policies and procedures to ''establish information barriers or other institutional safeguards reasonably designed to ensure that research analysts are insulated from review, pressure or oversight by persons engaged in investment banking services activities or other persons, including sales and trading department personnel, who might be biased in their judgment or supervision.'' Some commenters to the original proposal suggested that ''review'' was unnecessary in this provision because the review of debt research analysts was addressed sufficiently in other parts of the proposed rule.[140] One such commenter further suggested that the terms ''review'' and ''oversight'' are redundant.[141] FINRA stated it does not agree that the terms ''review'' and ''oversight'' are coextensive, as the former may connote informal evaluation, while the latter may signify more formal supervision or authority. FINRA noted that while other provisions of the proposed rule change may address related conduct—for example, the provision that prohibits investment banking personnel, principal trading personnel and sales and trading personnel from supervision or control of debt research analysts—this provision extends to ''other persons'' who may be biased in their judgment or supervision. Finally, FINRA stated it included the ''review, pressure or oversight'' language to mirror the requirements for equity rules in Sarbanes-Oxley and therefore promote consistency. For these reasons, FINRA declined to revise the proposed rule change.

One commenter to the original proposal asked FINRA to clarify that the information barriers or other institutional safeguards required by the proposed rule are not intended to prohibit or limit activities that would otherwise be permitted under other provisions of the rule.[142] In the Amendment Notice, FINRA stated that was their intent.

This commenter stated in their comment in response to Amendment No. 1 that they interpreted this to mean that the proposal would permit members to allow persons engaged in sales and trading activities to provide informal and formal feedback on research analysts as one factor to be considered by research management for the purposes of the evaluation of the analyst.[143] FINRA stated that, in general, it agreed with the commenter's interpretation.[144]

The commenter also asserted that the terms ''bias'' and ''pressure'' are broad and ambiguous on their face and requested that FINRA clarify that for purposes of the information barriers requirement that they are intended to address persons who may try to improperly influence research.[145] As an example, the commenter asked whether a bias would be present if an analyst was pressured to change the format of a research report to comply with the research department's standard procedures or the firm's technology specifications. FINRA stated it believes the terms ''pressure'' and ''bias'' are commonly understood, particularly in the context of rules intended to promote analyst independence and objectivity. FINRA further noted that the terms appear in certain research-related provisions of Sarbanes–Oxley without definition. With respect to the commenter's example, FINRA stated it does not believe a bias would be present simply because someone insists that a research analyst comply with formatting or technology specifications that do not otherwise implicate the rules.

One commenter to the original proposal asked FINRA to modify the information barriers or other institutional safeguards requirement to conform the provision to FINRA's ''reasonably designed'' standard for related policies and procedures.[146] FINRA stated it believed the change would be consistent with the standard for policies and procedures elsewhere in the proposal, and therefore proposed to amend the provision as requested in Amendment No. 1. The commenter noted with support this change in their second letter.[147]

One commenter to the original proposal opposed as overbroad the proposed expansion of the current ''catch-all'' disclosure requirement to include ''any other material conflict of interest of the research analyst or member that a research analyst *or an associated person of the member with the ability to influence* the content of a research report knows or has reason to know'' (emphasis added) at the time of publication or distribution of research report.[148] The commenter expressed concern about the emphasized language.

FINRA stated it proposed the change to capture material conflicts of interest known by persons other than the research analyst (*e.g.,* a supervisor or the head of research) who are in a position to improperly influence a debt research report. FINRA defined ''ability to influence the content of a debt research report'' in the proposed rule's supplementary material as ''an associated person who, in the ordinary course of that person's duties, has the authority to review the research report and change that research report prior to publication or distribution.'' The commenter stated that the proposed change could capture individuals (especially legal and compliance personnel) who possess confidential information regarding potential future investment banking transactions and thus mandate disclosure of this confidential information. Further, it was possible that this information would not have been excepted from disclosure by a proposed exception in the original proposal that would have excluded disclosure where it would ''reveal material non-public information regarding specific potential future investment banking transactions of the subject company.'' This is because, according to the commenter, legal and compliance may be aware of material conflicts of interest relating to the subject company that involve material

[139] WilmerHale Debt One.
[140] SIFMA and WilmerHale Debt One.
[141] WilmerHale Debt One.
[142] WilmerHale Debt One.
[143] WilmerHale Debt Two.
[144] FINRA Response.
[145] WilmerHale Debt One.
[146] WilmerHale Debt One.
[147] WilmerHale Debt Two.
[148] WilmerHale Debt One.

non-public information regarding specific future investment banking transactions of a *competitor* of the subject company. The commenter also expressed concern that the provision would slow down dissemination of research to canvass all research supervisors and management for conflicts. The commenter suggested that the change was unnecessary given other objectivity safeguards in the proposals that would guard against improper influence.

FINRA stated it continues to believe that the catch-all provision must include persons with the ability to influence the content of a debt research report to avoid creating a gap where a supervisor or other person with the authority to change the content of a research report knows of a material conflict. However, FINRA clarified that it intended for the provision to capture only those individuals who are required to review the content of a particular research report or have exercised their authority to review or change the research report prior to publication or distribution. In addition, FINRA stated it did not intend to capture legal or compliance personnel who may review a research report for compliance purposes but are not authorized to dictate a particular recommendation or rating. FINRA proposed to amend the supplementary material in the proposals consistent with this clarification in Amendment No. 1. In addition, FINRA proposed to modify in Amendment No. 1 the exception in proposed Rules 2242(c)(5) and (d)(2) (applying to public appearances) so as to not require disclosure that would otherwise reveal material non-public information regarding specific potential future investment banking transactions, whether or not the transaction involves the subject company.

This commenter in their comment in response to Amendment No. 1, while expressing their support for these changes, asked FINRA to make a modification of the parties who trigger disclosure of any other material conflict of interest. Specifically, the commenter asked FINRA to limit this disclosure to only be required when someone has authority to dictate a particular recommendation, rating, or price target.[149] The commenter was seeking to extend this authority requirement to other parities that can trigger the disclosure, specifically persons who review the report and persons who have exercised authority to review or change the report generally. FINRA declined to make further changes, noting that the change in Amendment No. 1 ''was meant to limit application of the provision where there is a discrete review by [legal or compliance personnel] outside of the research department who do not have primary content review responsibilities'' and that ''those individuals that a firm requires to review research reports (*e.g.,* a Supervisory Analyst) or who exercise their authority to change a research report (*e.g.,* a Director of Research) by definition have the ability to influence the content of a research report.'' [150]

One commenter to the original proposal requested confirmation that members may rely on hyperlinked disclosures for research reports that are delivered electronically, even if these reports are subsequently printed out by customers.[151] As long as a research report delivered electronically contains a hyperlink directly to the required disclosures, FINRA stated that the standard will be satisfied.

D. Comments and Discussion Regarding Research Products With Differing Recommendations

The proposed rule change would require firms to establish, maintain and enforce written policies and procedures reasonably designed to ensure that a research report is not distributed selectively to internal trading personnel or a particular customer or class of customers in advance of other customers that the firm has previously determined are entitled to receive the research report. The proposals also include supplementary material that explains that firms may provide different research products to different classes of customers—*e.g.,* long term fundamental research to all customers and short-term trading research to certain institutional customers—provided the products are not differentiated based on the timing of receipt of potentially market moving information and the firm discloses, if applicable, that one product may contain a different recommendation or rating from another product.

One commenter to the original proposal supported the provisions as proposed with general disclosure,[152] while another contended that FINRA should require members to disclose when its research products and services do, in fact, contain a recommendation contrary to the research product or service received by other customers.[153] The commenter favoring general disclosure asserted that disclosure of specific instances of contrary recommendations would impose significant burdens unjustified by the investor protection benefits. The commenter stated that a specific disclosure requirement would require close tracking and analysis of every research product or service to determine if a contrary recommendation exists. The commenter further stated that the difficulty of complying with such a requirement would be exacerbated in large firms by the number of research reports published and research analysts employed and the differing audiences for research products and services.[154] The commenter asserted that some firms may publish tens of thousands of research reports each year and employ hundreds of analysts across various disciplines and that a given research analyst or supervisor could not reasonably be expected to know of all other research products and services that may contain differing views.

The opposing commenter stated that they believed that permitting contrary opinions while only disclosing the possibility of this contrary research to investors was insufficient to adequately protect investors because the use of ''may'' in a disclosure is not the same as disclosing that there actually are opposing opinions. Further, they questioned whether such disclosure was consistent with the Act in that it may contrary to Rule 10b–5 by permitting the omission of a material fact in the research report. They did not believe that the disclosure of actual opposing views would be burdensome on members as they should be aware of contrasting opinions. As a result, FINRA should require specific disclosures.[155]

Another commenter to the original proposal expressed concern that the proposal raises issues about the parity of information received by retail and institutional investors, and whether research provided to institutional investors could contain views that differ from those in research to retail investors.[156]

The supplementary material states that products may lead to different recommendations or ratings, provided that each is consistent with the member's ratings system for each respective product. In other words, according to FINRA, all differing recommendations or ratings must be reconcilable such that they are not truly at odds with one another. As such, the proposed rule change would not, in

[149] WilmerHale Debt Two.

[150] FINRA Response.

[151] WilmerHale Debt One.

[152] WilmerHale Debt One.

[153] PIABA Debt.

[154] WilmerHale Debt One.

[155] PIABA Debt.

[156] CFA Institute One.

FINRA's view, allow research provided to an institutional investor to contain views inconsistent with those offered in retail debt research.[157] FINRA provided the following example from the filing regarding equity research: A firm might define a ''buy'' rating in its long-term research product to mean that a stock will outperform the S&P 500 over the next year, while a ''sell'' rating in its short-term trading product might mean the stock will underperform its sector index over the next month. In this case, FINRA stated that the firm could, under the proposal, maintain a ''buy'' in the long-term research and a ''sell'' in its trading research at the same time if the firm believed the stock would temporarily drop near term based on failing to meet expectations in an earnings report but still outperform the S&P over the next year. One commenter, in their second letter, stated that this clarification addressed their concerns that investor protections were being impacted.[158]

Since the proposed rule change would not allow inconsistent recommendations that could mislead one or more investors, FINRA stated that it believes general disclosure of alternative products with different objectives and recommendations is appropriate relative to its investor protection benefits. The commenter who supported this approach expressed support for FINRA's decision in their second letter.[159]

E. Comments and Discussion Regarding Structural and Procedural Safeguards

One commenter to the original proposal asked that FINRA clarify that members that have developed policies and procedures consistent with FINRA Rule 5280 (Trading Ahead of Research Reports) would also be in compliance with the debt proposal's expectation of structural separation between investment banking and debt research, and between sales and trading and principal trading and debt research.[160] FINRA indicated in the proposed rule change that while the proposed rule would not require physical separation, FINRA would expect such physical separation except in extraordinary circumstances where the costs are unreasonable due to a firm's size and resource limitations. FINRA Rule 5280 does not, according to FINRA, specify physical separation between all of the persons involved. While similar in design and purpose to some aspects of the proposed requirements in the debt proposal, FINRA clarified that FINRA Rule 5280 is not congruent with the proposal to the point where compliance with the policies and procedures provision of that rule would be deemed compliance with the debt proposal separation requirements. FINRA stated that both FINRA Rule 5280 and the debt proposal require policies and procedures reasonably designed to limit information flow.

FINRA also stated it believes that physical separation is an effective component to a reasonably designed compliance system that requires information barriers.

The same commenter asked that FINRA modify the prohibition on debt analyst attendance at road shows to permit passive participation since there is less opportunity to meet and assess issuer management than in the equity context.[161] FINRA stated it believes that even passive participation by debt research analysts in road shows and other marketing may present conflicts of interest and, therefore, declined to revise the proposal as suggested.[162] In their second letter, the commenter reiterated this suggested change because, while they note the need for analysts to maintain their objectivity, unlike equity research analysts who have frequent interactions with issuer management and may assist in the due diligence process for offerings, debt research analysts typically do not participate in due diligence and do not have the same opportunities to meet with issuer management and road shows may present the only opportunity to do so.[163] For the same reasons as above, FINRA declined again to make this change.[164]

F. Comments and Discussion Regarding Communications Between Research Analysts and Trading Desk Personnel

A commenter to the original proposal asked FINRA to delete the term ''attempting'' in the proposed Supplementary Material .03(a)(1), which would require members to have policies and procedures reasonably designed to prohibit sales and trading and principal trading personnel from ''attempting to influence a debt research analyst's opinion or views for the purpose of benefitting the trading position of the firm, a customer, or a class of customers.'' [165] The commenter stated that it is unclear how a firm should enforce a prohibition on attempts to influence. FINRA notes that Supplementary Material .03(b)(2) sets forth permissible communications between debt research analysts and sales and trading and principal trading personnel, including, for example, allowing a debt research analyst to provide ''customized analysis, recommendations or trade ideas'' to customers or traders upon request, provided that the communications are ''not inconsistent with the analyst's current or pending debt research, and that any subsequently published debt research is not for the purpose of benefitting the trading position of the firm, a customer or a class of customers.'' In the context of such a request, FINRA stated that is not hard to envision the possibility that a trader, for example, might attempt to influence the analyst's view by emphasizing that a particular recommendation would be beneficial to the firm. FINRA expressed its belief that there are a variety of policies and procedures that could address such attempts, including periodic monitoring of such communications. As such, FINRA declined to delete ''attempting'' from the provision.

The commenter further expressed concern that the term ''pending'' is vague in the above-cited provision.[166] The commenter suggested that FINRA delete the term or confirm that ''pending'' means ''imminent publication of a debt research report.'' FINRA stated it believes it is important that any customized analysis, recommendations or trade ideas be consistent not only with published research, but also any research being drafted in anticipation of publication or distribution that may contain changed or additional view or opinions. FINRA stated it considers such research in draft to be pending and therefore declined to delete the term or adopt an ''imminent'' standard as suggested by the commenter.

Proposed Supplementary Material .03(b)(3) would provide that, in determining what is consistent with a debt research analyst's published debt research for purposes of sharing certain views with sales and trading and principal trading personnel, members

[157] According to FINRA, the proposed rule change would not require that all investors receive all research products, nor would it preclude a firm from offering, for example, a research product to select customers that includes greater depth of analysis. However, it would not, in FINRA's view, be consistent with the proposed rule change to provide inconsistent views to different classes of customers or to advantage one class of customers based on the timing of receipt of a recommendation, rating or potentially market moving information.

[158] CFA Institute Two.

[159] WilmerHale Debt Two.

[160] WilmerHale Debt One.

[161] WilmerHale Debt One.

[162] *See also* Notice.

[163] WilmerHale Debt Two.

[164] FINRA Response

[165] WilmerHale Debt One.

[166] *Id.*

may consider the context, including that the investment objectives or time horizons being discussed may differ from those underlying the debt analyst's published views. One commenter to the original proposal asked FINRA to clarify that the standard may be applied wherever consistency with a debt research analyst's views may be assessed under the proposed debt rule, such as with respect to debt research analyst account trading or providing customized analysis, recommendations, or trade ideas to sales and trading, principal trading, and customers.[167] FINRA agreed in the Amendment Notice that context may be considered whenever consistency of research or views is at issue.

G. Comments and Discussion Regarding Disclosure Requirements

One commenter to the original proposal expressed concern about the proposed requirements that a member disclose in retail debt research reports its distribution of all debt security ratings (and the percentage of subject companies in each buy/hold/sell category for which the member has provided investment banking services within the previous twelve months) and historical ratings information on the debt securities that are the subject of the debt research report for a period of three years or the time during which the member has assigned a rating, whichever is shorter.[168] The commenter asked FINRA to eliminate these provisions because the commenter believes that they are impractical and provide minimal benefit to investors in the context of debt research, even though they may be very useful in the equity context.[169] The commenter stated that the large number of bond issues followed by analysts make the provisions especially burdensome and do not allow for helpful comparisons for investors across debt securities or issuers. With respect to the ratings distribution requirements, the commenter asserted that in some cases, a debt analyst may assign a rating to the issuer that applies to all of that issuer's bonds, thereby skewing the distribution because those issuers will be overrepresented in the distribution. The commenter also stated that the tracking requirements for these provisions would be particularly burdensome, given the numerous bonds issued by the same subject company and the fact that bonds are constantly being replaced with newer ones. Finally, the commenter stated that the three-year look back period is too long and suggested instead a one-year period if FINRA retains the historical rating table requirement.

FINRA stated it believes that, similar to the current equity rules, to the extent that a firm produces retail debt research that assigns a rating to an issuer—*i.e.,* a credit analysis—these disclosure provisions would provide value to retail investors to quickly gauge any apparent bias toward more or less favorable ratings or investment banking clients and to assess the accuracy of past ratings. Moreover, FINRA stated it understands that the burden to comply with the requirements with respect to this limited subset of debt research would be manageable for firms. Therefore, FINRA proposed to amend Rules 2242(c)(2) and (3) in Amendment No. 1 to apply the ratings distribution requirement and historical rating table requirement only to each debt research report limited to the analysis of an issuer of a debt security that includes a rating of the subject company. Since the proposal would be limited to these issuer credit analyses and would not apply to individual bonds, FINRA expressed belief that many of the commenter's burden concerns would be alleviated and that it would be reasonable and appropriate to maintain the proposed three-year look back period with respect to the historical rating provision. In their second letter, the commenter expressed support for this change.[170]

While FINRA also believes that the disclosures would be valuable to retail investors with respect to debt research on individual debt securities, FINRA stated it recognizes the additional complexity and cost associated with compliance, particularly where a retail debt research report may include multiple ratings of individual debt securities, some of which may be positive and others negative or neutral. FINRA stated it believes it would be beneficial to obtain additional information about the array of debt research products that are now being distributed to retail investors, as well as the operational challenges and costs to apply these disclosure provisions to debt research on individual debt securities. Accordingly, FINRA proposed in Amendment No. 1 to eliminate for now the requirements with respect to debt research reports on individual debt securities. FINRA stated it will reconsider the appropriateness of the disclosure requirements as applied to research on individual debt securities after obtaining and assessing the additional information.

The same commenter also requested that FINRA allow members to provide a hyperlink or web address to web-based disclosures in all debt research reports, rather than requiring the disclosures within a printed report.[171] The commenter noted that while the Commission has interpreted section 15D(b) of the Exchange Act to require disclosure in each equity report, the law does not apply to debt research.[172] FINRA stated it believes that disclosures in retail debt research reports should be proximate to the content of those reports and easily available to recipients of the research without requiring any substantive additional steps. Therefore, to the extent a debt research report is not delivered electronically with hyperlinked disclosures, FINRA stated it believes the disclosures must be in the research report itself. FINRA also expressed its belief that this will promote consistency between equity and retail debt research. FINRA further noted that institutional debt research would not require the specific disclosures.

H. Comments and Discussion Regarding the Institutional Debt Research Exemption

The proposed rule change would exempt debt research provided solely to certain eligible institutional investors from many of the proposed rule's provisions, provided that a member obtains consent from the institutional investor to receive that research and the research reports contain specified disclosure to alert recipients that the reports do not carry the same protections as retail debt research. The proposal distinguishes between larger and smaller institutions in the manner in which the consent must be obtained. Firms would be permitted to use negative consent where the customer meets the definition of a QIB and satisfies the institutional suitability standards of FINRA Rule 2111 with respect to debt transactions and strategies. Institutional accounts that meet the definition of FINRA Rule 4512(c), but do not satisfy the higher tier standard required for negative consent, would be permitted to affirmatively elect in writing to receive institutional debt research.

One commenter to the original proposal opposed providing any exemption for debt research distributed solely to eligible institutional investors, contending that it would deprive the

[167] *Id.*

[168] WilmerHale Debt One.

[169] *Id.*

[170] WilmerHale Debt Two.

[171] WilmerHale Debt One.

[172] *See* 15 U.S.C. 78o–6(b) and (d)(2).

market's largest participants of the important protections of the proposed rules for retail debt research.[173] Another such commenter reiterated concerns expressed in response to an earlier iteration of the debt research proposal that the proposed standard for negative consent would be difficult to implement and would disadvantage institutional investors who are capable of, and in fact, make independent investment decisions about debt transactions and strategies. The commenter suggested as an alternative that the institutional investor standard should be based on only on the institutional suitability standard in Rule 2111.[174]

Another commenter to the original proposal supported the proposed tiered approach for how institutional investors may receive research reports.[175] The commenter stated that a QIB presumably has the sophistication and human and financial resources to evaluate debt research without the disclosures and other protections that accompany reports provided to retail investors. The commenter also supported permitting an institutional investor that does not fall within the higher tier category to receive the debt research without the retail investor protections if it notifies the firm in writing of its election.

FINRA stated in the Notice and Amendment Notice that it believes an institutional exemption is appropriate to allow more sophisticated institutional market participants that can assess risks associated with debt trading and are aware of conflicts that may exist between a member's recommendations and trading interests, to continue to receive the timely flow of analysis and trade ideas that they value. FINRA noted that institutional debt research still would remain subject to several provisions of the rules, including the required separation between debt research and investment banking and the requirements for conflict management policies and procedures to insulate debt analysts from pressure by traders and others. In addition, FINRA noted that no institutional investor will be exposed to this less-protected institutional research without either negative or affirmative consent, as applicable.

FINRA noted, with regard to the standard for negative consent, it does not believe that less sophisticated institutional investors should be required to take any additional steps to receive the full protections of the proposed rules. To the extent the QIB standard for negative consent is too difficult to implement, the proposal would provide an alternative to obtain a one-time affirmative consent for any Rule 4512(c) institutional account and further provides a one-year grace period to obtain that consent, so as not to disrupt the current flow of debt research to institutional customers. As discussed in the rule filing, FINRA included the alternative methods of consent and the grace period to satisfy the differing industry views on which of two consent options would be most cost effective.

Another commenter to the original proposal asked that FINRA confirm that, in distributing debt research reports under the institutional debt research framework to certain non-U.S. institutional investors who are customers of a member's non-U.S. broker-dealer affiliate, the member may rely on similar classifications in the non-U.S. institutional investors' home jurisdictions.[176] The commenter contended that this is necessary because some global firms distribute their debt research reports to non-U.S. institutional investors who may not have been vetted as QIBs for a variety of reasons. The debt proposal never contemplated recognizing equivalent institutional standards in other jurisdictions, and FINRA stated it does not believe that approach is appropriate or workable. FINRA questioned whether there are standards in other jurisdictions that are truly the equivalent of the QIB standard, and stated that it is impractical for FINRA to survey and assess the institutional standards around the world to determine equivalency, not to mention whether the home jurisdiction adequately examines for and enforces compliance with the standard. FINRA noted that, under the proposal, to the extent non-U.S. institutional investors have not been vetted as QIBs, firms have the option of either vetting them if they wish to send them institutional debt research by negative consent or obtaining affirmative written consent to the extent the institution satisfies the Rule 4212(c) standard.

The same commenter asked FINRA to clarify the application of the institutional debt research framework to desk analysts or other personnel who are part of the trading desk and are not ''research department'' personnel. In particular, the commenter suggested that proposed Rules 2242(b)(2)(H) (with respect to pressuring) and (b)(2)(L) (which would require policies and procedures reasonably designed to, among other things, restrict or limit activities by debt research analysts that can reasonably be expected to compromise their objectivity) should not apply when sales and trading personnel or principal trading personnel publish debt research reports in reliance on the institutional research exemption because the requirements of those provisions cannot be reconciled with the inherent nature of conflicts present.[177] Those provisions would require firms to have policies and procedures to both establish information barrier or other institutional safeguards reasonably designed to insulate debt research analysts from pressure by, among others, principal trading or sales and trading personnel and restrict or limit activities by debt research analysts that can reasonably be expected to compromise their objectivity. FINRA disagreed with the commenter. They stated that they believe that minimum objectivity standards should apply to institutional debt research regardless of whether the research is published by research department personnel, sales and trading personnel or principal trading personnel. FINRA further stated it believes that a firm can and should put in place policies and procedures reasonably designed to ensure that other traders or sales and trading personnel do not overtly pressure a trader who produces debt research to express a particular view and to prevent that trader from participating in solicitations of investment banking or road show participation.

I. Comments and Discussion Regarding the Exemptions for Limited Investment Banking Activity and Limited Principal Trading Activity

The proposed rule change would exempt members with limited principal trading activity or limited investment banking activity from the review, supervision, budget, and compensation provisions in the proposed rule related to principal trading and investment banking personnel, respectively. The limited principal trading exemption would apply to firms that engage in principal trading activity where, in absolute value on an annual basis, the member's trading gains or losses on principal trades in debt securities are $15 million or less over the previous three years, on average per year, and the member employs fewer than ten debt traders. The limited investment banking exemption would apply, as it does in the equity rules, to firms that have managed or co-managed ten or fewer investment banking services

[173] PIABA Debt.

[174] SIFMA.

[175] CFA Institute One.

[176] WilmerHale Debt One.

[177] *Id.*

transactions on average per year, over the previous three years and generated $5 million or less in gross investment banking revenues from those transactions.

One commenter to the original proposal questioned whether the exemptions could compromise the independence and accuracy of the analysis and opinions provided.[178] The commenter further expressed concern that the exemption might allow traders to act on debt research prior to publication and distribution of that research. The commenter noted FINRA's commitment to monitor firms that avail themselves of the exemptions to evaluate whether the thresholds for the exemptions are appropriate and asked FINRA to publish findings that could help properly weigh the burdens on small firms while ensuring the independence of investment research. The commenter also encouraged FINRA to provide additional guidance as to what specific measures should be taken to ensure that debt research analysts are insulated from pressure by persons engaged in principal trading or sales and trading activities or other persons who might be biased in their judgment or supervision.

FINRA stated in the Notice and the Amendment Notice that it included the exemptions to balance the burdens of compliance with the level or risk to investors. FINRA stated that it determined the thresholds for each exemption based on data analysis and a survey of firms that engage in principal trading activity or investment banking activity, respectively. FINRA clarified that it has not found abuses with respect to the limited investment banking exemption in the equity context and notes that some important separation requirements would still apply to the eligible firms, such as the prohibition on compensating a debt research analyst based on a specific investment banking transaction or contributions to a member's investment banking services activities.

FINRA clarified that the proposed limited principal trading exemption would apply where, based on the survey and data analysis, it reasonably believes the amount of potential principal trading profits poses appreciably lower risk of pressure on debt research analysts by sales and trading or principal trading personnel and where there would be a significant marginal cost to add a trader dedicated to producing research relative to the increase in investor protection. FINRA further noted that the proposal would still prohibit debt research analysts at exempt firms from being compensated based on specific trading transactions.

With respect to both exemptions, as the commenter noted, firms would still be required to establish information barriers or other institutional safeguards reasonably designed to ensure debt research analysts are insulated from pressure by persons engaged in investment banking or principal trading activities, among others. FINRA stated it believes a number of policies could be implemented to achieve compliance with this requirement. For example, in the context of principal trading, these measures might include monitoring of communications between debt research analysts and individuals on the trading desk and reviewing published research in relation to transactions executed by the firm in the subject company's debt securities. FINRA also noted that neither exemption would allow trading ahead of research by firm traders, as FINRA Rule 5280 would continue to apply to both debt and equity research and prohibits such conduct. Finally, as noted by the commenter, FINRA stated it intends to monitor the research produced by firms that avail themselves of the exemptions to assess whether the thresholds to qualify for the exemptions are appropriate or should be modified.

The commenter responded in its second letter that, while FINRA addressed their concerns, they still had concerns that the examples given by FINRA in the Amendment Notice were insufficient. They recommended additional guidance by FINRA to help ensure adequate compliance. They also approved of FINRA's commitment to continue to monitor this issue and urged publication of the results.[179] In their response, FINRA noted that the examples were not intended to be exhaustive and that, in light of the principles-based approach of the proposal there will be different ways for members to design policies and procedures reasonably designed to protect against pressure. FINRA stated it will continue to monitor the issue and will consider sharing its findings as appropriate.[180]

J. Comments and Discussion Regarding the Filing Requirement Exclusion

One commenter to the original proposal asked FINRA to consider amending FINRA Rule 2210 to exclude debt research reports from that rule's filing requirements, since there is an exception from the filing requirements for equity research reports that concern only equity securities that trade on an exchange.[181] FINRA stated it is willing to separately consider the merits of the request, but does not believe the issue is appropriate for resolution in the context of the debt proposal since it primarily relates to the provisions of a rule that are not the subject of the proposed rule change.

K. Comments and Discussion Regarding the Implementation Date

One commenter to the original proposal requested that the implementation date be at least twelve months after Commission approval of the proposed rule change and that FINRA sequence the compliance dates of the equity research filing and the proposed rule change in that order.[182] Another such commenter requested that FINRA provide a ''grace period'' of one year or the maximum time permissible, if that is less than one year, between the adoption of the proposed rule and the implementation date.[183] FINRA stated that it is sensitive to the time firms will require to update their policies and procedures and systems to comply with the proposed rule change and will take those factors into consideration when establishing implementation dates. As stated in the Amendment Notice, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. FINRA further stated that the effective date will be no later than 180 days following publication of the Regulatory Notice announcing Commission approval.

J. Summary of Findings and Conclusion

The Commission has carefully considered the proposed rule change, all of the comments received, and FINRA's responses to the comments. Based on its review of the record, the Commission finds that the proposed rule change, as amended by Amendment No. 1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.[184] In particular, the Commission finds that the proposed rule change, as amended by Amendment No. 1, is consistent with section 15A(b)(6) of the Act, which requires, among other things, that FINRA's rules be designed to prevent fraudulent and manipulative acts and

[178] CFA Institute One.

[179] CFA Institute Two.

[180] FINRA Response.

[181] WilmerHale Debt One.

[182] SIFMA.

[183] WilmerHale Debt One.

[184] In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.[185]

FINRA stated in its proposal that it ''believes that the proposed rule change would promote increased quality, objectivity and transparency of debt research distributed to investors by requiring firms to identify and mitigate conflicts in the preparation and distribution of such research'' and that ''the [proposed] rule will provide investors with more reliable information on which to base investment decisions in debt securities, while maintaining timely flow of information important to institutional market participants and providing those institutional investors with appropriate safeguards.''

We generally agree with these assertions. The potential abuses spawned by the conflicts of interest between research and the business interests of broker-dealers in the equity space are well-known and well-established.[186] As FINRA explained in the Notice, debt research is not immune to the challenges that these conflicts create. For example, the Massachusetts Secretary of the Commonwealth in 2008 alleged that a FINRA member ''co-opted its supposedly independent [r]esearch [d]epartment to assist in sales efforts geared towards reducing its inventory'' of debt instruments.[187] These allegations are similar to those raised in the allegations that led to the global research analyst settlement as a result of the abuses found regarding equity research.[188] As a result, as noted by the U.S. Government Accountability Office, ''until FINRA adopts a fixed-income research rule, investors continue to face a potential risk.'' [189] The proposed rule change attempts to address this need in a way that seems to effectively balance the public interest in effectively managing debt research conflicts of interest with the ability of members to also effectively provide research, and thus information, to the investing public. We also note that the relevant commenters to the proposal as amended, all of which were commenters to the original proposal, stated in their second comment letters that they generally agree with the proposal as amended.[190]

Regarding concerns raised by commenters regarding the principles-based structure of the proposal, we note the proposed rule change establishes the key provisions of NASD Rule 2711 for debt research and includes a number of protections for investors beyond those currently found in that rule, including the requirement that research management make independent decisions regarding research coverage,[191] maintenance of information barriers or other institutional safeguards between research and investment banking, sales and trading, and other persons who might be biased in their judgment or supervision including, for certain members, requiring physical separation,[192] information barriers between research analysts and trading desk personnel,[193] and ensure that purported facts in research reports are based on reliable information.[194] Further, FINRA's responses to interpretive questions posed by the commenters to the original proposal in the Amendment Notice should help eliminate uncertainty regarding how the proposal will operate. For instance, one commenter noted with approval the clarification regarding the ''at a minimum'' requirement which seemed to be the source of the commenter's confusion.[195] FINRA also provided further guidance on other issues in the FINRA Response, such as whether sales and trading personnel can provide feedback for purposes of evaluating an analyst.

In approving this proposal, however, we expect that FINRA will continue to monitor the effectiveness of the rule proposal, especially with regards to the treatment of research provided to institutional investors, and modify the rule should it prove to be unworkable or fail to provide an appropriate level of protection to investors.[196]

For the reasons stated above, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to section 19(b)(2) of the Act,[197] that the proposed rule change (SR–FINRA–2014–048), as modified by Amendment No. 1 thereto, be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[198]

Brent J. Fields,

Secretary.

[FR Doc. 2015–17972 Filed 7–21–15; 8:45 am]

BILLING CODE 8011–01–P

[185] 15 U.S.C. 78o–3(b)(6).

[186] *See, e.g.,* ''Ten of Nation's Top Investment Firms Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking,'' Press Release 2003–54 (available at *http://www.sec.gov/news/press/2003-54.htm*). As one commenter noted, these conflicts can still influence equity research. NASAA Debt Two. *See also* ''FINRA Fines 10 Firms a Total of $43.5 Million for Allowing Equity Research Analysts to Solicit Investment Banking Business and for Offering Favorable Research Coverage in Connection With Toys'R'Us IPO,'' FINRA News Release (available at *http://www.finra.org/newsroom/2014/finra-fines-10-firms-total-435-million*).

[187] Commonwealth of Massachusetts, Office of the Secretary of the Commonwealth, Securities Division, *In the Matter of Merrill Lynch, Pierce, Fenner & Smith, Incorporated,* Administrative Complaint, Docket No. 2008–0058 (Jul. 31, 2008) (available at *http://archives.lib.state.ma.us/bitstream/handle/2452/213560/ocn886547410.pdf?sequence=1&isAllowed=y*).

[188] *See,* ''Ten of Nation's Top Investment Firms Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking,'' Press Release 2003–54 (available at *http://www.sec.gov/news/press/2003-54.htm*) (stating that ''[t]he enforcement actions allege that, from approximately mid-1999 through mid-2001 or later, all of the firms engaged in acts and practices that created or maintained inappropriate influence by investment banking over research analysts, thereby imposing conflicts of interest on research analysts that the firms failed to manage in an adequate or appropriate manner'').

[189] U.S. Government Accountability Office, GAO–12–209, *Securities Research: Additional Actions Could Improve Regulatory Oversight of Analyst Conflicts of Interest,* at 41 (Jan. 12, 2012) (available at *http://www.gao.gov/assets/590/587613.pdf*).

[190] WilmerHale Debt Two, CFA Institute Two, and NASAA Debt Two.

[191] Proposed FINRA Rule 2242(b)(2)(B).

[192] Proposed FINRA Rule 2242(b)(2)(H) and Notice (''Among the structural safeguards, FINRA believes separation between investment banking and debt research, and between sales and trading and principal trading and debt research, is of particular importance. As such, while the proposed rule change does not mandate physical separation between the debt research department and the investment banking, sales and trading and principal trading departments (or other person who might seek to influence research analysts), FINRA would expect such physical separation except in extraordinary circumstances where the costs are unreasonable due to a firm's size and resource limitations. In those instances, a firm must implement written policies and procedures, including information barriers, to effectively achieve and monitor separation between debt research and investment banking, sales and trading and principal trading personnel.'')

[193] Proposed FINRA Rule 2242.03.

[194] Proposed FINRA Rule 2242(c)(1)(A).

[195] WilmerHale Debt Two.

[196] We note that, as one commenter to the equity version of this proposal noted, the interpretation of what constitutes ''reasonableness'' may prove difficult for FINRA and member alike. *See* Letter from Egidio Mogavero, Managing Director and Chief Compliance Officer, JMP Securities, dated Mar. 19, 2015.

[197] 15 U.S.C. 78s(b)(2).

[198] 17 CFR 200.30–3(a)(12).