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**JON SCHNEIDER**  
ITG, Inc.  
Kansas City, MO

May 24, 2017

**President & CEO**

**JAMES TOES**  
Security Traders Association  
New York, NY

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

**Vice Chairman**

**MIKE RASK**  
Hodges Capital  
Dallas, TX

**Treasurer**

**DOUG CLARK**  
ITG Canada Corp  
Toronto, Ontario CAN

Re: FINRA Regulatory Notice 17-16; Desk Commentary Safe Harbor -

**Secretary**

**JODIE MROTEK**  
Henderson Geneva Capital  
Management  
Milwaukee, WI

Dear Ms. Mitchell,

**Past Chairman**

**JOHN RUSSELL**  
Franklin Templeton Investments  
San Mateo, CA

The Security Traders Association (“STA”) <sup>1</sup>welcomes the opportunity to comment on proposed amendments to FINRA Rule 2241 (Research Analysts and Research Reports) and FINRA Rule 2242 (Debt Research Analysts and Debt Research Reports) to create a limited safe harbor for “specified brief, written analysis distributed to eligible institutional investors that comes from sales and trading or principal trading personnel but that may rise to the level of a research report (desk commentary)”<sup>2</sup>, herein referred to as, the “Proposal”, or the “Safe Harbor”. The Safe Harbor would be non-exclusive and only available to communications that meet specific conditions regarding the author, the content of the communication and the recipient of the communication. Each limitation reflects FINRA’s stated objective to ensure that retail investors retain the full protections of the research rules and that any safe harbor does not cause firms to migrate their research function to the trading desk to avoid Rules 2241 or 2242.

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**NICK OTTE**  
Scotttrade  
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TD Securities  
Toronto, Ontario CAN

The STA’s comments on issues related to market structure come from our roles as practitioners in the markets. STA membership does not represent any specific business model, but rather encompasses a broad range of industry participants who rely on liquid and transparent markets to transact orders on behalf of investors. It is from this broad based membership, including institutional “buy side” firms and the broker dealers who execute their orders, which the STA seeks to provide perspectives on the Proposal.

***STA’s primary concern with the Proposal is our belief that it will unnecessarily degrade liquidity in the marketplace, especially in the securities of those companies with small to mid-size market capitalizations and in situations where no research coverage exists.***

*Chairman of the Board*

<sup>1</sup> The STA is a trade organization founded in 1934 for individual professionals in the securities industry and is committed to promoting goodwill and fostering high standards of integrity in accord with the Association’s founding principle, Dictum Meum Pactum – “My Word is My Bond”

<sup>2</sup> [FINRA Regulatory Notice 17-16 April 2017](#)



**JON SCHNEIDER**  
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## General Statements on the Proposal

*President & CEO*  
**JAMES TOES**  
Security Traders Association  
New York, NY

STA agrees with many of the background and discussion statements made in the Proposal, in particular that desk commentary often times,

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**MIKE RASK**  
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*"..never reaches the portfolio manager or others who make the investment decisions. Rather, it may inform buyside traders' timing in executing orders to carry out previously made investment decisions."*

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The conditions which define "recipient" provide meaningful protections to ensure that retail investors retain the full protections of the research rules.

*Secretary*  
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Henderson Geneva Capital  
Management  
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While the Proposal identifies some of their activities, it does not specifically mention sector specialists, a role which falls under, but is distinct from, principal trading personnel and sales and trading personnel.

*Past Chairman*  
**JOHN RUSSELL**  
Franklin Templeton Investments  
San Mateo, CA

FINRA generally notes that it "has observed some cases in which desk commentary may technically fall within the research report definition, even where it falls well short of the type of fundamental research that originally gave rise to the research conflict of interest rules".

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STA appreciates that the Safe Harbor is non-exclusive so conduct not falling within the Safe Harbor is not per se a violation of the rule.

## General Recommendations

STA believes that sector specialists play an indirect, but incremental role in the amount of liquidity available in the marketplace, in particular for small to mid-size company securities where research coverage is limited. Therefore, we recommend that items which unnecessarily restrict their actions be removed from the Proposal, in particular, certain prohibitions which seek to mitigate "pressures by persons engaged in investment banking" and restrictions on the content of desk commentary.

STA is concerned that if approved by the SEC, FINRA's proposed safe harbor for desk commentary will become the rule, rather than the exception to the rule. Therefore, we urge FINRA to clarify this point in any future rule filing with the SEC, or if the proposal is approved, any final rule and notice to members.

STA recommends that FINRA provide specific examples of desk commentary that, in FINRA's opinion, rise to the level of a research report so the industry can respond effectively.



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In the event that a workable safe harbor cannot be designed, STA would recommend FINRA reconsider offering guidance as opposed to amending FINRA Rule 2241 and Rule 2242.

## Specific Comments

### *Sector Specialist*

The position of sector specialist is relatively new compared to principal trading personnel and sales and trading personnel. Understanding the history of the creation and evolution of this role is relevant to the topic of desk commentary and needs to be recognized more clearly in the Proposal. Around the time of the introduction of Regulation NMS<sup>3</sup> a reliance on and subsequent demand for trading technology developed so firms could comply with new rule sets pertaining to order execution. With further advancements of technology, the ability of principal trading personnel to trade more companies per individual trader increased. Efficiencies in the trading of securities were realized with benefits accruing to investors in the form of lower execution costs. However, the technological advancements created an unsustainable burden on principal trading personnel to monitor, interpret and disseminate intraday information and news flashes. Therefore, firms created a new position of sector specialist whose role initially was to assist principle trading personnel in these areas. The responsibilities of the sector specialist later evolved to contributions of information used by principal trading personnel in decisions pertaining to capital commitment requests by institutional customers. Sector specialists did not, nor do they today, engage in the price negotiations between broker dealers and their institutional customers, but the information they provide on the underlying security and/or news flashes increases the willingness of those involved in these types of negotiations to do so. As sector specialists began producing desk commentary, institutional customers found the information useful in timing the execution of orders to carry out previously made investment decisions. Therefore, STA views the sector specialists as playing an indirect, but incremental role in the amount of secondary liquidity available in the marketplace, in particular for small to mid-size companies and acutely in instances where no research coverage exists.

The Proposal contains certain restrictions on the content of desk commentary and required prohibitions which seek to mitigate “pressures by persons engaged in investment banking”. STA believes this would unnecessarily impede the actions, and devalues the contributions, of sector specialists, thus causing degradation in liquidity available to investors.

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<sup>3</sup> Regulation NMS

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GEORGIA SECURITIES ASSOCIATION • KANSAS CITY SECURITIES ASSOCIATION • SECURITY TRADERS ASSOCIATION OF LOS ANGELES • MID-ATLANTIC SECURITY TRADERS ASSOCIATION  
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STA therefore recommends that:

- A. FINRA more clearly define the condition of “brief observations”, as it pertains to allowable content for the safe-harbor. It is STA’s view that certain industry sectors have business models which are more complex than others and therefore the term “brief” is not workable for commentary in a wide group of industries. In our letter<sup>4</sup> to the Committee on Financial Services, U.S. House of Representatives dated May 1, 2017 STA wrote:

*Since the April 5, 2012 enactment of the JOBS Act, the testing-the-waters provision has proven to be beneficial for issuers in particular industry sectors and for their investors. According to a 2017 report by the law firm Proskauer & Rose, LLP , ninety percent (90%) of issuers between 2013 to 2016 who disclosed test-the-waters communications were in the biotech, biopharm or technology, media, telecom (TMT) sectors. This data point does not surprise STA given that products found in the business models of these types of companies are complex and the time needed for investors to make informed decisions is longer.*

- B. The below list of required prohibitions which mitigate “pressures by persons engaged in investment banking” that currently exist for research analysts and would need to be replicated for authors of desk commentary be removed.

*(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*

These required prohibitions would restrict the ability of sector specialists to remain knowledgeable on industry trends and meaningful developments, thus diminishing the quality and amount of information sector specialists bring to decisions on capital commitment and liquidity to investors. Sector specialists have been able to participate in these meetings and STA is not aware of any harm that has come to retail investors.

<sup>4</sup> [Letter to the Honorable Jeb Hensarling, Chairman and Honorable Maxine Waters, Ranking Member: Committee on Financial Services, May 1, 2017](#)



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## Conclusion

In closing, STA wishes to acknowledge that FINRA has allocated considerable time and resources working with various firms and industry groups on drafting the Proposal and that this is the first time STA has commented on the topic of desk commentary. STA looks forward to working with FINRA on this important proposal.

Sincerely,

Jon Schneider, Chairman of the Board

Jim Toes, President & CEO