

7 April 2015

Brent J. Fields  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

**Re: Self-Regulatory Organizations: Financial Industry Regulatory Authority, Inc.: Notice of Filing of Amendment No. 1 to a Proposed Rule Change to Adopt FINRA's Rule 2242 (Debt Research Analysts and Debt Research Reports) (Release No. 34-74490; File No. SR-FINRA-2014-048)**

Dear Mr. Fields:

CFA Institute<sup>1</sup> appreciates the opportunity to provide comments on Amendment No. 1 (Amendment) to FINRA's proposed rule to address potential conflicts of interest in the preparation and distribution of debt research reports. CFA Institute represents the views of investment professionals before standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and on issues that affect the efficiency, integrity and accountability of global financial markets.

### **Executive Summary**

In response to FINRA's prior rule filing on proposed Rule 2242 (the Proposal), CFA Institute expressed concerns primarily in two areas: (1) that research to institutional investors could contain views that are different from research to retail investors; and (2) the lack of separation of research analysts from sales and trading and principal trading personnel for limited principal trading firms and limited investment banking firms. Without the separation, we were concerned

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<sup>1</sup>CFA Institute is a global, not-for-profit professional association of more than 129,700 investment analysts, advisers, portfolio managers, and other investment professionals in 147 countries, of more than 122,500 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 144 member societies in 69 countries and territories.

that the research would be subject to influences that could compromise the independence and accuracy of the analysis and opinions that analysts would provide.

In this Amendment, FINRA directly addresses our issues in a matter that substantially alleviates our prior concerns.

### **Discussion**

As noted in our earlier letter<sup>2</sup> to FINRA's rule proposal, CFA Institute is strongly committed to measures that reduce the conflicts of interest in the preparation and issuance of research reports and generally supports FINRA's proposal with respect to its proposed adoption of Rule 2242. We particularly appreciate the attention given to our comments, as well as those of the other commenters, as part of the process in finalizing this rule.

***Inconsistent ratings.*** The Proposal noted that institutional debt research would need to prominently disclose when the views in the report could differ from the views offered in retail debt research reports. In response, we noted concerns about the parity of information received by retail and institutional investors, and whether one group of investors could receive information that provided them an advantage over another group of investors.

The Amendment addresses this by explaining 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, all differing recommendations or ratings must be reconcilable such that they are not truly at odds with one another. As such, the proposed rule would not allow research provided to an institutional investor to contain views inconsistent with those offered in retail debt research."

As further clarification, the Amendment notes that while only some investors may be offered a research product, "it would be inconsistent 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."

In light of this reply to our concern, we understand that the differing recommendations are related to different products and thus differing recommendations do not pivot on whether the research is being provided to institutional or retail investors. We are satisfied with this clarification that investor protections are not being compromised.

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<sup>2</sup> See 9 February 2015 letter to Brent J. Fields from Kurt N. Schacht and Linda Rittenhouse re Self-Regulatory Organizations: Financial Industry Regulatory Authority, Inc.: Notice of Filing of a Proposed Rule Change to Adopt FINRA's Rule 2242 (Debt Research Analysts and Debt Research Reports) (Release No. 34-73623; File No. SR-FINRA-2014-048).

***Exemptions for limited principal trading activity and limited investment banking.*** In our comment letter on the Proposal, we noted our appreciation of FINRA's attempts to reduce compliance burdens on smaller firms by providing exemptions from some requirements for those with limited principal trading and investment banking departments. Nevertheless, we encouraged FINRA to provide guidance as to the measures these firms should take in order to protect research analysts from pressure by persons engaged in principal trading and investment banking activities. Without the separation, we expressed concern that the research would be subject to influences that could compromise the independence and accuracy of the analysis and opinions that analysts would provide.

In response, the Amendment provides several examples of the types of information barriers and safeguards required that would reasonably ensure that debt research analysts are insulated from pressure. For example, the Amendment notes appropriate measures to meet this requirement in the context of principal trading 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." In light of FINRA 5280, the Amendment also notes that these exemptions will not allow any firm traders to trade ahead of research.

We appreciate the examples provided in the Amendment that respond to our concerns. Nevertheless, we see the examples given as inadequate. For example, depending on the methods used, the monitoring of communications could be either cost-prohibitive or insufficient to catch non-verbal communications. Likewise, the review of published research in comparison with executed trades may or may not prove dispositive as to whether or not there was a leaking of research material to traders or investment bankers seated in the same general area. We continue to suggest additional guidance in the final rule to help ensure compliance with the spirit of this rule.

We also applauded FINRA's commitment in the Proposal to continue to monitor research by the firms claiming these exemptions with an eye as to whether the proposed thresholds are correct. In its Amendment, FINRA reiterates its commitment to continue monitoring this area and assess whether the thresholds are appropriate or should be modified. We continue to urge publication of these findings.

### **Conclusion**

We appreciate FINRA's efforts to establish regulations for debt security research that are substantially consistent with those implemented for equity security research. This collaborative approach whereby diverse opinions are addressed undoubtedly produces a better final rule. Given the important safeguards in question, we encourage ongoing monitoring of these measures to protect the integrity of the debt research process.

Should you have any questions about our positions, please do not hesitate to contact Kurt N. Schacht, CFA at [kurt.schacht@cfainstitute.org](mailto:kurt.schacht@cfainstitute.org) or 212.756.7728; or Linda L. Rittenhouse at [linda.rittenhouse@cfainstitute.org](mailto:linda.rittenhouse@cfainstitute.org) or 434.951.5333.

Sincerely,

/s/ Kurt N. Schacht

Kurt N. Schacht, CFA  
Managing Director, Standards and  
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/s/ Linda L. Rittenhouse

Linda L. Rittenhouse  
Director, Capital Markets Policy  
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