

Research Analysts and Research Reports

FINRA Provides Guidance on Prohibition Against Offering Favorable Research to Induce Investment Banking Business

Executive Summary

FINRA is reminding member firms of the need for heightened supervision over solicitation and research activities in circumstances where an issuer has communicated an expectation of favorable research as a condition of participating in an offering.

Questions concerning this *Notice* should be directed to Philip Shaikun, Associate Vice President, Office of General Counsel, at (202) 728-8451.

Background and Discussion

NASD Rule 2711 fosters objectivity in research reports by, among other things, insulating research analysts from pressure to tailor their coverage to the interests of a firm's current or prospective investment banking clients. To that end, NASD Rule 2711(e) prohibits firms from directly or indirectly offering favorable research or a specific rating or price target as consideration or inducement for the receipt of business or compensation. NASD Rule 2711(c)(4) prohibits research analysts from participating in efforts to solicit investment banking business, including participation in "pitches" to prospective investment banking clients and other communications with issuers for the purpose of soliciting investment banking business. FINRA has interpreted that provision to prohibit in pitch materials any information about a firm's research capacity in a manner that suggests, directly or indirectly, that the firm might provide favorable research coverage.¹

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Notice Type

- ▶ Guidance

Suggested Routing

- ▶ Compliance
- ▶ Investment Banking
- ▶ Legal
- ▶ Research
- ▶ Senior Management

Key Topics

- ▶ Conflicts of Interest
- ▶ Research

Referenced Rules

- ▶ NASD Rule 2711
- ▶ NTM 07-04
- ▶ SEC Regulation AC

It has come to FINRA's attention that certain issuers may be attempting to extract implicit promises of favorable research by suggesting publicly or directly to potential deal participants in advance of an anticipated offering that positive research coverage will be an implicit or explicit condition to selection as an underwriter or selling group member. The suggestions may take the form of hints, insinuations or other subtle references, but are intended to condition the award of investment banking business on the nature of research attendant to the deal. For example, the CEO of an issuer recently stated in an interview that he was dissatisfied with the tone of research coverage of his company by certain firms that previously served as underwriters for the company. As a result, the CEO reportedly intends to require candidates for the company's next offering to demonstrate "a clear understanding of who [the company] is and our trajectory, and why [the company] is a stock that investors should own." He further is quoted as saying, "If I'm confident they can articulate that well, they will have a chance" at being selected as an offering participant.²

FINRA views these and similar advance statements as attempts to create an expectation that a firm chosen to participate in a subsequent offering will maintain favorable research on the issuer's stock, irrespective of the stock price or the company's ongoing performance. FINRA views even tacit acquiescence to such overtures to be a violation of NASD Rule 2711(e),³ and under certain facts and circumstances, potentially a violation of NASD Rule 2711(c)(4).

FINRA understands that such uninvited pronouncements place prospective offering participants in a challenging situation should they seek to compete for a role in the offering. Nonetheless, in circumstances where an issuer makes known, expressly or implicitly, that the selection of an offering participant will be predicated on an expectation of positive research coverage, FINRA will closely scrutinize offering participants' research and other deal-related activities for compliance with, among others, NASD Rule 2711 and SEC Regulation Analyst Certification.

Member firms that choose to compete for or participate in offerings under such circumstances must expressly repudiate to the issuer any expectation with respect to the content of research coverage and document such repudiation. In addition, the firms must implement heightened supervision of their solicitation activities, including pitch meetings and other communications with the issuer, to ensure there is no express or implied acknowledgement or accedence to the research expectation. Finally, members must increase oversight of the preparation and content of their research on the subject company—both before and after deal participants are chosen—including any permissible communications between research and investment banking personnel.

Endnotes

1. *See Notice to Members 07-04* (January 2007).
2. Serena Ng, *AIG Gets Tough on Analyst Views*, Wall Street Journal, August 26, 2011.
3. While FINRA is concerned with the action of the issuer in such scenarios, FINRA generally does not have jurisdiction over the conduct of non-broker-dealer issuers and their employees and agents.