

10 May 2018

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Government Securities Initiative

Dear Ms. Mitchell:

CFA Institute¹ appreciates the opportunity to comment on FINRA's Government Securities Initiative that seeks comment on whether certain FINRA rules should apply to government securities. CFA Institute represents the views of those investment professionals who are its members before standard setters, regulatory authorities, and legislative bodies worldwide about issues affecting the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and on issues affecting the efficiency, integrity and accountability of global financial markets.

Executive Summary

CFA Institute is a strong proponent of practices that support market integrity and investor trust. It is from this position that we have considered FINRA's Government Securities Initiative.

We are not insensitive to the monetary costs of compliance with new rules or regulations, and often support the enforcement of existing regulations, rather than the creation of new ones. However, the potential undermining of market integrity stemming from the long-term effects of certain practices also carries costs, although they may be harder to quantify.

We cannot support allowing certain practices to continue unregulated when they create an unlevel playing field and raise basic questions of market integrity. Accordingly, we support an approach whereby rules that are applicable to equity securities and debt securities should also apply to government securities, absent a compelling reason otherwise.

¹ CFA Institute is a global, not-for-profit professional association of more than 159,000 investment analysts, advisers, portfolio managers, and other investment professionals in 166 countries, of whom more than 152,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 152 member societies in 71 countries and territories.

Background

FINRA has conducted a review of its rules that do not clearly apply to U.S. Treasury securities (or government securities, generally) to determine whether there are valid reasons for continuing to exclude them.² Through its Government Securities Initiative (the “Initiative”) FINRA seeks public comment on whether those rules should expressly apply to government securities, or continue to exclude them. In some instances, FINRA also found rules that applied to government securities, but did not apply to debt securities. It similarly seeks comment on the applicability of those rules to debt securities, in addition to government securities.

The specific rules³ on which FINRA is requesting comment regarding their applicability to government securities (including US Treasury securities) include FINRA Rules: 2242 (Debt Research Analysts and Debt Research Reports); 5240 (Anti-Intimidation/Coordination); 5250 (Payments for Market Making); 5270 (Front Running of Block Transactions); 5280 (Trading Ahead of Research Reports); 5320 (Prohibition Against Trading Ahead of Customer Orders); and NASD Rules: 1032(f) (Securities Trader); 1032(i) (Limited Representative-Investment Banking); and 1050 (Registration of Research Analysts).

In addition, FINRA is requesting comment on whether the following rules should apply to all debt securities, in addition to government securities: FINRA Rule 5320; NASD Rule 1032 (f); and NASD Rule 1050.

Discussion

As an organization of Chartered Financial Analysts who abide by a strict Standards of Practice (or risk losing their charter), CFA Institute strongly supports reasonable measures that undergird the integrity of the financial markets, together with open and full transparency. Accordingly, we generally support parity of information in the application of rules and regulations, unless there are substantial reasons why information, rules and regulations should differ among classes of securities. A factor in this analysis relates to whether the costs of complying with the regulation outweigh the benefits to investors and the efficient functioning of the marketplace, in general. When market integrity and trust may be compromised—through appearance of, or actual conflicts of interest—costs may be harder to quantify, but are nonetheless important.

Generally, the operation of the government securities markets is conducted by the Treasury and Federal Reserve. The market is not only massive but generally well-known. Events within the normal course of business or an individual’s trading generally would not, in and of themselves, cause movements in this market as currently structured. We believe the real issue then is not the practical effect (ability to move the market) but instead the effect of certain practices (real or perceived) on market integrity. Investors should be able to believe that those dealing in

² FINRA Rule 0150 lists its rules that expressly apply to transactions and activities relating to exempted securities, including government securities (but excluding municipal securities).

government securities should abide by the same rules and ethical standards as those serving in similar roles in the debt and equity markets.

As a general premise, we believe the approach should be that the rules applicable to equity and/or debt securities should apply to government securities markets, as well, unless there is a compelling reason that they should not. We also believe that application of this principle is more compelling when the rule is specifically designed to address practices that clearly are unethical and disadvantage investors.

We address several specific rules below.

FINRA Rule 2242 (Debt Research Analysts and Debt Research Reports)

Rule 2242 addresses the management of conflicts of interest in research by requiring firms to have procedures to manage the conflicts, including separation of the investment and trading functions from the research function. It also restricts certain activities of analysts, as well as requires disclosure of conflicts of interest. While applicable to debt securities, this rule explicitly excludes U.S. Treasury securities.

We appreciate FINRA's past reluctance to become involved with direct obligations of the United States. However, we do not perceive any reason why Rule 2242 should not apply to U.S. Treasury securities. While the magnitude of problems created by conflicts related to research on U.S. Treasury securities may not be as great as that related to debt securities, we believe that parity in rules, the reduction in possible conflicts of interest, and the enhancement of market integrity all argue for extension of this rule to Treasury securities.

FINRA Rule 5280 (Trading Ahead of Research Reports)

This rule prohibits trading in securities based on non-public information related to a research report in that security, and requires firms to establish boundaries between research and trading personnel so as to prevent trading that would benefit the firm or select customers. While the rule applies to debt and equity research reports, FINRA notes that it also is intended to apply in a broader context—including “any written information from the research department that a reasonable person would expect to result in a transaction based on that information.”

We strongly support applying Rule 5280 to government securities. We believe the recognized application of the rule to information beyond debt and equity research reports indicates an intention to apply the reach of the rule broadly. More importantly, fairness to *all* firm clients—not just select ones—requires this outcome.

FINRA Rule 5240 (Anti-intimidation/Coordination)

Rule 5240 prohibits conduct by firms and associated persons from engaging in coordinated conduct that seeks to improperly influence someone, including behavior (often coordinating

prices, including quotations, trades and trade reports) to discourage activities of, or retaliate against, other market makers or participants. FINRA notes that this rule is designed, in part, to prevent behavior “that is inconsistent with just and equitable principles of trade.”

While the rule is not limited to equity securities, FINRA recognizes that “priced quotes are not as prevalent in the debt markets as in the equities markets, and there is not a ‘consolidated tape’ of transactions.” Nonetheless, we support applying this rule to debt securities, including government securities, as an important statement that unlawful coordination and retaliatory conduct will not be tolerated by regulators and as part of the different securities markets. While the occurrences of these types of conduct may be more prevalent in the equity market, market integrity demands attention to, and prohibition of these types of conduct in all securities markets.

FINRA Rule 5270 (Front Running of Block Transactions)

Rule 5270 prohibits trading in any security (and any related financial security) that is the subject of a block transaction while in possession of material, non-public information related to the imminent customer block transaction. It also prohibits trading in an underlying security when the imminent block transaction involves a related financial instrument. Trading-ahead prohibitions under this rule apply to most debt securities. While the rule does not apply to block trading of government securities (including U.S. Treasury securities), FINRA believes the type of behavior prohibited under the rule generally extends to government securities through another FINRA rule requiring “high standards of commercial honor and just and equitable principles of trade.”

We support efforts to expressly bring trading in government securities under the reach of Rule 5270. While we recognize that the nature of government securities may warrant certain carveouts under the rule, we believe that prohibiting front running is an ethical principle that must be reinforced in all of our securities markets.

FINRA Rule 5320 (Prohibition Against Trading Ahead of Customer Orders)

Rule 5320 restricts firms’ trading for their own accounts in securities on the same side of the market at the price that would satisfy customers’ orders in the same securities, unless they take action immediately after the trades to execute the customers’ orders at equal or better prices. Other related FINRA rules provide exceptions to these prohibitions under certain conditions, while others, including Minimum Price Improvement Standards and Order Handling Procedures, provide additional requirements that firms must meet to satisfy Rule 5320 when engaging in proprietary trading.

While Rule 5320 currently applies only to equity securities, we urge FINRA to extend its application to debt securities, including government U.S. securities. Investors should be safe from firms trading ahead of them, regardless of the type of securities involved.

NASD Rule 1050 (Registration of Research Analysts)

Rule 1050 requires research analysts to register with FINRA, which includes first passing the Series 86 (Analysis) and Series 87 (Regulatory Administration) exams. As FINRA notes in this Initiative, these qualification exams can be taken only after registering as a General Securities Representative. While the rule became effective at a time when there was only an equity conflict of interest rule, a debt research analyst conflict of rule has since been implemented. FINRA now seeks comment on whether debt research analysts should now be required to register under NASD Rule 1050 and, if so, whether the content of applicable examinations should be different from Series 86 and 87 in light of differences in the debt securities market.

As an organization of financial analysts, we are dedicated to maintaining the highest standards in the industry in terms of providing research and mitigating conflicts of interest. We believe that debt research analysts owe investors and the securities marketplace a similar commitment to high-quality research that is not comprised by inattention to conflicts of issues, as is applied in equity markets. Trust in the industry and strengthening market integrity demand high standards in the industry, regardless of the securities in consideration. We thus see no basis for exempting debt securities analysts from qualification exams and believe they should be tested on their substantive knowledge and understanding of the industry in which they work, on a similar basis as are equity securities research analysts.

To that end, we strongly support a qualification and registration requirement for debt research analysts. With respect to the types of examinations that best test knowledge and ethics (going to the question of whether they should differ from Series 86 and 87), we suggest that the public comments that FINRA receives on any such rule proposal will help inform the direction and substance of the exams. Similarly, with respect to whether a rule should exempt “any associated persons primarily responsible for the substance of debt research reports” from such requirements based on their job function, we believe interested parties will be able to make their case for exemption through the rule comment process.

Conclusion

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

Sincerely,

/s/ Kurt N. Schacht

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