



NASAA

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**NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.**

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April 17, 2015

*Submitted electronically to rule-comments@sec.gov*

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

RE: Release No. 34-74488, File Number SR-FINRA-2014-047

Dear Mr. Fields:

On behalf of the North American Securities Administrators Association (“NASAA”),<sup>1</sup> I hereby submit the following comments in response to Release No. 34-74488, File Number SR-FINRA-2014-047, entitled *Notice of Filing of Amendment No. 1 to a Proposed Rule Change to Adopt FINRA Rule 2241 (Research Analysts and Research Reports) in the Consolidated FINRA Rule Book* published on March 18, 2015 (“the Amended Proposal”).<sup>2</sup> The Amended Proposal retains many of the significant changes to the regulatory framework surrounding the conflicts of interest inherently present between a firm’s investment banking and equity research analysis business contemplated by the original proposal. NASAA appreciates the opportunity to offer its comments on the Amended Proposal.

In the Amended Proposal, FINRA makes clear that it “does not intend for any provisions of the [Amended Proposal] that may be adopted to supersede provisions of the Global Settlement.”<sup>3</sup> As explained in the Amended Proposal, the terms of the Global Settlement can only be modified by the court overseeing the settlement; as such, NASAA agrees that nothing in the Amended Proposal alters the terms of the Global Settlement.

As discussed in NASAA’s prior comments, the conflicts present between a firm’s investment banking business and its equity research department are well documented and historically have been ineffectively managed by firms.<sup>4</sup> In recognition of this mismanagement

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<sup>1</sup> NASAA is the association of the 67 state, provincial, and territorial securities regulatory agencies of the United States, Canada, and Mexico. NASAA serves as the forum for these regulators to work with each other in an effort to protect investors at the grassroots level and to promote fair and open capital markets.

<sup>2</sup> Notice of Filing of Amendment No. 1 to a Proposed Rule Change to Adopt FINRA Rule 2241 (Research Analysts and Research Reports) in the Consolidated FINRA Rule Book, 80 Fed. Reg. 14174 (Mar. 18, 2015).

<sup>3</sup> *Id.* at 14184.

<sup>4</sup> See Letter from William Beatty, President, NASAA, to Brent Fields, Secretary, Securities and Exchange Commission (Dec. 19, 2014) available at <http://www.sec.gov/comments/sr-finra-2014-047/finra2014047-4.pdf>.

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and the harm it dealt investors, NASAA urged FINRA to maintain the prescriptive approach of the current rules, while adding the policies and procedures requirements contemplated by the original proposal.<sup>5</sup> The Amended Proposal, however, does not reflect the current prescriptive nature of the rules and is instead focused of a policies and procedures approach. As noted previously, in NASAA's view, a prescriptive regulatory regime is more appropriate, given the recent and continued violations in this area.<sup>6</sup>

As NASAA and other commenters noted, the original proposal's attempt to combine the existing prescriptive regime and the policies and procedures approach contemplated by the original proposal was unclear and likely to result in confusion.<sup>7</sup> In response, in the Amended Proposal, FINRA has proposed to eliminate certain language in an attempt to clarify the rule.<sup>8</sup> However, in doing so, FINRA has removed the prescriptive nature of the rules entirely. Specifically, the Amended Proposal removes from the original proposal language that required firms' policies and procedures be designed "at a minimum" to prevent certain conduct.<sup>9</sup> In NASAA's view, this language was helpful in maintaining the prescriptive nature of the current rules by ensuring that a firm's policies and procedures met at least a minimum standard.

In its attempts to further clarify the rule, FINRA has also proposed to remove language from Supplementary Material .09 that made clear that any violation of the a firm's policies and procedures implemented pursuant to the rule was also a violation of the rule itself.<sup>10</sup> In NASAA's view, removing this language weakens the proposed rule. FINRA maintains that the following language, which remains in the rule, is adequate: "In addition, consistent with Rule 0140, it shall be a violation of this Rule for an associated person to engage in the restricted or prohibited conduct to be addressed through the establishment, maintenance and enforcement of policies and procedures required by this Rule or related Supplementary Material."<sup>11</sup> The language that FINRA has proposed to remove—"Failure of an associated person to comply with such policies and procedures shall constitute a violation of this Rule"<sup>12</sup>—is a clearer, more direct way of ensuring individual compliance with a firm's policies and procedures. By deleting the "at a minimum" language described above and removing the clear directive that failing to comply with a firm's policies and procedures was in and of itself a violation of the rule, the Amended Proposal has removed the prescriptive nature of the current research analyst rules.

The Amended Proposal also retains the proposed changes to the quiet periods as originally proposed.<sup>13</sup> NASAA reiterates its view that the current quiet periods should be

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<sup>5</sup> *Id.* at 3.

<sup>6</sup> *Id.* at 2-3.

<sup>7</sup> *Id.* at 3 n.8; *see also* Letter from Kevin Zambrowicz, Associate General Counsel and Managing Director, and Sean Davy, Managing Director, Securities Industry and Financial Markets Association, to Brent J. Fields, Secretary, SEC (Dec. 15, 2014); Letter from Stephanie R. Nicolas, Wilmer Cutler Pickering Hale and Dorr LLP, to Brent J. Fields, Secretary, SEC (Dec. 16, 2014).

<sup>8</sup> 80 Fed. Reg. at 14181.

<sup>9</sup> *Id.* at 14181-82.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> *Id.* at 14183.

maintained in order to reduce the incentive firms have to promise favorable research in exchange for investment banking business. The current quiet periods allow firms to “cool off” after the completion of certain activities before their research departments can offer coverage on the subject securities or issuers. NASAA is concerned that the proposed shorter quiet periods would result in a greater likelihood that firms would promise favorable research coverage because under the shorter periods, research could be released more quickly. The longer quiet periods strike the proper balance between providing investors with information and minimizing these timing incentives to firms.

Given the continued violations and the risk to investors posed by a failure to address conflicts of interest between a firm’s research department and its investment banking business, NASAA opposes a complete shift to the policies and procedures scheme contained in the Amended Proposal. In light of the continued failure by firms to address these issues, the increased flexibility allowed under a policies and procedures scheme is inappropriate. NASAA reiterates its prior position that the current prescriptive regime should remain, while the proposed policies and procedures approach should be added to the existing framework. NASAA appreciates the opportunity to offer its comments on the Proposal, and should you have any questions about these comments, please contact NASAA’s Acting Executive Director and General Counsel, Joseph Brady, at [jb@nasaa.org](mailto:jb@nasaa.org).

Sincerely,

A handwritten signature in black ink, appearing to read "William Beatty". The signature is fluid and cursive, with a large initial "W" and "B".

William Beatty  
NASAA President  
Washington Securities Administrator