

**MEMO# 30681**

April 25, 2017

## **FINRA Proposes Desk Commentary Safe Harbor; Member Call to Discuss Proposal on Tuesday, May 2 at 4:00 pm ET**

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April 25, 2017 TO: Equity Markets Advisory Committee RE: FINRA Proposes Desk Commentary Safe Harbor; Member Call to Discuss Proposal on Tuesday, May 2 at 4:00 pm ET

The Financial Industry Regulatory Authority (FINRA) recently issued a notice to members proposing a limited safe harbor for equity and debt desk commentary—typically brief, written analysis distributed to eligible institutional investors that comes from sales and trading personnel of a broker-dealer.<sup>[1]</sup> As we previously informed you, FINRA's enforcement staff raised questions about whether desk commentary should be considered a "research report" under FINRA rules. Any desk communications deemed to be research under FINRA rules would need to comply with a wide range of regulatory requirements, including with respect to their production and distribution.

In March 2016, ICI and its members met with FINRA and Securities and Exchange Commission (SEC) staff to explain the importance of desk commentary to institutional investors (such as regulated funds) and to request that FINRA clarify its position on this commentary so that funds can continue to receive this type of information. The Proposal is FINRA's response to our request. FINRA will review comments on the Proposal and determine whether to move forward with the safe harbor. To finalize the proposed safe harbor, FINRA would have to submit it to the SEC for approval.

The comment period on the Proposal expires on May 30, 2017. We will hold a member call to discuss the Proposal on May 2 at 4:00 pm ET. Please contact Helenia Walker at [helenia.walker@ici.org](mailto:helenia.walker@ici.org) if you would like to participate in the call.

### **Scope of the Safe Harbor**

The proposed safe harbor would exempt a broker-dealer communication that meets certain conditions concerning the author, content, and recipient from many provisions of FINRA Rules 2241 (Research Analysts and Research Reports) and 2242 (Debt Research Analysts and Research Reports). The Proposal notes that many types of desk commentary would not meet the definition of "research report" under FINRA rules, but some types of commentary "may technically fall within the research report definition," even though it falls well short of

the type of fundamental research that FINRA's research rules are designed to address. FINRA recognizes that discerning between those desk communications that constitute research reports and those that do not can be difficult and time consuming and believes the proposed safe harbor would create "a feasible and effective supervisory framework that will provide firms more compliance certainty in their review of [desk] communications."[\[2\]](#) The proposed safe harbor is not mandatory—a broker dealer can decide not to rely on it and instead make a case-by-case determination about whether a particular desk communication constitutes a research report.

FINRA believes that the conditions of the proposed safe harbor would maintain the desk communications that institutional investors value while continuing to provide appropriate safeguards, particularly to retail investors. To that end, FINRA proposes to make the safe harbor available only for communications that meet the following conditions, which FINRA intends to set forth in the text of a rule proposal (which would have to be submitted to the SEC for approval):

- **Author:** The communication is produced by sales and trading and principal trading personnel who: (a) are not primarily engaged in the preparation of research reports that do not meet the safe harbor content limitation; (b) do not require registration as a research analyst pursuant to NASD Rule 1050 (Registration of Research Analysts) because their primary job function is something other than to provide investment research; and (c) do not report directly or indirectly to research department personnel;
- **Content:** The content of the communication 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
- **Recipient:** The communication may only be distributed solely to consenting investors that meet the definition of 'institutional account' under FINRA Rule 4512(c) (Customer Account Information) and have satisfied the FINRA Rule 2111 (Suitability) institutional suitability standard with respect to equity or debt transactions or trading strategies, as applicable.[\[3\]](#) The definition of "institutional account" under FINRA Rule 4512(c) includes the account of any registered investment company and an investment adviser registered with the SEC under Section 203 of the Investment Advisers Act, among other types of account. The Proposal would allow a broker-dealer to use negative consent (*i.e.* notice and non-objection) to satisfy the "consenting investor" standard.[\[4\]](#)

## **Additional Compliance Obligations**

The Proposal would impose a number of compliance obligations on broker-dealers that seek to use the desk commentary safe harbor. The proposed safe harbor would require broker-dealers to establish, maintain and enforce written policies and procedures reasonably designed to ensure that communications subject to the safe harbor are made available only to eligible institutional investors. The proposed safe harbor also would not relieve a broker-dealer of its obligations to comply with the anti-fraud provisions of the federal securities laws and FINRA rules.

In addition, broker-dealers would be required to comply with several provisions of FINRA Rules 2241 and 2242 to mitigate what FINRA describes as the "most serious research-related conflicts that can be present with desk commentary."[\[5\]](#) The proposed safe harbor would require broker-dealers to establish, maintain, and enforce written policies and

procedures reasonably designed to:

- Prevent the use of research reports or research analysts to manipulate the market and prohibit prepublication review, clearance or approval of research reports by persons engaged in investment banking services activities;
- Establish information barriers or other institutional safeguards reasonably designed to ensure that research analysts are insulated from pressure by persons engaged in investment banking services activities or other persons, including sales and trading personnel, who might be biased in their judgment or supervision;
- Prohibit direct or indirect retaliation or threats of retaliation against research analysts by persons engaged in investment banking services activities or other employees as the result of an adverse, negative, or otherwise unfavorable research report written by the research analyst that may adversely affect the firm's present or prospective business interests;
- Prohibit explicit or implicit promises of favorable research, a particular research rating or recommendation or specific research content as inducement for the receipt of business or compensation;
- Restrict or limit activities by research analysts that can reasonably be expected to compromise their objectivity, including prohibiting: (1) participation in pitches and other solicitations of investment banking services transactions; and (2) participation in road shows and other marketing on behalf of an issuer related to an investment banking services transaction;
- Prohibit investment banking department personnel from directly or indirectly: (1) directing a research analyst to engage in sales or marketing efforts related to an investment banking services transaction; and (2) directing a research analyst to engage in any communication with a current or prospective customer about an investment banking services transaction;
- Prohibit prepublication review of a research report by a subject company; and
- Prohibit research analysts from engaging in any communication with a current or prospective customer in the presence of investment banking department personnel or company management about an investment banking services transaction.

The safe harbor for equity desk commentary would require compliance with additional provisions of FINRA Rule 2241 to mitigate against the influences of investment banking.[\[6\]](#)

Lastly, the proposed safe harbor would require desk commentary to carry a "health warning" stating:

- "This document is intended for institutional investors and is not subject to all of the independence and disclosure standards applicable to research reports prepared for retail investors"; and
- If applicable, "Clients should assume that this document is not independent of [Firm's] proprietary interests. [Firm] trades, and will continue to trade, the securities covered in this document for its own account and on a discretionary basis on behalf of certain clients. Such trading interests may be contrary to or entered into in advance of this document."

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**endnotes**

[1] See Regulatory Notice 17-14 (April 2017), *available at* [http://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/Regulatory-Notice-17-16.pdf](http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-17-16.pdf) (Proposal).

[2] See Proposal at 3.

[3] Proposal at 4.

[4] To avoid disruption in the receipt of desk commentary, the Proposal would provide broker-dealers a 90-day transition period during which desk commentary eligible for the safe harbor could be sent to eligible institutional investors while the broker-dealer obtains the necessary consent.

[5] Proposal at 5.

[6] See Proposal at 7-8 (describing additional policies and procedures that broker-dealers would be required to implement to comply with the safe harbor).