



LEERINK SWANN

November 10, 2008

Via *Electronic Transmission* ([pubcom@finra.org](mailto:pubcom@finra.org)) and *Overnight*

Marcia E. Asquith  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20006-1506

Re: Regulatory Notice 08-55

Dear Ms. Asquith:

Leerink Swann LLC ("Leerink")<sup>1</sup> is submitting this letter in response to the request by FINRA for comments on the Proposed Research Registration and Conflict of Interest Rules ("Notice")<sup>2</sup>.

We appreciate and thank you for the opportunity to comment on the Notice, and, for the purpose of this letter, will initially comment on several of the proposed changes to quiet periods and lock-ups the firm supports and then focus our comments on two narrow and distinct issues. Those issues are: 1. the proposed restriction or limitation of research analysts participating in road shows or other marketing on behalf of issuers<sup>3</sup>; and 2. the selective distribution of research reports<sup>4</sup>.

Quiet Period and Lock-Ups

We agree with the proposed changes to reduce the existing forty-day post-IPO research quiet period to ten days and the elimination of the black-out periods after a secondary offering and those surrounding the expiration of lock-up agreements<sup>5</sup>. The investing public stands to benefit from the

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<sup>1</sup> Leerink Swann LLC is a SEC-registered broker-dealer and a member of FINRA.

<sup>2</sup> See FINRA Regulatory Notice 08-55 ("Notice")

<sup>3</sup> See Proposed Rule 2240(b)(2)(J)(ii)

<sup>4</sup> See Proposed Rule 2240(g)

<sup>5</sup> See Proposed Rule 2240(b)(2)(G)

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issuance of research containing valuable market information during those periods.

Those proposed changes are positive steps. The comments below raise questions relating to other proposals that require more discussion and consideration before submission to the Securities and Exchange Commission.

### Marketing Initiatives

Rule 2711 was adopted in 2002 with the purpose of improving "the objectivity of research and provide investors with more useful and reliable information when making investment decisions."<sup>6</sup> The Rule was later amended in 2003 to include a provision prohibiting analysts from participating in efforts to solicit investment banking business, including "pitches" for investment banking business to prospective investment banking clients.<sup>7</sup> The stated purpose of the NASD in adopting the prohibition was "to further the overriding goals of research objectivity and investor confidence by eliminating all participation by research analysts in solicitation efforts that could suggest a promise of favorable research in exchange for underwriting business."<sup>8</sup>

The current version of Rule 2711(c) (5) prohibits research analysts from participating in a road show related to an investment banking services *transaction* (emphasis supplied) and from communicating with current or prospective customers in the presence of investment banking department personnel or company management about such an investment banking services *transaction* (emphasis supplied). In submitting the proposal to amend Rule 2711 relating to road shows to the SEC on September 17, 2004, NASD stated that "by prohibiting research analyst participation in road shows, the proposed rule change will further reduce the pressure on research analysts to give an

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<sup>6</sup> See NASD Notice to Members 02-39, page 1

<sup>7</sup> See NASD Notice to Members 03-44

<sup>8</sup> See letter from Philip A. Shaikun, Associate General Counsel (NASD) to James A. Brigagliano, Esq., Assistant Director, Division of Market Regulation, dated July 29, 2003, Page 7.

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overly optimistic assessment of a particular transaction."<sup>9</sup> Recognizing, however, that analysts provided a valuable service in the marketplace, the proposal allowed for research analysts to educate investors about a particular offering or other transaction, so long as the communication occurred outside the presence of the company or investment banking department personnel. This exception preserved the ability of the research analyst to give a candid assessment of a *transaction or sale of securities*<sup>10</sup> (emphasis supplied). In announcing the approval of the amendment in Notice to Members 05-34 in May 2004, the NASD again stated that the rule, as amended, would "further reduce pressure on research analysts to give an overly optimistic assessment of a particular *transaction*"<sup>11</sup> (emphasis supplied).

Interestingly, on September 24, 2004, one week after the amended proposal referenced *supra* was filed with the SEC, Judge Pauley approved the terms of Addendum A to the Global Research Analyst Settlement. Undertaking 11 prohibited research personnel at the settling firms "from participating in company-or Investment Banking-sponsored road shows related to a public offering or other investment banking *transaction*"<sup>12</sup> (emphasis supplied).

It is clear that the intent of the regulatory authorities for the past seven years was to allow the research analyst to offer a candid assessment of a transaction or sale of securities outside of the presence of either his firm's investment bankers or representatives of the company. Proposed Rule 2240(b)(2)(J)(ii) prohibiting analysts' "participation in road shows and other marketing on behalf of issuers"<sup>13</sup> eliminates an important condition that the prohibition relate to the analyst's participation

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<sup>9</sup> See File No. SR-NASD-2004-141, dated September 17, 2004, Page 5

<sup>10</sup> *Id*

<sup>11</sup> See NASD Notice to Members 05-34, May 2005, page 2

<sup>12</sup> See Section 11.a of Addendum A, Undertakings, approved September 24, 2004

<sup>13</sup> See fn 3

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in the marketing of a specific investment banking services transaction. Is it possible that FINRA intends to prohibit all participation in marketing by research analysts whether or not related to investment banking services? If that is the purpose, how then can "analysts, who are expected to function as unbiased intermediaries between issuers and the investors who buy and sell their securities"<sup>14</sup> carry out that role? Clarification is required and FINRA should understand the implications for issuers, private investors and institutions. Clearly, the impact will also be felt by companies - both private and public. Not every contact with a company should be looked at as marketing the investment banking services of the analyst's firm or jeopardizing the analyst's objectivity.

Research analysts are expected to analyze and understand the industry or sector they cover. Not every company will be a banking client or prospect of the analyst's firm at any given moment. We all know that things can change rapidly in today's financial services' world and opportunities, once unreachable, can develop overnight. How can the analyst be an unbiased intermediary if he is not able to take advantage of what companies make available to him in the way of marketing themselves?

Companies regularly sponsor analyst days to help analysts better understand the products, meet management and tour facilities. This activity is marketing in its purest sense. The proposed rule would appear to prohibit the analyst from attending one of these events if institutional investors or analysts from other firms were also in attendance. Would companies be forced to limit attendance to one analyst at a time or would one-on-one meetings also be prohibited?

Companies will often approach firms to provide an audience so that the company's management team can tell its story to salespeople and clients. Firms may often be able to provide exposure to some of its clients, particularly

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<sup>14</sup> Notice at 2

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institutions and their portfolio managers, that the companies cannot otherwise obtain. The questions raised by salespeople and portfolio managers and their reaction to the story are of particular value to the analyst in better understanding sectors and industries, competitive issues, industry trends, etc. in order for him to serve as an unbiased intermediary. The benefit to the company in speaking with investment professionals cannot be overlooked. Would the proposed rule prohibit the analyst from attending these company marketing presentations if clients participate? If only the salespeople attend, can the analyst participate or would the analyst need to leave the room?

FINRA members often sponsor widely-attended, invitation-only client conferences and roundtables providing a large number of companies - both public and private - the opportunity to tell their stories to investors. Analysts will often moderate many of the sessions at these events. The sessions may include a number of different companies in the same sector discussing their products with the institutional clients. Again, a marketing initiative for companies facilitated by FINRA members. Will participation by analysts in these events be prohibited? Would they even be permitted to attend?

How do institutional clients value this access to company management? Company marketing is considered an integral part of the role of sell-side analysts and during company marketing meetings, it is standard industry practice for the companies to be accompanied by analysts. In surveys of institutional clients conducted by *Institutional Investor* over the past five years, "Management Access" has consistently ranked among the top priorities at either 4<sup>th</sup> or 5<sup>th</sup>. Considered by many to be the most prominent survey in the industry, the 2008 survey consulted 3000 individuals at 830 firms, including 87 of the then largest U.S. money managers.<sup>15</sup>

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<sup>15</sup> *Institutional Investor*, October 2004-2008

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According to a proprietary report based on 1,052 in-person interviews with buy-side analysts from 395 targeted institutions and 230 interviews with portfolio managers from 506 targeted firms during the period of November 2007 through March 2008 conducted by Greenwich Associates, company marketing is a well-entrenched practice which institutions value highly and for which they directly allocate commissions<sup>16</sup>. Direct access to companies' management (non-deal road shows, one-on-one meetings and conference calls) was considered in two ways: 1. as one of twelve qualitative factors in the Greenwich Quality Index; and 2. indications from buy-side firms of the percentage of commissions they pay for this direct access. In the survey, direct access to companies' management was the number two priority in allocating commissions. This result has been consistent throughout the past three years. In terms of actual amounts, buy-side analysts allocate 22% of commissions and buy-side portfolio managers allocate between 20-25% for this access. This empirical evidence clearly demonstrates the importance of research analysts continuing to be able to participate in these marketing events.

Research conferences and seminars were also included in the Greenwich survey and over the past three years were ranked as a high priority in allocating commissions. Analysts for buy-side firms responding ranked research conferences and seminars as the number three priority representing 13% of commissions allocated to the sell-side. Portfolio managers ranked the activity as number four representing 12% at both small and large clients.

A significant number of institutional clients demonstrate their view of the sell-side firms through portfolio manager and analyst votes on a quarterly, semi-annual or annual basis. These votes are important feedback to sell-side managers for the votes tell you what the firm does well and what it may need to improve upon. In one recent vote received by this firm, the management of the buy-side firm indicated that approximately 31% of

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<sup>16</sup> Greenwich Associates ("Greenwich"), 2008

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commissions allocated were for company marketing meetings as "meetings with corporate management are the most highly valued service our brokers can provide ... Points are awarded for small group meetings, one-on-ones at conferences, meetings in our office or field trips your analysts arrange to corporate headquarters". These type of comments are frequently made as demonstrated in the results of the *Institutional Investor* and Greenwich Associates surveys.

Marketing is an important component for all companies. The questions raised *supra* require further consideration in advance of any rule filing with the Securities and Exchange Commission.

#### Distribution of Member Research Reports

Proposed Rule 2240(g) is meant to codify FINRA's existing interpretation of Rule 2110 with regards to the timing and distribution of research reports and provide additional guidance concerning firms offering different research products and services to certain classes of clients with the proviso that the firm discloses its research dissemination practices<sup>17</sup>. The proposed rule and Supplementary Material raise a number of issues and necessitate clarification by FINRA.

The existing interpretation<sup>18</sup> referred to in the Notice appears to be narrower than represented in the Notice as it addresses the issue of a member firm's trading activities that occur in anticipation of a firm's issuance of a research report. The published interpretation does not permit a firm to purposefully change its inventory position through "trading activities undertaken with the intent of altering a firm's position in a security in anticipation of accommodating investor interest once the research report has been issued<sup>19</sup>". While the published interpretation does not refer to clients, firms understand that FINRA views

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<sup>17</sup> Notice, Proposed Supplementary Material .04

<sup>18</sup> See IM-2110-4

<sup>19</sup> *Id*

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improperly giving advance notice of research reports and ratings to institutional (or other) clients as violating regulatory standards<sup>20</sup> and support that position. To the same end, in a subsequent rule filing submitted to adopt FINRA Rule 5280 (Trading Ahead of Research Reports), FINRA again addresses the issue of front-running research reports stating it "believes that a member should have an affirmative obligation to manage conflicts of interest in trading securities."<sup>21</sup> FINRA goes on to say that the proposal "will protect the investing public by preventing firms from utilizing non-public advance knowledge of the timing or content of a research report to benefit its own trading to the detriment of its own customers."<sup>22</sup> FINRA describes this approach as "more consistent with existing and proposed rules regarding supervision and the requirements of NASD Rule 2711 and NYSE Rule 472 to eliminate conflicts involving the publication and distribution of research reports."<sup>23</sup>

The Proposed Supplementary Material expands the existing interpretation to impose new requirements on firms that provide different research products and services - not solely research - for certain clients. Specifically, member firms would be required to inform its other clients that its alternative research products and services may reach different conclusions or recommendations that could impact the price of a security<sup>24</sup>. It must be emphasized that the proposal would now extend beyond "research reports", a defined term, to "research products and services", which is not defined. In the investment business (as in many others), clients that generate more commissions receive different levels of service and products. These products and service levels are varied and may not always relate to recommendations or ratings. In the institutional business, tiered relationships are rarely memorialized by written agreement. Firms rely on institutional salespeople and

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<sup>20</sup> See Phua Young, NASD Complaint, May 28, 2003.

<sup>21</sup> See File No. SR-FINRA-2008-054 dated October 29, 2008, page 6

<sup>22</sup> *Id.*, page 7

<sup>23</sup> *Id.*, page 6

<sup>24</sup> *Greenwich*



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sales traders to "cover" clients and discuss levels of service with clients. In reality, clients in the institutional world understand that more commissions will result in more attention. The simplest way for a client to express its dissatisfaction with a sell-side firm is to stop sending order flow. Conversely, sell-side service may drop in relation to commission flow from the buy-side.

A number of questions arise:

1. Is the use of the term "research products and services" meant to only apply to "research reports"?
2. If not, what is the definition of "research products and services"?
3. Is proposed Rule 2240(g) and proposed Supplementary Material .04 meant to apply solely to prohibiting a firm offering a trading advantage to one type of client over another client?; and
4. Should a carve-out from the notification provision be included for institutional clients? If not, can the notification be provided orally?

FINRA should provide clarification for the issues identified *supra*.

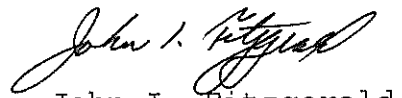
We recognize FINRA's objective to establish a "principle based" regulatory environment allowing a firm to develop policies and procedures based on the individual firm's size and business model. Clarification, however, is needed to allow firms to better understand how the specific proposals discussed *supra* "further the overriding goals of research objectivity and investor confidence".

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If you have any questions or wish to discuss the  
comments, please contact me at 617-918-4564.

Very truly yours,



John I. Fitzgerald

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