

FINRA Proposes Immediately Effective Clarifications to the Debt Research Rule

FINRA proposed amendments (SR-FINRA-2016-017) to the debt research rule (FINRA Rule 2242 – *Debt Research Analysts and Debt Research Reports*), which addresses conflicts of interest relating to the publication and distribution of debt research reports. The proposed amendments clarify the application of the rule in four respects: (1) The consent requirement for institutional debt research reports distributed to non-U.S. investors by non-U.S. affiliates of broker-dealers; (2) The consent requirement for institutional debt research reports distributed to specified persons for informational purposes unrelated to investing in debt securities; (3) The scope of the institutional debt research report exemption when distributing third-party debt research reports to eligible institutional investors; and (4) The disclosure requirements for debt research analysts in public appearances.

FINRA designated the proposed amendments as constituting a “non-controversial” rule change, which renders the proposal effective upon receipt of this filing by the SEC. The implementation date of the proposed amendments is July 16, 2016. [Click here](#) for the full text of the FINRA filing.

Distribution to Non-U.S. Investors by Non-U.S. Affiliate of U.S. Broker-Dealer

“FINRA drafted the institutional debt research exemption with U.S. customers in mind.”

The amendments clarify that research reports, including globally branded research reports, may be distributed by a non-U.S. affiliate of the broker-dealer to its non-U.S. customers pursuant to proposed Supplementary Material .12.

FINRA Rule 2242(j) exempts debt research reports distributed solely to eligible institutional investors 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. Rule 2242(j)(1) requires either negative or affirmative written consent for eligible institutional investors to receive institutional debt research pursuant to the exemption. FINRA proposed to amend Rule 2242 to clarify that Rule 2242(j)(1) will not apply to the distribution of an institutional debt research report by a non-U.S. affiliate of a broker-dealer to a non-U.S. investor, provided that: (a) the non-U.S. investor is not a customer of the broker-dealer; (b) the non-U.S. investor is a customer of the non-U.S. affiliate of the broker-dealer; and (c) the non-U.S. affiliate of the broker-dealer has a reasonable basis to believe that the customer meets the definition of "institutional account" in Rule 4512(c).

Distribution of Institutional Debt Research for Informational Purposes

"FINRA believes that it is appropriate to permit members to distribute institutional debt research reports to [non-investors for informational purposes]..."

FINRA's proposed amendments to the debt research rule permit a broker-dealer to distribute institutional debt research reports to specified persons for informational purposes, unrelated to investing in debt securities, provided that the broker-dealer does not distribute the reports prior to their publication and the broker-dealer has disclosed that: (i) the broker-dealer may provide to institutional investors debt research reports that are not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors; and (ii) the debt research reports would be provided only for informational purposes and not for the purpose of making an investment

decision related to debt securities. Supplementary Material .13 specifies that institutional debt research may be distributed for informational purposes unrelated to investing in debt securities: (1) regulators for regulatory purposes; (2) academics for academic purposes; (3) issuers for the purpose of enhancing knowledge of their industry and competitors and market and economic factors; and (4) media organizations for news gathering purposes. The proposed Supplementary Material also provides that, if the person receiving institutional debt research does not contact the broker-dealer to request that such institutional debt research reports not be provided, the broker-dealer may reasonably conclude that the person has consented to receiving debt institutional research reports.

Distribution of Third-Party Debt Research Reports to Institutional Investors

FINRA believes that it is consistent with the exemption not to require specific disclosures when distributing third-party research reports, but instead to require a 'health warning.'"

The proposed amendments clarify that a broker-dealer that distributes third-party debt research reports to institutional investors pursuant to the institutional exemption in Rule 2242(j) must establish, maintain and enforce written policies and procedures reasonably designed to comply with Rule 2242(g)(1) (which prohibits a broker-dealer from distributing third-party debt research if it knows or has reason to know that such research is not objective or reliable), Rules 2242(g)(2) and (g)(4) (applying same review requirements as third-party debt research reports and independent third-party debt research reports distributed to retail investors), and Rule 2242(g)(6) (which requires that third-party debt research reports are clearly labeled as such). With respect to disclosures, the proposed amendments clarify that third party debt research reports distributed pursuant to the institutional exemption are not required to carry the specific

disclosures applicable to retail debt research; rather, FINRA requires one of the following "health warning":

(A) *"This document is intended for institutional investors and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors"*

or, if applicable

(B) *"This report may not be independent of [Firm's] proprietary interests. [Firm] trades the securities covered in this report for its own account and on a discretionary basis on behalf of certain clients. Such trading interests may be contrary to the recommendation(s) offered in this report."*

Public Appearances by Debt Research Analysts

"[Proposed amendments] exempt public appearances by debt research analysts from the disclosure requirements ... where attendance is limited to institutional investors ..."

FINRA clarifies that the public appearance disclosure requirements do not apply in circumstances where attendance is limited to institutional investors eligible to receive institutional debt research reports. The proposed amendments require that broker-dealers maintain records of public appearances by debt research analysts sufficient to demonstrate that attendance at the public appearance was limited to institutional investors eligible to receive institutional debt research. Broker-dealers will be required to maintain such records for at least three years from the date of the public appearance.