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20 June 2017

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006

Re: Desk Commentary Safe Harbor (Regulatory Notice 17-16)

Dear Ms. Mitchell:

CFA Institute[1] is writing to provide comments to FINRA on its proposed limited safe harbor from FINRA equity and debt research rules for desk commentary (the Proposal). CFA Institute represents the views of those investment professionals who are its members 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

We support the conditions on which FINRA bases its proposed safe harbor for desk commentary. Imposing author, content and recipient conditions, among others, creates a workable supervisory framework for firms who want to use the safe harbor.

We particularly support the use of a "health warning" on the face of the commentary alerting recipients to the fact that the commentary is not independent of the firm's proprietary interests. We believe this provides an important protection from misunderstanding should the commentary inadvertently reach retail investors.

Discussion

CFA Institute generally supports FINRA's proposal to provide a safe harbor for desk commentary provided only to institutional investors, subject to certain conditions designed to mitigate conflicts of interest, disclosure of nonpublic information and undue pressure on research

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[1] CFA Institute is a global, not-for-profit professional association of more than 149,000 investment analysts, advisers, portfolio managers, and other investment professionals in 163 countries, of more than 143,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 148 member societies in 73 countries and territories.

analysts. As an organization of more than 149,000 investment professionals, many of whom are research analysts, we believe that any safe harbor for equity and debt research reports must continue to recognize the protections that safeguard analysts from undue pressure to dilute existing standards, and that maintain the integrity of the research sector. We believe FINRA's proposal accomplishes this.

FINRA proposes a limited safe harbor from its current Rule 2241 (Research Analysts and Research Reports) and Rule 2242 (Debt Research Analysts and Debt Research Reports) for certain analysis by sales and trading (or principal trading) personnel. This research would be distributed only to institutional investors, and may technically qualify as a "research report" or "debt research report" but is written by sales and trading or principal trading personnel (referred to as Desk Commentary). Finally, this research would typically serve as a data point by institutional investors or by traders to time the trades on orders on which they have already made investment decisions. FINRA believes that while institutional investors may find Desk Commentary useful, they understand the potential conflicts such research may incorporate and would not fundamentally rely upon it for investment decisions.

The proposed amendments would require adherence to many of the same conditions currently required under Rules 2241 and 2242 (Research Report rules) to mitigate conflicts of interest, appropriate to the audience receiving the Desk Commentary. FINRA reasons that this approach will "provide firms more compliance certainty in their review of these research communications" and allow the flow of information while maintaining rules designed to manage conflicts of interest. Fundamental research, or that distributed to *retail* investors, would remain subject to all of the requirements of the Research Report rules and would not qualify for the safe harbor afforded Desk Commentary.

Author, Content, and Recipient Conditions

The safe harbor for providing Desk Commentary that technically may fall within the definition of research reports requires the Commentary to meet specific author, content, and recipient conditions:

- Generally, the author of the communication must be from the sales and trading desks and principal trading personnel who are not research analysts, do not report to research department personnel, and are not engaged in preparing fundamental research reports;
- The content must be "limited to brief observations (not including a rating, price target or earnings estimate) regarding recent, current, or near-term expected trading activity, trading ideas or opportunities, market conditions, economic statistics or company results, or regarding a recent recommendation or research report;" and
- Recipients of the Desk Commentary can only be "institutional accounts" who consent to receive it (through negative consent) and who have met applicable FINRA suitability standards.

We support this approach. Specifically, the requirement that firms can distribute Desk Commentary only to institutional accounts is an important limitation, as it requires a) the firm providing the commentary to believe the recipient can evaluate the risks independently, and b) that the institutional investor can use of independent judgment in evaluating the recommendations. This shared responsibility between provider and recipient of the Desk Commentary helps to reduce concerns the commentary will be misinterpreted.

Compliance with Research Report Conditions

We understand that the proposed safe harbor requires additional policies and procedures to manage conflicts of interest. In particular, firms would have to comply with the following conditions to claim the safe harbor for Desk Commentary:

- Prohibit prepublication review, clearance or approval of reports by investment banking personnel;
- Establish information barriers to insulate research analysts from pressure;
- Prohibit retaliation against research analysts for negative reports that might hurt the firm’s business prospects;
- Prohibit promises of favorable research as an inducement;
- Limit activities by research analysts that could compromise their objectivity (including pitches and road shows);
- Prohibit prepublication review by a subject company; and
- Prohibit analysts for communicating with customers in the presence of investment banking personnel or company management about investment banking services transactions.

In theory and substance, we support making the conditions noted above part of the safe harbor compliance. In practice, however, we question how one, in particular, would work. Prohibiting prepublication review of Desk Commentary by investment banking personnel seems infeasible given that the Desk Commentary is being authored by sales and trading personnel, who often collaborate with the investment banking arm. We ask FINRA to provide guidance as to how this would work.

Use of the safe harbor also would require firms to create policies and procedures to ensure that Desk Commentary is made available only to eligible institutional investors. In addition, firms would need to comply with anti-fraud provisions under both federal securities laws and FINRA rules. Importantly, the safe harbor is contingent on firms creating the policies and procedures designed to prevent the distribution of Desk Commentary that includes internal material non-public information.

We support these requirements. Compliance with these conditions for all Desk Commentary helps to ensure that investment banking services or transactions do not play a meaningful role in the substance of the Commentary.

Additional Conditions for Equity Desk Commentary

Equity Desk Commentary would require additional policies and procedures to address conflicts related to investment banking for commentary that constitutes research. When that happens, firms would need policies and procedures to:

- Prohibit investment banking personnel from supervising or controlling research analysts (including over compensation);
- Exclude senior management engaged in investment banking from determining the research department budget; and
- Prohibit compensation determinations to be made on specific transactions and contributions related to investment banking.

Equity research can be particularly vulnerable to influence from the investment banking side of a firm. We support inclusion of these additional conditions for using the safe harbor.

Health Warning

In addition to these conditions, the safe harbor would require use of a "health warning" on the Desk Commentary to alert recipients to the fact that it is intended for institutional investors, is not subject to the same independence and disclosure requirements as research for retail investors, and that clients should assume that it is *not* independent of the firm's proprietary interests. The health warning explicitly notes that the firm may continue to trade the securities for its own account and that trading interests may be contrary to or entered into in advance of the document.

This warning would substitute for having to provide specific conflict disclosures required for Research Reports, given institutional investors are thought to be capable of evaluating the risks. Institutional investors would also be able to opt out of receiving the Desk Commentary, and to receive only research that is subject to the full range of protections under the Research Rules.

We strongly support this health warning as providing a clear, explicit and direct message that puts institutional investor recipients on notice and that is appropriate to the sophistication of this class of investors. We agree with FINRA's reasoning that requiring firms to provide disclosure of specific conflicts relating to Desk Commentary would add costs, while providing little additional protection, given the recipients' ability to understand the risks being warned of.

Safe Harbor Relief

Firms that comply with the proposed safe harbor conditions would be relieved of having to meet several conditions required of Research Reports.

First, firms providing Desk Commentary would not have to comply with several conditions relating to managing conflicts of interest, particularly specific disclosure requirements and requirements for separating the research and sales and trading and principal trading personnel. In addition, equity research analysts would not have to comply with registration and qualification requirements under NASD Rule 1050—which applies to research analysts who prepare the substance of an equity report.

Given the conditions for distributing Desk Commentary and that it is not intended to constitute an actual research report, we believe these exemptions are reasonable.

Conclusion

It is important that commentary in any form contain safeguards to ensure that its substance is not unduly threatened by the investment banking arm of a firm and that investors who receive the commentary understand its limitations. To this end, we believe that the proposed requirements for Desk Commentary do a good job of meeting these objectives.

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

Sincerely,

/s/ Kurt N. Schacht

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