



FINRA's Final Equity Research Rules Go Effective; Final Debt Research Rules' Effective Date Quickly Approaching

In November 2014, FINRA proposed to adopt NASD Rule 2711 as new FINRA Rule 2241, with several modifications, to address conflicts of interest relating to equity research analysts and research reports ("Rule 2241"). FINRA additionally proposed to adopt new FINRA Rule 2242, designed to address conflicts of interest relating to the publication and distribution of debt research reports ("Rule 2242"). Together, the proposals sought to effectively serve the public interest by successfully managing research conflicts of interest, while contemporaneously preserving the ability of FINRA members ("member firms") to continue to provide research, and thus information, to the investing public.¹ Finalized versions of Rule 2241 and Rule 2242 were approved by the Securities and Exchange Commission ("SEC") in July 2015. While Rule 2241's requirements became effective on December 24, 2015, Rule 2242 will not become effective until February 22, 2016.

Rule 2241 and Rule 2242 create a much more stringent regulatory environment for member firms and their equity and debt analysts. FINRA has additionally indicated in its priorities letter for 2016 that it will continue to focus on whether a member firm's research analysts are inappropriately involved in the firm's investment banking activities and whether investment banking personnel are exercising undue influence over analysts.²

This Alert is separated into two parts. Part I provides a brief overview of the requirements of both Rule 2241 and Rule 2242. Part II provides a comparison chart, which illustrates the specific overlapping provisions contained in both Rule 2241 and Rule 2242, as well as provisions that are unique to each rule. As described in further detail below, although the majority of the provisions contained in both Rule 2241 and Rule 2242 are largely similar, there are several notable differences.

I. Summary of the Key Provisions Contained in Rule 2241 and Rule 2242

This section provides a summary of the provisions contained in both Rule 2241 and Rule 2242, including a description of the notable differences, where applicable, between the rules.

A. DEFINITIONS

Definitions. Rule 2241 applies to equity "research analysts," which is defined in Rule 2241 as any associated person who is primarily responsible for, and any associated person who reports directly or indirectly to a research

¹ See Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change, as Modified by Amendment No. 1 Thereto, to Adopt FINRA Rule 2242 (Debt Research Analysts and Debt Research Reports), SEC Release No. 34-75472, at 73 (July 16, 2015), available at <https://www.sec.gov/rules/sro/finra/2015/34-75472.pdf>.

² See FINRA Regulatory and Examination Priorities Letter for 2016 (Jan. 5, 2016), available at <http://www.finra.org/sites/default/files/2016-regulatory-and-examination-priorities-letter.pdf>.

analyst in connection with, the preparation of the substance of a “research report.” It is not relevant whether a person has the specific job title of “research analyst.”³ “Equity security” has the same meaning as provided in Section 3(a)(11) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”).⁴

FINRA Rule 2242 applies to “debt research analysts,” which like Rule 2241 is defined as “an associated person who is primarily responsible for, and any associated person who reports directly or indirectly to a debt research analyst in connection with, the preparation of the substance of a debt research report, whether or not any such person has the job title of ‘research analyst.’”⁵ “Debt security” includes any security as defined in Section 3(a)(10) of the Exchange Act, excluding any “equity security,” “municipal security” and “security-based swap” as defined under the Exchange Act, and any “U.S. Treasury” as defined under FINRA Rule 6710(p).⁶

“Research reports” are similarly defined under Rule 2241 and Rule 2242 as any written (including electronic) communication that provides (1) an analysis of equity (or debt) securities of individual companies or industries (or a debt security or an issuer of a debt security), and (2) information reasonably sufficient upon which to base an investment decision. However, Rule 2241 no longer includes a report relating to a mutual fund not listed or traded on an exchange.⁷

Rule 2241 and Rule 2242 expressly exclude from the definition of “research report”:

- Communications that are limited to: (i) discussions of broad-based indices; (ii) commentaries on economic, political, or market conditions; (iii) technical analyses concerning the demand and supply for a sector, index, or industry based on trading volume and price; (iv) recommendations regarding increasing or decreasing holdings in particular industries or sectors; (v) notices of certain ratings or price target changes;⁸ and (iv) statistical summaries of multiple companies’ financial data, including lists of current ratings;⁹
- Periodic reports or other communications prepared for investment company shareholders or discretionary investment account clients, which discuss individual securities in the context of a fund’s account or past performance;¹⁰
- Communications that constitute statutory prospectuses that are filed as part of a registration statement;¹¹ and
- Communications that constitute private placement memoranda and comparable offering-related documents prepared in connection with investment bank transactions (other than those that purport to be research).¹²

Rule 2241 further excludes from the definition of “research report” any communications distributed to fewer than 15 persons,¹³ while Rule 2242 provides exclusions from the definition of “research report” for: (i) an analysis prepared for a specific person or a limited group of fewer than 15 persons; and (ii) commentaries on or analyses of

³ FINRA Rule 2241(a)(8).

⁴ FINRA Rule 2241(a)(2).

⁵ FINRA Rule 2242(a)(1).

⁶ FINRA Rule 2242(a)(4).

⁷ FINRA Rule 2241(a)(11); FINRA Rule 2242(a)(3).

⁸ FINRA Rule 2241(a)(11)(A)(i)-(iii), (v)-(vi); FINRA Rule 2242(a)(3)(A)(i)-(iii), (v)-(vi).

⁹ FINRA Rule 2241(a)(11)(A)(iv); FINRA Rule 2242(a)(3)(B)(i). Note, however, that FINRA Rule 2242 qualifies this exclusion by noting that listings of current ratings will be excluded to the extent that they do not include an analysis of individual companies’ data.

¹⁰ FINRA Rule 2241(a)(11)(B)(ii); FINRA Rule 2242(a)(3)(B)(iii).

¹¹ FINRA Rule 2241(a)(11)(C); FINRA Rule 2242(a)(3)(C).

¹² FINRA Rule 2241(a)(11)(D); FINRA Rule 2242(a)(3)(D).

¹³ FINRA Rule 2241(a)(11)(B)(i).

particular types of debt securities or characteristics.¹⁴

B. CONFLICTS OF INTEREST

Identifying and Managing Conflicts of Interest. Under Rule 2241 and Rule 2242, member firms must establish, maintain and enforce written policies and procedures reasonably designed to identify and effectively manage any conflicts of interests related to research reports.¹⁵ Specifically, a member firm's policies must address the preparation, content and distribution of research reports, public appearances by research analysts and the interaction between research analysts and those outside of the firm's research department.¹⁶ Written policies and procedures must also be reasonably designed to promote objective and reliable research that provides only the truly held opinions of the firm's research analysts, and must affirmatively seek to diminish the manipulation of research analysts (or their research reports) in an attempt to favor the interests of the firm or a current or prospective customer or class of customers.¹⁷

Firms must also develop policies and procedures that specifically address pre-publication review. At a minimum, such policies and procedures must prohibit pre-publication review, clearance or approval of research reports by: (i) investment banking personnel (or, in the case of debt research, any investment banking, principal trading and sales and trading personnel); and (ii) all other persons not directly responsible for the preparation, content and distribution of research reports, other than the member firm's legal and compliance personnel.¹⁸

Member firms are also required to maintain policies and procedures that prohibit prepublication review of a research report by a subject company for purposes other than verification of facts.¹⁹ Member firms may provide sections of a draft research report to non-investment banking personnel (or, in the case of debt research, non-principal trading, non-sales and trading personnel) or the subject company for factual review, if: (i) the draft sections do not consist of any research summary, research rating or price target; (ii) a complete draft of the report is provided to the member firm's legal or compliance personnel prior to the sections being provided to non-investment banking personnel (or, in the case of debt research, non-principal trading, non-sales and trading personnel) or the subject company; and (iii) any subsequent proposed changes to the rating (or, in the case of equity research, the price target) are accompanied by a written justification to the member firm's legal or compliance personnel and the changes are authorized by such legal or compliance personnel.²⁰

FINRA Rule 2241 largely diminishes the input and influence that investment banking personnel may have on equity research reports and equity research analysts. Furthermore, FINRA Rule 2241 requires that firms limit or restrict investment banking personnel's input or influence on coverage determinations and instead, provide such final discretion regarding coverage to equity research personnel and management.²¹

In addition to investment banking personnel, FINRA Rule 2242 similarly limits the input and influence of sales and trading and principal trading personnel on debt research analysts. FINRA Rule 2242 further limits the supervision of debt research analysts to persons not engaged in (i) investment banking services transactions, (ii) principal trading activities or (iii) sales and trading.²²

Compensation of Research Analysts. A member firm must, under both Rule 2241 and Rule 2242,

¹⁴ FINRA Rule 2242(a)(3)(A)(iii); FINRA Rule 2242(a)(3)(B)(ii).

¹⁵ See FINRA Rule 2241(b)(1); FINRA Rule 2242(b)(1).

¹⁶ FINRA Rule 2241(b)(1)(A)-(C); FINRA Rule 2242(b)(1)(A)-(C).

¹⁷ FINRA Rule 2241(b)(2); FINRA Rule 2242(b)(2).

¹⁸ FINRA Rule 2241(b)(2)(A); FINRA Rule 2242(b)(2)(A)-(B).

¹⁹ FINRA Rule 2241(b)(2)(N); FINRA Rule 2242(b)(2)(N). Member firms are also prohibited under Rule 2241 and Rule 2242 from making promises of (i) favorable research and (ii) a particular research recommendation, rating or specific content, as inducement for receipt of business or compensation. See FINRA Rule 2241(b)(2)(K); FINRA Rule 2242(b)(2)(K).

²⁰ See FINRA Rule 2241.05; FINRA Rule 2242.05. Moreover, the member firm must retain copies of all draft and final versions of research reports for three years. *Id.*

²¹ FINRA Rule 2241(b)(2)(B).

²² FINRA Rule 2242(b)(2)(C)-(D).

implement written policies and procedures that at a minimum prohibit investment banking personnel (or, in the case of debt research, personnel engaged in investment banking services transactions, principal trading activities or sales and trading) from supervising or controlling research analysts, including exerting influence or control over research analyst compensation evaluations and determinations.²³

Moreover, a member firm's policies and procedures must prohibit compensation of research analysts based upon specific contributions to investment banking activities (or, for debt research, principal trading activities), as well as require that compensation of research analysts primarily responsible for the preparation of the substance of a research report be reviewed and approved on an annual basis by a compensation committee.²⁴ The compensation committee must report to the member firm's board of directors, as applicable, and may not consist of any of the member firm's investment banking personnel (as well as persons engaged in principal trading activities in the case of debt research).²⁵

Under Rule 2241, the compensation committee is required to consider several factors when evaluating the appropriate compensation for equity research analysts, including: (i) individual performance (*e.g.*, productivity and quality of research); (ii) the correlation between the analyst's recommendations and actual performance of the recommended securities; and (iii) the overall ratings received from clients, sales force and peers independent of the firm's investment banking department.²⁶ Rule 2242 requires the compensation committee to consider: (i) individual performance (*e.g.*, productivity and quality of debt research); and (ii) the overall ratings received from customers and peers. While persons engaged in principal trading activities may not provide input on a debt research analyst's compensation, sales and trading personnel may provide their input to debt research management on the evaluation of the debt research analyst in order to convey customer feedback—however, all final compensation determinations must be made by research management and the compensation committee.²⁷

Research Department Budget. Under Rule 2241 and Rule 2242, a member firm must limit determinations of the appropriate research department budget to senior management of the member firm. However, senior management engaged in investment banking services (or, in the case of debt research, investment banking activities or principal trading activities) are expressly prohibited from providing any input on such determinations.²⁸

Information Barriers and Safeguards. Rule 2241 and Rule 2242 both require that a member firm's policies and procedures establish information barriers or other institutional safeguards that ensure that research analysts are insulated from the review, pressure or oversight by persons engaged in investment banking services, sales and trading (or, in the case of debt research, principal trading or sales and trading activities) and other persons who may be biased in their judgment or supervision.²⁹ Although Rule 2241 and Rule 2242 do not explicitly require physical separation between research analysts and certain personnel, FINRA notes that it expects physical separation except in "extraordinary circumstances where the costs are unreasonable due to a firm's size and resources."³⁰

Anti-Retaliation. Pursuant Rule 2241, a member firm's policies and procedures must prohibit the member firm's investment banking personnel, and other firm employees engaged in investment banking services activities,

²³ FINRA Rule 2241(b)(2)(C); FINRA Rule 2242(b)(2)(D).

²⁴ FINRA Rule 2241(b)(2)(E)-(F); FINRA Rule 2242(b)(2)(F)-(G).

²⁵ FINRA Rule 2241(b)(2)(F).

²⁶ FINRA Rule 2241(b)(2)(F)(i)-(iii).

²⁷ FINRA Rule 2242(b)(2)(G)(i)-(ii).

²⁸ FINRA Rule 2241(b)(2)(D); FINRA Rule 2242(b)(2)(E). FINRA Rule 2242 further specifies, however, that revenues and results of the member firm as a whole may be considered in determining the debt research department budget and allocation of debt research department budget. See FINRA Rule 2242(b)(2)(E).

²⁹ FINRA Rule 2241(b)(2)(G); FINRA Rule 2241(b)(2)(H).

³⁰ See Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change, as Modified by Amendment No. 1 Thereto, to Adopt FINRA Rule 2241 (Research Analysts and Research Reports) in the Consolidated FINRA Rulebook, SEC Release No. 34-75471, at 56 n.193 (July 16, 2015), available at <https://www.sec.gov/rules/sro/finra/2015/34-75471.pdf>; SEC Release No. 34-75472, *supra* note 1 at 58.

from directly or indirectly retaliating (or threatening retaliation) against equity research analysts as a result of any adverse research report or public appearance.³¹ While Rule 2242 maintains an analogous anti-retaliation provision, it creates a broader prohibition by applying it to any employee of the member firm and not just those engaged specifically in investment banking services activities.³²

Quiet Periods. Under Rule 2241, but not Rule 2242, a member firm's policies and procedures must prohibit research analysts from publishing research or making public appearances (*i.e.*, establishment of a "quiet period") in connection with an issuer's IPO (if the member firm has participated as an underwriter or dealer) or an issuer's secondary offering (if the member firm has participated as a manager or co-manager). The policies and procedures must stipulate the following "quiet periods": (i) a minimum of ten days in the case of an IPO; and (ii) a minimum of three days in the case of a secondary offering.³³ Rule 2241 amends the quiet periods established under NASD Rule 2711, which contained quiet periods for IPOs and secondary offerings of 40 days and 10 days, respectively.

Rule 2241 expressly excludes from the "quiet period": (i) the publication or distribution of a research report or public appearance following an IPO or secondary offering by an emerging growth company ("EGC"), as defined under Section 3(a)(80) of the Securities Act of 1933, as amended (the "Securities Act"); (ii) the publishing or distribution of a research report, or making of a public appearance, concerning the effects of a significant news or event on an issuer provided that the firm's legal or compliance personnel provided prior authorization before such publication was distributed or public appearance made; and (iii) the distribution of research reports or making of public appearances pursuant to Rule 139 under the Securities Act.³⁴

Solicitation and Marketing. Under Rule 2241 and Rule 2242, a member firm must restrict a research analyst's activities that can reasonably be expected to comprise the analyst's objectivity.³⁵ Equity and debt research analysts are prohibited from participating in pitches and other solicitation of investment banking services transactions. Moreover, equity and debt research analysts are prohibited from participating in road shows and other marketing on behalf of an issuer related to investment banking services.³⁶ The supplementary materials to Rule 2241 and Rule 2242 further stipulate that pitch materials cannot include any information about the member firm's research capacity in a manner that suggests the firm would provide, either directly or indirectly, favorable research.³⁷

Joint Due Diligence. A member firm's policies and procedures must prohibit an equity and debt research analyst's participation in due diligence in the presence of investment banking personnel prior to the selection of underwriters for an investment banking services transaction.³⁸ However, following the award of a mandate, joint diligence sessions are permitted with appropriate institutional safeguards.

FINRA has clarified that it interprets the joint due diligence requirement under Rule 2241 ". . . to apply only to the extent it is not contrary to the JOBS Act." Accordingly, the due diligence proscription would not ". . . apply where the joint due diligence activities involve a communication with the management of an EGC that is attended by both the [equity] research analyst and an investment banker."³⁹

Restrictions on Personal Trading by a Research Analyst. A member firm must maintain policies and procedures that restrict research analyst account trading in: (i) securities, (ii) any derivatives of such securities, and (iii) any funds whose performance is materially dependent upon the performance of any securities covered by

³¹ FINRA Rule 2241(b)(2)(H).

³² FINRA Rule 2242(b)(2)(I).

³³ FINRA Rule 2241(b)(2)(I).

³⁴ FINRA Rule 2241(b)(2)(I)(ii)-(iii).

³⁵ FINRA Rule 2241(b)(2)(L); FINRA Rule 2242(b)(2)(L).

³⁶ FINRA Rule 2241(b)(2)(L)(i)-(ii); FINRA Rule 2242(b)(2)(L)(i)-(ii). However, member firms should take note that these activities represent a "non-exhaustive list" of the types that can violate this provision under Rule 2241. See SEC Release No. 34-75471, *supra* note 30 at 9 n.35.

³⁷ FINRA Rule 2241.01; FINRA Rule 2242.02.

³⁸ FINRA Rule 2241.02; FINRA Rule 2242.09.

³⁹ See SEC Release No. 34-75471, *supra* note 30 at 10 n.39.

the research analyst.⁴⁰ Furthermore, policies and procedures must ensure that research analyst accounts, supervisors of such analysts and associated persons able to influence the content of research reports do not benefit from knowledge of the content or the timing of the report before recipients of the report have a reasonable opportunity to act on the report's information.⁴¹ However, unlike Rule 2242, Rule 2241 further prohibits equity analysts from receiving pre-IPO shares in the sector that he or she covers and trading against his or her recent recommendations.⁴²

Both Rule 2241 and Rule 2242 provide several exclusions from the aforementioned restrictions on personal trading. First, an equity or debt research analyst may be permitted to trade against his or her most recent recommendation as long as the trade falls within the member firm's definition of "financial hardship circumstances."⁴³ Second, an equity or debt research analyst may trade in securities in a manner that is inconsistent with his or her recommendation (even where a member firm has instituted a policy that prohibits any analyst from holding securities, or options on or derivatives of such securities), provided that: (i) the member firm establishes a reasonable plan to liquidate such holdings; and (ii) the plan is approved by the firm's legal or compliance personnel.⁴⁴

C. CONTENT AND DISCLOSURE

Content and Disclosure in Research Reports. Under both Rule 2241 and Rule 2242, a member firm must establish policies and procedures that are reasonably designed to ensure that: (i) purported facts in research reports are based on reliable information; (ii) reports disclose any material conflicts known not only by research analysts but also by any associated person with the ability to influence the content of the report; and (iii) any recommendation or rating (or, in the case of an equity research report, any price target) has a reasonable basis and is accompanied by a clear explanation of any valuation method used and a fair presentation of the risks that may impede achievement of the recommendation or rating (or price target).⁴⁵

A member firm is also required to disclose in any equity or debt research report at the time of publication of a distributed report: (i) if the research analyst or a member of the research analyst's household has a financial interest in the debt or equity securities of the subject company; (ii) if the research analyst has received compensation based upon the member firm's investment banking revenues, among other factors; and (iii) if the member firm or any of its affiliates: (a) managed or co-managed a public offering of securities for the subject company, (b) received compensation for investment banking services from the subject company performed in the past 12 months or (c) expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months.⁴⁶ A member firm additionally must, as part of the "catch-all" disclosure requirements for Rule 2241 and Rule 2242, disclose in a research report any other material conflict of interest of the research analyst or member firm that the research analyst knows or has reason to know of at the time of the publication or distribution of a research report.⁴⁷ Finally, in addition to the disclosure requirements expressly provided for in Rule 2241 and Rule 2242, member firms and their equity and debt research analysts must comply with all applicable disclosure provisions of FINRA Rule 2210 and the U.S. federal securities laws.⁴⁸

There are several content disclosure requirements that are unique to each of Rule 2241 and Rule 2242. First, under Rule 2241, equity research reports must disclose when a member firm or its affiliates have a "significant financial interest in the equity of a company," and at a minimum, beneficial ownership of 1% or more of any class of common equity securities of the subject company. Furthermore, Rule 2241 requires that an equity research

⁴⁰ FINRA Rule 2241(b)(2)(J); FINRA Rule 2242(b)(2)(J).

⁴¹ FINRA Rule 2241(b)(2)(J)(i); FINRA Rule 2242(b)(2)(J)(i).

⁴² FINRA Rule 2241(b)(2)(J)(iii).

⁴³ FINRA Rule 2241(b)(2)(J)(ii); FINRA Rule 2242(b)(2)(J)(ii).

⁴⁴ FINRA Rule 2241.10; FINRA Rule 2242.10. For a plan to be "reasonable" under Rule 2241 and Rule 2242, the plan must be consistent with the principles announced in FINRA Rule 2241(b)(2)(J)(i) and Rule 2242(b)(2)(J)(i), respectively.

⁴⁵ See FINRA Rule 2241(c)(1)-(2); FINRA Rule 2242(c)(1)-(2).

⁴⁶ See FINRA Rule 2241(c)(4); FINRA Rule 2242(c)(4).

⁴⁷ FINRA Rule 2241(c)(4)(I); FINRA Rule 2242(c)(4)(H).

⁴⁸ FINRA Rule 2241(e); FINRA Rule 2242(e).

report disclose whether the firm was making a market in the securities of the subject company at the time of publication or distribution of an equity research report.⁴⁹ On the other hand, Rule 2242 requires firms to disclose in the debt research report whether it trades or may trade as principal in the debt securities (or related derivatives) that are the subject of the debt research report.⁵⁰

Distribution of Firm and Third-Party Research Reports. Member firms must establish, maintain and enforce written policies and procedures that are reasonably designed to ensure that a research report is not distributed selectively to trading personnel or to selected customers of the firm.⁵¹ Different research products may be distributed to different customers, but differentiation cannot be based on the timing of receipt of potentially market sensitive information.⁵²

When distributing third-party reports, the member firm must ensure that the report (i) is clearly labeled to ensure that there is no confusion on the part of the recipient as to the person or entity that prepared the report, (ii) does not contain any untrue statement of material fact, (iii) is not otherwise false or misleading and (iv) reliable and objective.⁵³ Firms distributing a third-party report must also disclose any significant interest in securities of the report's subject company and any other material conflict that may have influenced the choice of a third-party research provider.⁵⁴

Disclosure for Public Appearances. When an equity or debt research analyst makes a public appearance, he or she must largely satisfy the same disclosure requirements that are required when distributing research reports under Rule 2241 and Rule 2242. However, unlike the disclosure requirements for research reports, the "catch all" disclosure requirement for public appearances would only apply to a conflict of interest of the equity or debt research analyst or member firm that the research analyst knows or has reason to know at the time of the public appearance.⁵⁵ A member firm must also maintain records of public appearances sufficient to demonstrate compliance by its research analysts with applicable disclosure requirements.⁵⁶

Termination of Coverage. Rule 2241, but not Rule 2242, expressly requires that a member firm promptly notify its customers if it intends to terminate coverage of a subject company. Such notice must be made to the member firm's customers using the firm's ordinary means to disseminate research reports on the subject company. The notice must also be accompanied by a final research report (comparable in scope and detail to prior research reports) and a final recommendation or rating. Where it is impracticable to provide such a final research report, recommendation or rating, a member firm may alternatively disclose to its customers its reason for terminating coverage.⁵⁷

D. EXEMPTIONS

Exemption for Limited Investment Banking Activity. Both Rule 2241 and Rule 2242 provide an exemption from their respective requirements for member firms that have (i) participated in ten or fewer investment banking services transactions over the past three years as manager or co-manager; and (ii) generated \$5 million or less in gross investment banking revenues from those transactions. However, this exemption is only available for those member firms that establish information barriers or other institutional safeguards to ensure that their analysts are insulated from pressure by persons engaged in investment banking services activities or other persons, including sales and trading department personnel, who might be biased in their judgment or

⁴⁹ FINRA Rule 2241(c)(4)(F)-(G).

⁵⁰ FINRA Rule 2242(c)(4)(F).

⁵¹ FINRA Rule 2241(g); FINRA Rule 2242(f).

⁵² FINRA Rule 2241.07; FINA Rule 2242.07.

⁵³ See FINRA Rule 2241(h); FINRA Rule 2242(g).

⁵⁴ FINRA Rule 2241(h)(4); FINRA Rule 2242(g)(3).

⁵⁵ FINRA Rule 2241(d); FINRA Rule 2242(d).

⁵⁶ FINRA Rule 2241(d)(3); FINRA Rule 2242(d)(3).

⁵⁷ FINRA Rule 2241(f).

supervision.⁵⁸

Exemption for Good Cause. Both Rule 2241 and Rule 2242 provide an exemption for “good cause.” Specifically, FINRA may in exceptional and unusual circumstances grant a conditional or unconditional exemption from any requirement under Rule 2241 or Rule 2242 for good cause shown after taking into account relevant factors, including: (i) the extent to which such an exemption is consistent with the purposes of Rule 2241 or Rule 2242, as applicable; (ii) the protection of investors; and (iii) the public interest.⁵⁹

Exemption for Limited Principal Trading Activity. Rule 2242 contains a unique exemption for member firms that engage in limited principal trading activity. To rely on such an exemption, the member firm must (i) have trading gains or losses on principal trades in debt securities (in absolute value on an annual basis) that do not exceed \$15 million or over the previous three years, on average per year; and (ii) employ fewer than ten debt traders. Member firms that claim this exemption must maintain records sufficient to establish eligibility for the exemption and also maintain (for at least three years) any communication that, but for this exemption, would be subject to the provisions of Rule 2242.⁶⁰

Exemption for Debt Research Reports Provided to Institutional Investors. Rule 2242 contains an exemption for the distribution of debt research to qualified institutional buyers (“QIBs”). A member firm may rely on this exemption if: (i) the firm has a reasonable basis to believe that the QIB customer is capable of evaluating investment risks independently, both in general and with regard to the particular transactions and investment strategies involving a debt security; and (ii) the QIB affirmatively indicates that it is exercising independent judgment pursuant to FINRA’s suitability requirement. Even where the QIB has not contacted the firm to request that such institutional debt research not be provided, the firm may reasonably conclude that the QIB has consented to receive debt institutional research reports (*i.e.*, via negative consent). A member firm may similarly provide debt research reports to a person that qualifies as an “institutional account” pursuant to FINRA Rule 4512(c), provided that such person, prior to receiving the debt research report, affirmatively notifies the member firm in writing that it wishes to receive institutional debt research and forego treatment as a retail investor for the purposes of Rule 2242 (*i.e.*, via affirmative written consent).⁶¹ The member firm may, however, distribute institutional debt research to any person, other than a “natural person,” that qualifies as an “institutional account” for a period of up to one year after the SEC’s approval date of Rule 2242 (the “Transition Period”) without first obtaining affirmative written consent. After the Transition Period expires, a member firm must obtain the necessary consents to distribute institutional debt research to any person (natural or otherwise).⁶²

II. Comparison Chart

See our comparison chart on the following page.

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⁵⁸ FINRA Rule 2241(i); FINRA Rule 2242(h).

⁵⁹ FINRA Rule 2241(j); FINRA Rule 2242(k).

⁶⁰ FINRA Rule 2242(i).

⁶¹ FINRA Rule 2242(j).

⁶² FINRA Rule 2242.11.

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Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations

Comparison Between FINRA Rule 2241 and Rule 2242

Provision	Included in FINRA Rule 2241	Included in FINRA Rule 2242
Definitions	✓	✓
Identifying and Managing Conflicts of Interest	✓	✓
Content and Disclosure in Research Reports	✓	✓
Disclosure in Public Appearances	✓	✓
Disclosure Required by Other Provisions	✓	✓
Termination of Coverage	✓	✗
Distribution of Member Research Reports	✓	✓
Distribution of Third-Party Research Reports	✓	✓
Exemption for Members with Limited Investment Banking Activity	✓	✓
Exemption for Good Cause	✓	✓
Exemption for Limited Principal Trading Activity	✗	✓
Exemption for Research Reports Provided to Institutional Investors	✗	✓
Supplementary Materials		
Efforts to Solicit Investment Banking Business	✓	✓
Joint Due Diligence	✓	✓
Restrictions on Communications with Customers and Internal Personnel	✓	✓
Information Barriers Between Research Analysts and Trading Desk Personnel	✗	✓
Disclosure of Non-Investment Banking Services Compensation	✓	✗
Disclosure of Compensation Received by Affiliates	✗	✓
Submission of Sections of a Draft Research Reports for Factual Review	✓	✓
Beneficial Ownership of Equity Securities	✓	✗
Distribution of Member Research Products	✓	✓
Ability to Influence the Content of a Research Report	✓	✓
Obligations of Persons Associated with a Member	✓	✓
Divesting Research Analyst Holdings	✓	✓
Distribution of Institutional Debt Research During Transition Period	✗	✓

- ✗ Provision not contained in FINRA Rule
- ✓ Provision contained in FINRA Rule