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# **Guiding Principles To Promote The Integrity of Fixed Income Research**

A Global Approach To Managing Potential Conflicts of Interest

May, 2004

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### ACKNOWLEDGMENTS AND PROCESS

Under the overall direction of the Association's Board of Directors, these Guiding Principles were initially developed by the members of The Bond Market Association in multiple meetings and discussions that took place during the summer and fall of 2003. An exposure draft was published for comment in December, 2003. The Guiding Principles reflect most of the commentators' suggestions, as well as the substantial input provided by members of the Association's United States Fixed Income Research Task Force and European Fixed Income Research Task Force (composed of senior fixed income business, research and legal professionals from Association member firms), and from various research committees within each of the Association's asset class-focused divisions. The drafters of The Guiding Principles also have taken into account comments received from the United States Securities and Exchange Commission (SEC) and the United Kingdom's Financial Services Authority (FSA). The Association appreciates the time and effort taken by the SEC, FSA, the European Commission, NASD and NYSE to review the exposure draft. The final Guiding Principles, however, represent the views and recommendations of the Association and its members and not those of any governmental regulatory authority. In addition to the significant time, effort and intellectual contributions supplied by our Board and membership, we wish to acknowledge the valuable assistance and expert insight provided by Wilmer Cutler Pickering LLP, the Association's lead outside counsel for this project, as well as the assistance of Clifford Chance LLP, special European counsel, and Bingham McCutchen, special counsel for U.S. State affairs.

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May 19, 2004

On behalf of The Bond Market Association (the "Association"), we are pleased to provide you with the Association's "Guiding Principles to Promote the Integrity of Fixed Income Research."

This document includes the guiding principles, recommendations supporting those principles, and accompanying commentary regarding fixed income research practices (collectively, the "Guiding Principles"). Taken as a whole, the Guiding Principles are intended to enhance investor protection by promoting greater awareness of how potential conflicts of interest can be managed by integrated sell-side financial institutions that underwrite and trade debt securities and distribute to investors research about those securities.

The Guiding Principles represents a first step as part of an extensive collaborative effort of Association member firms to share their thinking about recommended practices and to standardize to the greatest extent possible those practices, so that market participants have a common framework for evaluating and understanding the role and function of fixed income research and the various disclosures made by member firms. The Guiding Principles articulate voluntary recommendations that are not intended to be a set of immutable rules. They are not intended to replace the need for individual member firms to develop and implement their own tailored procedures. They are designed, however, to serve as a helpful reference point as firms review and modify their own fixed income research practices.

The principles-based approach embodied in the Guiding Principles will help to ensure that the differing organizational structures and geographical markets of Association member firms, their varied uses of fixed income research, as well as the unique attributes of the fixed income markets (even within and among the multiple asset classes that comprise the global bond markets) are appropriately reflected in the specific fixed income research policies and practices adopted by individual member firms. In our view, this is the best and most efficient way to ensure a behavioral framework that promotes reliable information flow to debt market participants, including investors and issuers.

Although much of the public and regulatory focus in recent years has been in the area of equity research, the Association believes it is critically important to address the issue of research integrity in the fixed income markets in a manner that takes into account their unique characteristics. Differences from the equity markets such as the quantitative emphasis of fixed income research, the importance of objective benchmarks and relative values, the existence of independent

research resources, the important role of the sales and trading function in producing relevant high-quality information for investors, and the sophistication of market participants warrant a unique approach than from that employed to manage potential conflicts of interest involving equity research, as the regulatory community has itself repeatedly acknowledged. Nevertheless, the Association believes it is incumbent on firms to manage potential conflicts that fixed income research analysts may face in connection with both investment banking and sales and trading concerns by taking steps to prevent inappropriate influences over fixed income research and to disclose to investors the existence of material potential conflicts.

The Board acknowledges that member firms will continue to devote much time and effort in the months ahead as they review these Guiding Principles and implement or modify their own policies and procedures to promote the integrity of fixed income research. We hope these recommendations are helpful to all market participants. It is in that spirit that we have produced these Guiding Principles.

Respectfully submitted,



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# **Guiding Principles to Promote the Integrity of Fixed Income Research**

## **A Global Approach to Managing Potential Conflicts of Interest**

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### **1. Introduction and Overview of Fixed Income Research**

#### **1.1 The Association Recommends These Guiding Principles to Promote the Integrity of Fixed Income Research**

Over the last several years, the independence of research analysts and the conflicts of interest that they face have come under intense public scrutiny. There has been a global effort to address potential conflicts of interest affecting the production and dissemination of research, with regulators in almost all developed market economies enacting new rules related to research analyst conflicts of interest.<sup>1/</sup>

As early as 2001, the International Organization of Securities Commissions (“IOSCO”) created a task force to examine conflicts of interest faced by research analysts and to develop high-level principles that could be used as the basis for new regulations for research analysts in all IOSCO jurisdictions. In September 2003, IOSCO’s Technical Committee issued its Statement of Principles for Addressing Sell-Side Securities Analyst Conflicts of Interest.<sup>2/</sup> The Technical Committee’s Statement of Principles sets forth fundamental principles and core measures that are intended to apply in all jurisdictions, regardless of their legal systems or level of market development. The Committee recognized, however, that “there is no ‘one-size-fits-all’ approach to addressing analyst conflicts of interest,” and that jurisdictions may vary in how the measures are implemented, taking into consideration their respective legal framework, legislative powers, and market characteristics.<sup>3/</sup>

Attention in the U.S. has focused on a series of high-profile investigations, Congressional hearings, and enforcement actions centering on the conflicts of interest that arise when a firm’s equity research analyst recommends a company’s stock in research reports or public appearances and, at the same time, the firm underwrites, or seeks to underwrite, that company’s stock offerings.<sup>4/</sup> U.S. lawmakers and securities regulators also responded to these developments through a series of policy and rulemaking initiatives. In May 2002, the Securities and Exchange Commission (“SEC”) approved rule amendments proposed by the New York Stock Exchange, Inc. (“NYSE”) and the National Association of Securities Dealers, Inc. (“NASD”) (collectively, the “SROs”) to address equity research analyst conflicts of interest.<sup>5/</sup> Shortly thereafter, in July 2002, the U.S. Congress enacted Section 15D of the U.S.

Securities Exchange Act of 1934, as amended (“Exchange Act”) to address specifically the conflicts of interest that may arise when securities analysts recommend stock in equity research reports and public appearances.<sup>6/</sup> In February 2003, the SEC adopted Regulation Analyst Certification (“Regulation AC”), which generally requires research analysts (including fixed income research analysts) to certify as to the truthfulness of the views they express and to disclose any compensation related to the specific views expressed in research reports.<sup>7/</sup> In July 2003, the SROs revised their rules regarding equity analysts to further address potential conflicts of interest by implementing additional restrictions mandated by Section 15D of the Exchange Act.<sup>8/</sup>

There have been a number of initiatives in the European Union (“EU”) to develop regulatory policy concerning research-related conflicts. In particular, the EU Market Abuse Directive<sup>9/</sup> provides a legislative framework requiring individual member states to put in place appropriate regulation to ensure the fair presentation of, and the disclosure of conflicts of interest in, both equity and fixed income research and certain other material intended for distribution to the public. The European Commission has adopted implementing measures setting the detailed standards which member states must apply under that Directive.<sup>10/</sup> In September 2003, the Forum Group to the European Commission issued principles and recommendations relating to European securities research.<sup>11/</sup> It is expected that the proposed new EU Directive replacing the existing Investment Services Directive will include provisions for more detailed rules at the EU level specifying how investment firms should identify, prevent, manage, and/or disclose conflicts of interest, including conflicts relating to fixed income and equity research.<sup>12/</sup>

Alongside the developing EU framework, regulators in several individual European jurisdictions, such as France, Germany, Italy, Sweden and the U.K., have proposed or implemented their own regulations regarding research-related conflicts of interest.<sup>13/</sup> Most recently, in October 2003 and March 2004, the U.K. Financial Services Authority (“FSA”), following earlier consultations on this subject, adopted rules and guidance addressing conflicts of interest in relation to the production of research, covering both fixed income and equity research.<sup>14/</sup> The rules adopted by FSA, among other things, require firms that publish or distribute research that is held out as an impartial assessment, or that may be reasonably relied on as an impartial assessment, to establish and implement a policy for managing effectively conflicts of interest which might affect the impartiality of that research. The rules also impose new requirements on firms regarding dealing ahead of research.<sup>15/</sup>

Outside of the EU, regulators in Canada, Asia, and Australia have addressed analyst conflicts of interest issues, proposing or adopting new regulations to promote the integrity of the research process.<sup>16/</sup>

These global regulatory developments have prompted Association member firms to evaluate proactively their management of potential conflicts of interest issues related to fixed income research.<sup>17/</sup> Our members recognize that potential conflicts of interest can arise in the preparation of fixed income research, although the nature and intensity of such conflicts differ materially from those that may arise in the preparation of equity research. Specifically, potential conflicts of interest or the appearance of conflicts can arise when a fixed income research analyst: (1) is subject to any material influence (external or internal) that inhibits his or her ability to produce an impartial assessment of the subject matter discussed in a fixed income research report; or (2) performs certain non-research functions that reasonably could lead an intended recipient of the research to question the fixed income research analyst's independence.<sup>18/</sup>

As the regulatory community has acknowledged, the existence of potential conflicts does not necessarily mean that a research analyst is biased, or that the analyst's research is flawed.<sup>19/</sup> *Nevertheless, the Association believes that it is incumbent on firms to identify and manage potential conflicts of interest that research analysts may face, in order to actively promote the integrity of fixed income research.* This process might include: (1) developing a robust understanding of fixed income research and other written communications to investors that involve an assessment of the value of a fixed income security, including (a) the preparation, supervisory review, and distribution of research, (b) analyst compensation and incentive policies, (c) information flows (both internally and externally), and (d) organizational structure; (2) clarifying the role and function of fixed income research analysts, investment bankers, and sales and trading personnel in this process; (3) identifying where material potential conflicts of interest may exist, and managing those conflicts through some combination of (a) information barriers, (b) removal of distracting incentives that can unduly affect the impartiality of fixed income research, (c) clear and prominent disclosures to the intended recipients of fixed income research, or (d) structural organizational change; and (4) developing written policies and procedures to document these management controls.

These Guiding Principles reflect the collective thinking of multi-service financial institutions that are members of the Association and that prepare and publish fixed income research. They are intended to complement the existing global regulatory framework governing fixed income research and other communications with the public and to assist Association member firms in their efforts to promote the integrity of fixed income research. Even where there are no specific rules regulating fixed income research, the regulatory regimes in many jurisdictions contain rules, principles, and guidelines that apply to fixed income research, and that govern fair conduct and the management of potential conflicts arising in the context of both investment research and communications with the public generally.<sup>20/</sup>

## **1.2 The Guiding Principles Recognize that Fixed Income Research and Equity Research Differ in Several Critical Respects**

Much of the regulatory and public attention has focused on the conflicts of interest that arise in relation to equity research. However, fixed income and equity research differ significantly, and the Association strongly believes it would be inappropriate and impractical to superimpose on the fixed income markets exactly the same behavioral and organizational framework that has been created to address potential conflicts of interest that arise in the equity markets.<sup>21/</sup> While the Association believes the research-related conflicts of interests identified in the equity markets are instructive for handling potential research-related conflicts of interest in the fixed income markets, there are well-recognized and critical differences between fixed income and equity research that affect the potential for, and the intensity of, any conflicts of interest.

Among other factors, these differences pertain to: (1) the nature and content of fixed income research and its lesser potential to materially affect the price of individual securities; (2) the existence of credit rating agencies and other sources of credit research, which provide investors and other market participants with an independent source of information regarding the relative creditworthiness of debt securities and issuers; (3) the nature of investment banking relationships with issuers of debt securities, especially with regard to the primary offering process;<sup>22/</sup> and (4) the predominantly institutional, rather than retail, nature of the recipients of fixed income research.<sup>23/</sup> In addition to the differences between fixed income and equity research, there are important differences among the types of fixed income research that are produced regarding individual asset classes.<sup>24/</sup> The Association believes that all of these distinctions substantiate the merits of developing a standardized framework that is principles-based and can be tailored to the specific and unique aspects of fixed income research and the particular asset class covered. In addition, a principles-based approach respects the global nature of the fixed income markets, where bonds often are traded in multiple jurisdictions with differing legal and regulatory structures.

### **1.2.1 The Nature and Role of Fixed Income Research Differ Markedly from Those of Equity Research**

Fixed income research analysts play an important role in informing the marketplace about particular issuers or securities. Indeed, such analysts and the research they provide are critical in promoting market efficiency in the fixed income price discovery process. However, in contrast to the equity markets, where the views expressed in research reports may directly affect an issuer's share price, the prices of most debt securities

are, by nature, relatively less sensitive to the views of a particular analyst. This is because the value of debt securities is more objectively determined by macroeconomic factors, such as interest rates, the credit standing of the issuer, the promised coupon or yield of the specific instrument, historical “spreads,” and the existing or anticipated supply of “fungible” debt securities. Debt securities with similar terms, if issued by issuers of the same credit standing, are to some extent considered “fungible” and are often priced in relation to standard benchmark securities or interest rate measures. Prices, therefore, typically are affected heavily by objective external market factors, such as changes in interest rates, whether caused by a change in monetary policy by a central bank or by market perceptions.

Accordingly, a critical component of the research (particularly the relative value research) that is relevant to fixed income investors is macroeconomic in nature and focuses on trends in interest rates, prevailing market prices, and other economic developments as they affect the relative valuation of different types of debt securities. In some cases, fixed income research analyzes classes of bonds within asset classes, or in comparison to other asset classes, without reference to particular fixed income securities. Because research of this type is not focused on or issued in connection with individual bonds of a particular issuer, it generally is unlikely to impact the market position of individual issuers and generally does not directly affect the ability of the analyst’s firm to obtain investment banking business. When fixed income research does focus on individual credits or securities, it often is oriented around a “relative value” analysis that considers the price or value of a security relative to debt securities issued by other entities. Indeed, a single debt issuer may issue a variety of different types of debt securities (*e.g.*, secured or unsecured), each with its own structural dynamics -- the prices of which are likely to respond differently to interest rate-related or credit-related information.

The importance of understanding the structure of a specific debt security and its fit within an asset class means that issuer fundamentals play a relatively less significant role in fixed income research than in equity research.<sup>25/</sup> Similarly, the issuer’s ability to service its debt and to maintain its current financial coverage ratios are generally much more relevant to bondholders than future earnings projections (although, in the case of non-investment grade companies, future revenues, cash flow, and earnings outlook are equally relevant). With respect to a large percentage of debt securities, all market participants, whether investors, salespeople, traders, investment banking personnel, or issuers, need to understand the issuer’s debt capital structure in order to make informed

decisions about bond trades and to bring to market debt securities that meet issuer and investor demands. It is critical, therefore, for fixed income research analysts to work with all constituencies, particularly sales and trading personnel, in gathering, synthesizing, and interpreting prevailing market information, such as current yields, spreads, and fungible fixed income securities in order to obtain accurate valuations of and/or pricing information for many debt securities.

In addition to employing fixed income research analysts who prepare and publish research reports, firms often employ individuals to provide analytical support for fixed income trading desks because fixed income traders constantly need such information to perform their trade execution and/or market making functions and to provide liquidity to investors. Although these trading desk personnel are principally responsible for supporting the desk, they, as well as the traders themselves, may generate trader commentary, trade ideas, and other analyses for the desk's counterparties. These communications support the desk's trade execution and/or market making function and provide counterparties with valuable information that can be obtained only from someone who is closely associated with current trading activity. For example, such communications might include "color" about trading volume, market sentiment (*e.g.*, whether market participants are hedging, taking profits, etc.), supply, prevailing market prices, and relative value. Counterparties generally understand that such trader commentary, trade ideas, and other analyses produced by trading desk personnel are part of the trading desk's trade execution and/or market making function and are not "research reports" prepared by fixed income research analysts. They also understand that, because the debt markets are principal markets, trading desk personnel typically write about securities in which the desk has a position and in which it will trade as principal; accordingly, these counterparties generally understand that the trading desk may have an interest in the securities that are the subject of the trader commentary and that the commentary should not be relied upon as impartial.<sup>26/</sup>

### **1.2.2 Credit Rating Agencies Play an Important Role in the Fixed Income Markets by Providing Investors with an Independent Source of Information Regarding Issuer Creditworthiness**

Credit rating agencies play an important role in the fixed income markets by providing investors and other market participants with an independent source of information regarding the relative creditworthiness of debt and other fixed income instruments as well as



various corporate and other debt issuers.<sup>27/</sup> For almost a century, credit rating agencies have been providing opinions on the creditworthiness of issuers of fixed income securities and their financial obligations.<sup>28/</sup> In cases where an issuer's credit standing is an important element in determining price, investors routinely factor into the price discovery process the ratings assigned by recognized rating agencies. Although the degree of reliance on ratings as a determinative source of information differs among asset classes, the Association believes that the current system functions reasonably well and that ratings issued by the major rating agencies have proved to be a reliable source of independent information for the fixed income markets.<sup>29/</sup>

At the same time, it is important to appreciate that credit ratings remain only one source of information available to market participants about credit quality. An increasing number and variety of independent research firms provide information and analyses relevant to the debt markets and its participants.<sup>30/</sup> In addition, most buy-side firms that are active in the debt markets conduct their own intensive credit analyses for internal risk management purposes, including the maintenance of adequate capital, and for purposes of identifying pricing discrepancies in conducting trading operations.<sup>31/</sup> Accordingly, the reasoned and categorical assessments of the relative creditworthiness of debt securities and issuers generated by rating agencies and independent research firms, coupled with market forces, provide an important independent resource for investors and other participants in the fixed income markets.<sup>32/</sup> These resources also provide an independent "check" on the accuracy and reliability of "sell-side" fixed income research.

### **1.2.3 In Contrast to Equity Research, the Potential to Attract or Retain Issuer Clients Through the Publication of Favorable Research Is Diminished in the Fixed Income Markets**

As discussed above, the root of the conflict between equity research and investment banking functions derives from the nature of the investment banking relationship and its importance to issuers and underwriters of equity securities. Particularly with regard to initial public stock offerings, obtaining a lead underwriter position can be enormously valuable to an investment bank, because of the compensation that is directly related to the engagement and because of the basis that the engagement often forms for a continuing investment banking relationship with the issuer.

Fixed income markets comprise a significantly larger range of issuers, such as governments (including emerging markets sovereigns), supra-

national and national agencies, and corporations. In the case of government and agency issuers, there is significantly less potential (as compared to the equity markets) to establish an investment banking relationship or otherwise attract or retain issuer clients through the publication of favorable fixed income research regarding that issuer.<sup>33/</sup> Indeed, many government, agency, sovereign and sub-sovereign offerings are conducted through a competitive bid process, where the underwriters that provide the lowest bids are selected by the issuer -- regardless of any relationships that may exist between the issuer and the firm.<sup>34/</sup>

In the case of corporate issuers, the potential to attract or retain issuer clients through biased fixed income research is also diminished (in comparison with the equity market) for a number of reasons. First, the prices of most corporate debt securities largely are influenced by objective external market factors and, therefore, research reports regarding such securities are less likely to materially affect their prices. In any event, except in the context of debt restructurings, debt repurchases and repeat issuances, secondary market prices for corporate debt securities are unlikely to impact directly the interests of issuers, which are uniquely focused on their "cost of funds." Moreover, as a general matter, corporate bond issuers and their management select underwriters based on the firm's ability to provide liquidity and the breadth of its distribution capabilities in an offering. In addition, the personal incentives that may be created by securities-based compensation (*e.g.*, stock options) for issuer management to pressure firms or their research analysts to issue unduly optimistic research to boost securities prices are absent in the corporate bond markets.

#### **1.2.4 The Majority of Fixed Income Research Is Provided to Sophisticated Market Participants Who Have Access to Multiple Research Sources and Often Employ Their Own Research Staff**

The great bulk of fixed income research is directed and disseminated to sophisticated market participants who view it as one of many sources of information to consider when they make investment decisions. This fact derives in part from the reality that trading and investing in debt securities is largely an institutional endeavor.<sup>35/</sup> Further, the fact that fixed income research focuses on macroeconomic issues, yield spread relationships among different classes of bonds, and other technical factors, means that it is primarily of value to sophisticated and

professional market participants who understand how to utilize this information in making trading decisions.

The sophisticated nature of the majority of fixed income research recipients reduces the likelihood that they will rely exclusively on any single piece of research in making investment decisions or not fully understand the nature and role fixed income research plays in a multi-service sell-side financial institution.<sup>36/</sup> These market participants have access to many sources of information in making investment decisions; indeed, they often employ their own research staff to analyze issuer credit and the economics of individual investments. Further, these participants typically maintain relationships with, and access research from, a number of financial services institutions. As a result, the ability of any one fixed income research piece to influence investment decisions is muted.<sup>37/</sup>

### **1.3 Recognizing These Differences, the Guiding Principles Are Designed to Supplement the Existing Legal and Regulatory Framework and to Promote the Integrity of Fixed Income Research**

These Guiding Principles have been carefully crafted to recognize the significant differences between fixed income research and equity research discussed above, as well as the important differences in research regarding individual fixed income asset classes. The Association believes that, coupled with the existing regulatory framework for addressing analyst conflicts and communications, these Guiding Principles will not only provide Association member firms with appropriate guidelines for promoting the integrity of the fixed income research they distribute, but also enhance investor understanding of, and confidence in, the fixed income markets.

## **2. Executive Summary of Guiding Principles**

The Association believes that it is critical to establish a behavioral and organizational framework for fixed income research that promotes an independent information flow to debt market participants. These Guiding Principles reflect an extensive, collaborative effort of Association member firms to share their thinking about these issues and to standardize, to the greatest extent possible, a framework designed to identify, and eliminate or manage, potential conflicts of interests relating to fixed income research. As a general matter, these Guiding Principles reflect the Association's belief that potential conflicts of interest can and should be addressed through a combination of supervision, internal controls, and effective disclosure to the marketplace.

Many of these Guiding Principles focus on recommended measures and safeguards designed to foster a firm culture that promotes the integrity of fixed income research and the ability of fixed income research analysts to express their views without inappropriate pressure from investment bankers, other non-Research Department personnel (including traders and salespeople), and issuers. In that regard, Guiding Principle 4.1 seeks to advance such a culture by recommending that firms prohibit promises of favorable fixed income research in exchange for the receipt of business or compensation, prohibit retaliation against analysts, and assure that research coverage decisions are made by fixed income research personnel. Guiding Principle 4.2 recommends additional measures to protect fixed income research analysts from review, pressure, and control by persons involved in investment banking services. Guiding Principle 4.3 seeks to promote the integrity of fixed income research reports by recommending that firms specifically: (1) restrict the ability of non-Research Department personnel (including traders and salespeople) and issuers to review or approve draft research reports; and (2) prohibit such review or approval by investment bankers.

The Guiding Principles also address situations where the activities or interests of the fixed income research analyst may raise concerns about potential conflicts of interest. Accordingly, Guiding Principle 4.4 recommends that analyst compensation be structured to promote analyst independence, and Guiding Principle 4.5 suggests that firms impose limitations on the personal trading activity of fixed income research analysts where appropriate. Guiding Principle 4.7 recommends that firms: (1) prohibit research analysts from participating in efforts to solicit business for investment banking services; and (2) restrict them from engaging in investment banking-sponsored marketing efforts or other investment banking-related activities with respect to a particular transaction.

Because the Association believes that investor awareness is an essential means of managing potential research analyst conflicts, Guiding Principle 4.6 recommends that firms and fixed income research analysts inform investors of potential conflicts of

interest that may affect fixed income research. In particular, Guiding Principle 4.6 suggests disclosures to address factors that may affect (or be perceived to affect) the independence of specific debt security recommendations. Similarly, Guiding Principle 4.9 recommends disclosures to assist investors in distinguishing fixed income research from analyses produced by trading desk personnel as part of their trade execution and/or market making functions.

Finally, the Association believes that fixed income research supervisors and senior management ultimately bear responsibility for evaluating the appropriateness of the Guiding Principles in light of their particular businesses and for taking steps to promote the integrity of fixed income research. Guiding Principle 4.10, therefore, urges firms to allocate sufficient resources to supervise fixed income research analysts and provide fixed income research analysts, managers, investment banking personnel and sales and trading personnel with periodic training on research independence, applicable legal and regulatory requirements, and potential conflicts of interest.

Although many of the Guiding Principles outlined above focus on the potential conflicts of interest between fixed income research and investment banking activities, it is important to emphasize that the Guiding Principles are not so limited. They also begin to address potential sources of conflict that fixed income research analysts may face with respect to other analyst or firm interests and activities, such as sales and trading. In that regard, Guiding Principle 4.1 recommends that firms prohibit promises of favorable fixed income research in exchange for the receipt of any business or compensation, including business or compensation for sales and trading activities. It further recommends that firms prohibit retaliation where a fixed income research report or an analyst's public appearance may adversely affect the firm's sales and trading interests. Guiding Principle 4.3, in turn, recommends that firms: (1) prohibit all non-Research Department personnel, including sales and trading personnel, from improperly influencing fixed income research analysts; and (2) restrict such personnel from reviewing or approving draft fixed income research reports prior to publication.

Guiding Principle 4.4 addresses specific situations where a fixed income research analyst's personal interests with respect to a firm's sales and trading activities may raise concerns about potential conflicts of interest. In particular, this Guiding Principle recommends that firms prevent fixed income research analysts from receiving compensation based on the success of or revenues derived from any specific sales and trading activity. To further address situations where a fixed income research analyst's or the firm's interests with respect to sales and trading activities may present potential conflicts, Guiding Principles 4.6, 4.8, and 4.9 recommend that firms and analysts inform investors of those conflicts. Notably, Guiding Principle 4.8 recommends other, specific measures to address potential conflicts relating to a firm's trading desk, such as prohibitions on improperly trading securities and related derivative securities ahead of the publication of fixed income research reports.

Ultimately, these Guiding Principles are designed to assist Association member firms in establishing or modifying their individual policies and procedures to address potential conflicts of interest relating to fixed income research activities and their fixed income research analysts. They are intended to supplement, and not replace or modify, the statutes, governmental regulations, or other rules (including those of exchanges, boards of trade, or self regulatory organizations) that apply to Association members. These Guiding Principles are not intended to represent a “one-size-fits-all” template for managing all potential conflicts of interest that multi-service financial services institutions may face,<sup>38/</sup> nor are they intended to serve as a “code of conduct” to be rigidly and uniformly applied across the spectrum of Association member firms regardless of the firm’s size, investor base, or the type of asset class research that is published. Instead, they are intended to provide suggested guidance that firms can use as a reference point in creating policies and procedures appropriate for their own businesses. As is true of any voluntary industry initiative, the Guiding Principles are not a substitute for the policies and procedures of individual firms, which necessarily must be tailored to their business activities, corporate structures, local regulatory requirements, and other circumstances.

## Summary of the Guiding Principles

1. **Firms should promote the integrity of fixed income research and the ability of fixed income research analysts to express their own independent views.** In particular, firms should implement prohibitions on promising favorable research, implement prohibitions on retaliation for research that may adversely affect investment banking or sales and trading interests, and ensure that decisions regarding research coverage are made by Fixed Income Research Department personnel.
2. **Supervisory and management structures should insulate fixed income research analysts from review, pressure, and control by investment banking personnel.** In particular, firms should implement appropriate reporting line structures, ensure that fixed income research analyst evaluations are not carried out by investment banking personnel, and consider physical separation of research from other functions, where appropriate.
3. **Firms should take measures to prevent inappropriate influence by non-Research Department personnel and issuers over the content of fixed income research reports and the timing of their publication.** In particular, firms should implement firm-wide prohibitions on improperly influencing fixed income research analysts, and implement restrictions on review or approval of draft research reports by non-Research Department personnel and by issuers.
4. **Fixed income analysts should be compensated in a manner designed to promote their independence.**
5. **Firms should impose personal trading restrictions on fixed income research analysts to manage potential conflicts of interest.**
6. **Firms and fixed income research analysts should inform investors of potential conflicts of interest that may affect fixed income research.**
7. **Fixed income research analysts should not act as marketers or solicitors of investment banking services.**
8. **Firms should manage potential conflicts of interest relating to their trading desks and the publication of fixed income research.** In particular, firms should establish mechanisms to prevent research from being prejudiced by the firm's trading activities, implement prohibitions on improperly trading securities ahead of fixed income research reports and disclose potential conflicts.
9. **Trader commentary, trade ideas, and other analyses produced by trading desk personnel must be clearly identified as such, and as not being produced by the fixed income research department.**
10. **Firms should allocate sufficient supervisory resources to promote the integrity of the fixed income research process.** In particular, firms should establish appropriate written policies and procedures to supervise research analysts and provide periodic training.

### **3. Scope of Application and Defined Terms**

#### **3.1 Scope of Application**

These Guiding Principles are intended to assist all Association member firms that prepare and publish fixed income research as they establish or modify their individual policies and procedures for the conduct of fixed income research activities.<sup>39/</sup> The Association recognizes, however, that not all types of fixed income research present the same potential for conflicts of interest and that modifications to the Guiding Principles may be necessary for different types of research. Accordingly, Section 5 below provides members with some guidance regarding the appropriate application of the Guiding Principles to fixed income research in the case of specific asset classes and categories of securities.<sup>40/</sup>

These Guiding Principles derive from the experience and expertise of Association member firms primarily with respect to fixed income research activities in Europe and the U.S. However, the Association has not attempted to identify the specific modifications that might be appropriate for fixed income research activities conducted in each jurisdiction. The Association recognizes that jurisdictions vary in how they address potential conflicts of interest, and that firms operating globally must consider the particular legal and regulatory framework, market characteristics, and industry practices of each jurisdiction in which they operate. In this context, the Association believes that it is even more important to embrace an approach based on principles that firms can apply in light of their particular circumstances, rather than one based on detailed rules. Such an approach will best enable firms to accommodate the variations in law and practice that exist.

#### **3.2 Definitions Relating to Fixed Income Research Reports and Fixed Income Research Analysts**

For purposes of the Guiding Principles, the following terms have the following meanings:<sup>41/</sup>

##### **3.2.1 “Fixed income research report” or “research report”**

“Fixed income research report” or “research report” means a written or electronic communication that includes an analysis of a debt security or a debt issuer and provides information reasonably sufficient upon which to base an investment decision.<sup>42/</sup>

“Fixed income research reports” do not include the following types of communications:<sup>43/</sup>



- 3.2.1.1 Trader commentary, trade execution ideas, and other written or electronic analyses prepared for a current or prospective investor or counterparty (or group of current or prospective investors or counterparties) by a salesperson, trading desk employee, or other non-Research Department employee who is not engaged principally in the preparation or publication of communications that otherwise would be considered fixed income research reports.<sup>44/</sup> These communications, however, *are not excluded* from the definition of “fixed income research report” if: (1) they are identified or marketed as “fixed income research reports;” (2) such trading desk employee or other non-Research Department employee is identified or marketed as a “fixed income research analyst” or member of the “Fixed Income Research Department;”<sup>45/</sup> or (3) they are otherwise held out as being impartial analyses of the debt security or debt issuer concerned or it is reasonable, given all of the facts and circumstances, for the intended recipients to rely on them as such.<sup>46/</sup>
- 3.2.1.2 Reports commenting on economic, political or market conditions without any analysis or recommendation of a specific debt security or debt issuer;
- 3.2.1.3 Reports commenting on particular types of debt securities or asset classes, or characteristics of debt securities or asset classes, without any analysis or recommendation of a specific debt security or debt issuer;
- 3.2.1.4 Technical analysis concerning the demand and supply for an asset class, index or industry based on trading volume and price without any analysis or recommendation of a specific debt security or debt issuer;
- 3.2.1.5 Reports that discuss broad based indices without any analysis or recommendation of a specific debt security or debt issuer;
- 3.2.1.6 Reports that recommend increasing or decreasing holdings in particular industries, asset classes or types of securities without any analysis or recommendation of a specific debt security or debt issuer;

- 3.2.1.7 Statistical summaries of multiple companies' financial data (including listings of current ratings) that do not include any analysis of individual companies' data;
- 3.2.1.8 Any analysis prepared for a specific person or a limited group of fewer than fifteen persons;<sup>47/</sup>
- 3.2.1.9 Periodic reports or other communications prepared for investment company shareholders or discretionary investment account clients discussing past performance or the bases for previously made discretionary investment decisions;
- 3.2.1.10 Internal communications that are not given to investors; or
- 3.2.1.11 Ratings and research produced by credit rating agencies, such as recognized statistical rating organizations in the U.S.

**3.2.2 "Analyst," "fixed income research analyst," and "research analyst"**

"Analyst," "fixed income research analyst," and "research analyst" mean a member of the firm's staff who is principally responsible for, and any other member of staff (other than a clerical or administrative employee) who reports directly or indirectly to such a research analyst in connection with, the preparation of the substance of a "fixed income research report" (as that term is defined in Section 3.2.1), whether or not any such person has the job title of "research analyst."<sup>48/</sup>

**3.2.3 "Fixed income research analyst account"**

"Fixed income research analyst account" means any account in which a fixed income research analyst or a member of the fixed income research analyst's household (as that term is defined in Section 3.2.5 below) has a financial interest, or over which the fixed income research analyst has discretion or control, other than the following: (1) an account with an investment company or fund that is subject to local investment company laws or regulations; and (2) fully discretionary or managed accounts.<sup>49/</sup>

### **3.2.4 “Fixed Income Research Department” or “Research Department”**

“Fixed Income Research Department” or “Research Department” means any department or division, whether or not identified as such, that is principally responsible for preparing the substance of fixed income research reports on behalf of a firm.<sup>50/</sup>

### **3.2.5 “Member of a fixed income research analyst’s household”**

“Member of a fixed income research analyst’s household” means any individual whose principal residence is the same as the fixed income research analyst’s principal residence, but does not include a roommate, apartment mate, or other unrelated person who shares the same residence if that person is not financially dependent on the fixed income research analyst and the analyst is not financially dependent on that person.<sup>51/</sup>

## **3.3 Definitions Relating to Investment Banking Services and Investment Banking Personnel**

For purposes of these Guiding Principles, the following terms have the following meanings:

### **3.3.1 “Investment banking services”**

“Investment banking services” include acting as an underwriter or selling group member in an offering (debt or equity) for an issuer; acting as a financial adviser in a merger or acquisition; providing venture capital, equity lines of credit, private investment in public equities (“PIPEs”), or similar investments;<sup>52/</sup> or serving as placement agent for a debt issuer.<sup>53/</sup>

### **3.3.2 “Investment banking personnel”**

“Investment banking personnel” are firm personnel principally engaged in investment banking services (as that term is defined in Section 3.3.1 above). This term also includes all firm personnel who are directly or indirectly supervised by such persons (other than clerical and administrative employees) and all personnel who directly or indirectly supervise such persons, up to and including investment banking

management, but not including senior management of the firm or fixed income department who are not significantly involved in the day-to-day management of investment banking services provided by the firm or who otherwise have as their principal job function the management of sales and trading department personnel.<sup>54/</sup>

### **3.3.3 “Debt issuer” or “issuer”**

“Debt issuer” or “issuer” means any sovereign or municipal government, government agency or instrumentality, corporation, partnership or similar entity that issues for sale to investors one or more classes of debt securities. For purposes of these Guiding Principles, it does not include any limited purpose or variable interest trust or other bankruptcy-remote entity created for the express purpose of issuing a class or classes of fixed income securities collateralized by a defined group of assets.<sup>55/</sup>

## **4. The Guiding Principles: Analysis and Commentary**

### **4.1 Firms Should Promote the Integrity of Fixed Income Research and the Ability of Fixed Income Research Analysts to Express Their Own Independent Views**

#### **4.1.1 Prohibition on Promising Favorable Fixed Income Research**

Firms should prohibit all personnel from directly or indirectly offering (or threatening to change) favorable fixed income research coverage, specific investment conclusions, or specific recommendations as consideration or inducement for the receipt of any business or compensation.<sup>56/</sup>

#### **4.1.2 Prohibition on Retaliation for Fixed Income Research that May Adversely Affect the Firm's Investment Banking or Sales and Trading Interests**

Firms should prohibit retaliation by the firm or any of its employees against a fixed income research analyst for writing a fixed income research report or making a public appearance because the report or appearance may adversely affect the firm's present or prospective investment banking relationship with the relevant issuer or the firm's sales and trading interests.

This recommendation is not intended to limit a firm's or any person's authority to discipline or terminate a fixed income research analyst for any cause *other than* writing a research report or making comments in a public appearance that may adversely affect the firm's investment banking relationships or sales and trading interests.<sup>57/</sup> For example, the Association believes that it is consistent with these Guiding Principles for a firm to choose to discipline a research analyst for preparing a research report about an issuer or specific debt securities that incorporates unsubstantiated facts, repeats rumors, makes negative statements without any reasonable basis, or otherwise violates firm policies, procedures, or standards (including quality standards) -- even if that report could be regarded as one that may adversely affect the firm's investment banking or sales and trading interests.<sup>58/</sup>

### **4.1.3 Decisions Regarding Research Coverage Should Be Made by Fixed Income Research Department Personnel**

Decisions regarding research coverage (*i.e.*, whether or not to initiate or cease publication of fixed income research reports regarding a particular issuer, fixed income asset class, or debt security) and the timing of publication should be made by a firm's Fixed Income Research Department.<sup>59/</sup> In making coverage decisions, it would not be inconsistent with this Guiding Principle if Fixed Income Research Department management were to consider input from various sources, including investors as well as managers of the firm's sales, trading, and investment banking departments.<sup>60/</sup> It also would not be inconsistent with this Guiding Principle for legal or compliance personnel to affect the timing of the publication of a research report due to legal or regulatory considerations.

## **4.2 Supervisory and Management Structures Should Insulate Fixed Income Research Analysts from Review, Pressure, and Control by Investment Banking Personnel**

Fixed income research supervisory and management structures should be organized to insulate research analysts from review, pressure, and control by investment banking personnel.<sup>61/</sup> Recognizing that there is a variety of organizational models among firms that prepare fixed income research, the Association does not intend to recommend any particular model that firms should follow, nor does it believe that a single organizational model would benefit investors. Firms should be permitted to compete and offer a diversity of services to investors in the manner and form of their own choosing. Moreover, the Association anticipates that the practical application of this Guiding Principle will recognize substantial variance in organizational structure based on a firm's size, diversity of business activities, the relevant fixed income asset class, and other similar factors.

### **4.2.1 Reporting Line Structure**

Reporting lines should generally be structured so that fixed income research analysts are not supervised or controlled by investment banking personnel. It would, however, be consistent with this Guiding Principle for a fixed income research analyst to report to the head of the firm's fixed income department or division or other senior manager who is ultimately responsible for oversight of investment banking and other firm functions.<sup>62/</sup>

#### **4.2.2 Fixed Income Research Analyst Evaluations**

Investment banking personnel should not perform, nor have input into, evaluations of fixed income research analysts. Similarly, decisions to fire, reward or discipline fixed income research analysts should not be made by investment banking personnel.<sup>63/</sup> However, consistent with these Guiding Principles, a firm may decide to allow investment banking personnel to participate in the interview process for hiring new research analysts, as long as the hiring decision is made by research management.

#### **4.2.3 Physical Separation Where Appropriate**

Physical separation can be one of a number of effective means for maintaining the functional separation of investment banking and fixed income research personnel. Where appropriate, physical separation should be maintained to enhance the functional separation of the Research Department from investment banking personnel and to control the flow of information between investment banking personnel and fixed income research analysts.<sup>64/</sup> The Association believes that the degree and manner of physical separation that is appropriate will differ depending on the size of the firm, the configuration of available space, the nature of the fixed income research, the relevant fixed income asset class, the nature of the investment banking services business, and other similar factors.<sup>65/</sup>

### **4.3 Firms Should Take Measures to Prevent Inappropriate Influence by Non-Research Department Personnel and Issuers over the Content of Fixed Income Research Reports and the Timing of Their Publication**

Firms should take reasonable measures to manage fixed income research analysts' interactions with non-Research Department personnel and issuer representatives in order to prevent either group from exercising inappropriate influence over the content or publication timing of fixed income research reports. In particular, firms should develop appropriate policies and procedures to control access to, and review of, draft fixed income research reports in order to promote the integrity of fixed income research.

#### **4.3.1 Firm-wide Prohibitions on Improperly Influencing Fixed Income Research Analysts**

Firms should prohibit all non-Research Department personnel from attempting to coerce fixed income research analysts to: (1) alter their views regarding the content of a research report or the timing of its publication; or (2) change the investment conclusions in a research report, other than as appropriate to

correct factual inaccuracies or verify market information such as prevailing market prices, or to ensure consistency with established firm policies.

In implementing this Guiding Principle, firms may appropriately recognize that fixed income research analyst interaction with trading desk personnel is a common and critical practice in the debt markets. Because the value and pricing of fixed income securities generally is determined by macroeconomic factors, such as interest rates, by historical “spreads,” and by reference to certain benchmark securities, it is critical for fixed income research analysts and debt traders to interact when gathering, synthesizing, and interpreting market information to obtain relative valuations of, and prevailing market prices for, debt securities. Such routine interactions would be consistent with this Guiding Principle, provided that they do not: (1) impair the fixed income research analyst’s ability to express independently and accurately his or her personal views about any and all of the subject securities or issuers in a research report; or (2) communicate to trading desk personnel the likely investment conclusion or timing of a fixed income research publication in a manner that would be inconsistent with the Guiding Principles set forth in Section 4.8.

#### **4.3.2 Restrictions on Review or Approval of Draft Research Reports by Non-Research Department Personnel**

Firms should prohibit non-Research Department personnel (except for legal and compliance personnel) from reviewing or approving draft fixed income research reports before publication, except that non-Research Department personnel, other than investment banking personnel,<sup>66/</sup> may review draft reports for the purpose of verifying the factual accuracy of information in those reports.<sup>67/</sup> The purpose and scope of any such reviews should be clearly articulated and monitored.<sup>68/</sup>

#### **4.3.3 Restrictions on Review of Draft Research Reports by Issuers**

Firms should not permit issuers to review draft fixed income research reports before publication other than for the purpose of verifying the factual accuracy of information in the reports.<sup>69/</sup> The purpose and scope of any such reviews should be clearly articulated and monitored. In addition, if a research report contains an investment conclusion, this information should be removed from the draft report that is provided to the issuer.



#### **4.3.4 Mechanisms to Review Certain Changes in Investment Conclusions**

In designing fixed income research policies and procedures, firms should consider adopting mechanisms to review material changes made to investment conclusions in a research report after the draft research report has been submitted to non-Research Department personnel or to an issuer for factual verification.<sup>70/</sup>

#### **4.4 Fixed Income Analysts Should Be Compensated in a Manner Designed to Promote Their Independence**

The analyst compensation process should be designed to promote fixed income research analyst independence and quality, and to eliminate pressures that might exert undue influence on a fixed income research analyst's research assessments.

##### **4.4.1 Compensation Criteria Consistent with this Guiding Principle**

The following is a non-exclusive list of factors for determining fixed income research analyst compensation that the Association views as consistent with this Guiding Principle:<sup>71/</sup>

- 4.4.1.1 the analyst's individual performance and productivity;
- 4.4.1.2 the overall quality and accuracy of the analyst's research;
- 4.4.1.3 evaluations by investing clients and firm employees (including salespeople, traders, and risk management personnel) other than investment banking personnel;
- 4.4.1.4 the outstanding principal amount and trading value of, the profitability of, and the potential interest of the firm's investing clients in research with respect to, the asset class covered by the analyst;
- 4.4.1.5 the analyst's seniority, reputation, and experience;
- 4.4.1.6 the market for hiring and retaining analysts;

- 4.4.1.7 the firm's overall performance (which may include, in part, the profitability of the investment banking department); and/or
- 4.4.1.8 the profitability or revenues of the firm's fixed income division or department.

#### **4.4.2 Compensation Criteria Inconsistent with this Guiding Principle**

The Association would not view as consistent with this Guiding Principle any incentive, bonus, or other form of compensation awarded to research analysts:

- 4.4.2.1 in return for expressing a specific view or recommendation about an issuer, security, or industry;
- 4.4.2.2 based on their ability to secure or maintain business for investment banking services;<sup>72/</sup>
- 4.4.2.3 based on an investment banking employee's evaluation;<sup>73/</sup> or
- 4.4.2.4 based on the success of, or revenues derived from, any specific investment banking transaction or specific sales and trading transaction, or on revenues derived from investment banking services provided to a specific issuer(s) or industry sector(s).<sup>74/</sup>

#### **4.5 Firms Should Impose Personal Trading Restrictions on Fixed Income Research Analysts to Manage Potential Conflicts of Interest**

Firms should adopt personal trading restrictions for fixed income research analysts and their household members (as defined in Section 3.2.5 above) to manage potential conflicts of interest that may arise when analysts or their household members have personal financial interests in issuers that the analyst covers and for which the analyst provides an investment recommendation.<sup>75/</sup> In developing such restrictions, firms should consider limiting fixed income research analyst accounts from trading in covered securities in a manner contrary to published recommendations.<sup>76/</sup> Firms also should consider imposing trading blackout periods on such accounts to prohibit trading for a period before and after the issuance of a research report by the analyst.<sup>77/</sup>

## **4.6 Firms and Fixed Income Research Analysts Should Inform Investors of Potential Conflicts of Interest That May Affect Fixed Income Research**

An essential element of any effort to manage potential conflicts of interest is making investors aware of such potential conflicts.<sup>78/</sup> Firms and research analysts should promote investor awareness of potential research analyst conflicts of interest by disclosing in fixed income research reports and/or elsewhere certain material factors that may be viewed as potentially affecting the integrity of specific security recommendations or investment conclusions.

### **4.6.1 Disclosures Regarding Potential Conflicts of Interest in Research Reports**

In addition to disclosures required by applicable law or regulation, firms should make the following disclosures in fixed income research reports, where applicable:<sup>79/</sup>

- 4.6.1.1 *Analyst Compensation.* Firms should disclose if a fixed income research analyst's compensation is based on, among other things, the firm's overall performance, including general investment banking services revenues, or the profitability or revenues of the fixed income department or division or of the asset class covered by the analyst.<sup>80/</sup>
- 4.6.1.2 *Analyst Ownership.* Firms should disclose if the analyst's fixed income research analyst account(s) has a financial interest in the security of the issuer (or in related derivatives) that is the subject of the research report (other than interests in investment grade sovereigns).
- 4.6.1.3 *Analyst Affiliations with the Issuer.* Firms should disclose if the fixed income research analyst or a member of the analyst's household is an officer, director, or advisory board member of the issuer that is the subject of the research report.
- 4.6.1.4 *Public or Rule 144A Offerings.* Firms should disclose if the firm or any of its affiliates has managed or co-managed a public or Rule 144A offering of securities for the issuer within the past twelve months.<sup>81/</sup>

4.6.1.5 *Principal Trading.* Firms should disclose if the firm trades or may trade as principal in the fixed income securities (or in related derivatives) that are the subject of the research report.<sup>82/</sup>

4.6.1.6 *Meaning of Ratings.* To the extent that a fixed income research report contains ratings established by the firm, the firm should define the meaning of any such ratings. The definition of each rating should be consistent with its plain meaning.<sup>83/</sup>

#### **4.6.2 Disclosures Regarding Potential Conflicts of Interest in Public Appearances**

Fixed income research analysts also should provide investors with information regarding potential conflicts of interest when making public appearances. To that end, Association member firms may want to consider policies and procedures that require fixed income research analysts to direct readers or viewers as to where they may obtain applicable, current disclosures in written or electronic format.

#### **4.6.3 Additional Disclosures Regarding Fixed Income Research**

Each firm should assess its own business model, the nature and level of sophistication of investors who receive its fixed income research reports, and the nature of the research involved to determine if additional disclosures regarding fixed income research are appropriate.<sup>84/</sup> For example, as discussed in Guiding Principle 4.8.2, in some contexts, firms should inform investors of the fixed income research process and the interaction among the fixed income research analyst, the trading desk, sales, and other constituencies in that process.

#### **4.6.4 Clear and Prominent Disclosure**

Any disclosures and references to disclosures should be clear, prominent and timely. Taking into consideration the relevant regulatory framework, Association member firms may consider using hyperlinks to provide disclosures for electronic research reports.<sup>85/</sup>

## **4.7 Fixed Income Research Analysts Should Not Act as Marketers or Solicitors of Investment Banking Services**

### **4.7.1 Prohibition on Soliciting Investment Banking Services Business**

Firms should prohibit fixed income analysts from participating in efforts to solicit business for investment banking services. Accordingly, research analysts should not participate in any “pitches” to current or prospective clients for investment banking services business, nor have any other communications with issuers for the specific purpose of soliciting investment banking services business.<sup>86/</sup>

For purposes of these Guiding Principles, an investment banking “pitch” means a presentation or showcasing of a firm’s investment banking services in a meeting or other communication between an issuer’s and firm’s representatives at which a potential investment banking services mandate is discussed.<sup>87/</sup> This definition would *not* include “due diligence” meetings or calls with representatives of issuers and/or investment banking personnel if the sole purpose of the meeting or call is to gather information relating to the issuer or the proposed investment banking services transaction.

### **4.7.2 Prohibition on Directed Participation in Investment Banking-Sponsored Marketing Efforts**

Firms should prohibit investment banking personnel from directing fixed income research analysts to engage in marketing efforts with respect to an investment banking services transaction.<sup>88/</sup> As a general matter, firms also should prohibit fixed income research analysts from actively participating in issuer- or investment banking-sponsored road shows related to a public offering or other investment banking transaction (*e.g.*, analysts should not participate in the road shows as presenters).<sup>89/</sup>

### **4.7.3 Participation in Certain Investment Banking-Related Activities Is Consistent with This Guiding Principle**

It is well-recognized that research analysts provide valuable services to issuers and investors by assisting their firms’ investment banking departments in performing certain functions, such as carrying out due diligence responsibilities, screening potential investment banking clients, informing firms and issuers of likely market reactions to proposed transactions, and assisting in the pricing and structuring of investment banking transactions.<sup>90/</sup> As a general matter, these incidental functions should not, in and of

themselves, create an impression that the analyst is biased or inhibited from producing impartial research. The Association believes it is consistent with these Guiding Principles and entirely appropriate for fixed income research analysts to continue to perform certain well-recognized, investment-banking-related activities traditionally associated with research functions that do not involve the solicitation of business for investment banking services, including but not limited to the following:<sup>91/</sup>

- 4.7.3.1 *Screening potential investment banking clients.* Fixed income research analysts often assist their firms in screening potential investment banking clients or potential deals (including, but not limited to, a collateral pool underlying a potential structured finance deal).
- 4.7.3.2 *Due diligence activities.* After a mandate has been received, fixed income research analysts often participate in “due diligence” activities, including meetings or calls with representatives of issuers and/or investment banking personnel. The Association believes that such participation is appropriate, provided that the purpose of the meetings or calls is solely to gather information relating to the issuer or the proposed transaction, and that appropriate measures are taken to prevent the misuse of non-public information.<sup>92/</sup>
- 4.7.3.3 *Passive attendance at road shows.* Fixed income research analysts often attend road shows regarding investment banking transactions in order to remain informed about the issuer or the specifics of the fixed income transaction, and thus to be on an equal footing with investor clients. The Association believes that such attendance is appropriate, so long as the analyst’s role is limited to that of a passive attendee.<sup>93/</sup> Association member firms that permit analysts to passively attend these road shows should establish policies and procedures designed to ensure that the attendance is passive and thus to avoid the appearance of participation in the road show.
- 4.7.3.4 *Educational efforts regarding investment banking transactions.* Fixed income research analysts often participate in meetings with the sales force and potential investors regarding proposed investment banking transactions. The Association believes that such participation is appropriate, provided that the analyst’s role in such meetings is solely to educate

investors and the sales force regarding aspects of the transaction about which the analyst is uniquely qualified to speak. To that end, analysts should present a fair and balanced view of the issuer and the proposed transaction by discussing negative aspects, as well as the positive ones.<sup>94/</sup>

4.7.3.5 *Widely-attended conferences.* Fixed income research analysts often participate in widely-attended investor or industry conferences attended by investment banking personnel and/or issuers, or in which investment banking personnel and/or issuers participate. The Association believes that such participation is appropriate, provided that the analyst does not participate in a manner that would lead one to reasonably conclude that the analyst is acting in a manner inconsistent with these Guiding Principles.<sup>95/</sup>

4.7.3.6 *Pre-deal research.* Because of the relatively fewer restrictions outside the U.S. on written communications in advance of an offering of securities, it has been common practice in the EU for firms to meet a demand for such research in relation to fixed income offerings, subject to policies and procedures designed to address the issues associated with such publication.<sup>96/</sup> Given the diversity of existing practices in the EU and the lack of consensus among market participants, the Association does not believe at this time that it can or should recommend a *per se* prohibition on pre-deal research outside the U.S., especially in circumstances where Association member firms adopt policies and procedures that address, among other things:<sup>97/</sup> (1) prohibitions on promises of favorable coverage (and requirements that decisions on coverage should remain with fixed income research department personnel); (2) the need to ensure the factual consistency of any pre-deal research with any related prospectus or selling document, to comply with the procedures relating to the review of draft research reports to ensure factual accuracy, and to avoid the inclusion of investment recommendations, price ranges or targets; (3) the inclusion of disclosures of the involvement of the firm in the transaction and of statements that investment decisions should be based on the prospectus or other selling document (and an indication of when and where that document will be available); (4) appropriate controls over the distribution of the research and, in appropriate cases, limits on the distribution of

research in a period immediately prior to the offering; and (5) the need to ensure that a research analyst is given access to material non-public information in connection with a proposed transaction only in accordance with appropriate “wall crossing” procedures and remains subject to the resulting restrictions until they expire.

#### **4.8 Firms Should Manage Potential Conflicts of Interest Relating to Their Trading Desks and the Publication of Fixed Income Research**

##### **4.8.1 General Principles**

Association member firms should establish mechanisms to prevent analysts’ research and recommendations from being prejudiced by the firm’s trading activities. In particular, these mechanisms should be designed to prevent traders and other firm personnel from taking unfair advantage of non-public information regarding a fixed income research analyst’s investment conclusions.<sup>98</sup>

This Guiding Principle is not intended to discourage routine interaction between fixed income research analysts and trading desks. The Association recognizes that, because the value and pricing of fixed income securities generally is determined by macroeconomic factors and by reference to certain benchmark securities, it is essential for fixed income research analysts and debt traders to interact when gathering, synthesizing, and interpreting market information to obtain accurate valuations of and prices for debt securities. For example, a fixed income research analyst may ask a sales and trading employee about the level of trading activity and/or various spread levels for a particular security, class of securities, or securities within an industry. Such an inquiry, no matter how frequent, should not, in and of itself, be inconsistent with this Guiding Principle because the analyst has not communicated any information regarding either the timing of publication or the specific investment conclusion of a fixed income research report, although one could infer from the analyst’s inquiry that a research report likely will be published at some point. As a general matter, the mere fact of an analyst’s interaction with a trader, in the normal course of events, should not necessarily be viewed as conveying knowledge of the timing or material investment conclusions contained in a pending research report; other facts and circumstances would be relevant to such a determination.

Association member firms should adopt policies and procedures that are designed to prevent traders and other firm personnel from using knowledge of either the timing of, or the material investment conclusions in, a pending fixed



income research report in order to take advantage of non-public information that reasonably can be expected to have an immediate impact on the price of the debt securities that are the subject of the research report (or derivative securities thereof).<sup>99/</sup> This means that, among other things, firms should prohibit traders from intentionally establishing or changing inventory positions in contemplation of the issuance of a material fixed income research report if they have advance knowledge of either its timing or material investment conclusions.<sup>100/</sup>

This Guiding Principle is not intended to restrict a firm's ability to trade securities in the normal course of its market making activities or in response to unsolicited order flow.<sup>101/</sup> In addition, it is not intended to apply to general market knowledge or expectations, but rather to traders' and other firm personnel's actual knowledge of non-public information regarding the content or the timing of a fixed income research report. Accordingly, these restrictions do not apply to any knowledge shared by the market, such as reasonable market expectations that research will be issued (*e.g.*, around the reporting of company results, or, if the research is issued pursuant to Rule 139 under the Securities Act of 1933, within the context of a regularly scheduled publication date in the normal course of business).

Association member firms subject to the rules of the FSA should adopt policies and procedures designed to ensure that traders and other firm personnel do not make use of any prior knowledge regarding the publication of fixed income investment research to trade ahead of such publication in a manner inconsistent with those rules.<sup>102</sup> This Guiding Principle is not intended to apply to any "prior knowledge" that is shared by the market, such as regular reporting or reasonable market expectations. For example, this Guiding Principle would not preclude trading merely because the relevant employees expect or think it likely that the fixed income research analyst will publish research in accordance with a company's regular reporting cycle.

#### **4.8.2 Disclosure of Potential Conflicts of Interest Relating to the Trading Desk**

As discussed in Guiding Principle 4.9.1, firms should disclose if the firm trades or may trade as principal in the fixed income securities that are the subject of the research report. In some contexts, firms should also inform investors of the interaction among the fixed income research analyst, the trading desk, sales, and other constituencies in that process.

#### **4.9 Trader Commentary, Trade Ideas, and Other Analyses Produced by Trading Desk Personnel Must Be Clearly Identified as Such, and as Not Being Research Produced by the Fixed Income Research Department**

Where fixed income trading desk personnel produce trader commentary, trade ideas, and other analyses for trading desk counterparties, firms should adopt appropriate mechanisms to ensure that investors understand that such materials are produced by the trading desk and are not fixed income research reports prepared by fixed income research analysts.

Firms that are subject to the rules of the FSA should be aware that, under the FSA's rules, if sales and trading material otherwise qualifies as "investment research," then merely identifying it as sales and trading material is not enough to exclude it from the FSA's definition of "investment research."<sup>103</sup> Where the material falls within that definition, the trading desk may not trade ahead of the publication of such material unless one of the limited exemptions from the FSA's conduct of business rule COB 7.3R applies. Firms subject to the FSA rules should consult their own counsel on whether particular material constitutes investment research subject to such rules.

##### **4.9.1 Disclosures for Material Produced by Trading Desk Personnel**

Firms should, at a minimum, make the following disclosures, where applicable, to inform investors of the nature of trader commentary, trade ideas, and other analyses issued by the firm's trading desk and to ensure that these are not held out as being prepared in accordance with the provisions of these Guiding Principles applicable to a fixed income research report (and that it would not be reasonable for those to whom they are distributed to rely on them as impartial):

- 4.9.1.1 Firms should disclose that the material is a product of the trading desk and not the Fixed Income Research Department, and that the views of the trading desk may differ from those of the Fixed Income Research Department.
- 4.9.1.2 Firms should disclose if the trading desk trades or may trade as principal in the securities that are the subject of such material (or in related derivatives). (This disclosure is also recommended in Section 4.6.1.)
- 4.9.1.3 Firms should disclose if the trading desk has or may have proprietary positions in the securities that are the subject of such material (or in related derivatives).

#### **4.9.2 Supervisory Procedures for Material Produced by Trading Desk Personnel**

Firms should adopt appropriate supervisory procedures to review the content, where appropriate, of trader commentary, trade ideas, and other analyses produced by trading desk personnel. These procedures should be designed to ensure that any such material is clearly distinguishable in appearance from fixed income research prepared by the firm's Fixed Income Research Department. In addition, these procedures should be designed to prevent trading desk personnel from being identified or marketed as "fixed income research analysts" or members of the firm's "Research Department." As set forth in the definition of "fixed income research report" above (Section 3.2.1), a communication by trading desk personnel might be considered a "fixed income research report" if it is identified or marketed as such, if the individual who prepares such communication is identified or marketed as a "fixed income research analyst," or if it is otherwise held out as being an impartial analysis of the debt security or debt issuer concerned (or it would be reasonable for those to whom it is distributed to rely on it as such).

#### **4.9.3 Heightened Procedures for Material That Is Distributed to Persons Who Are Not Institutional Investors**

Firms that do not limit their distribution of trader commentary, trade ideas, and other analyses to institutional or other sophisticated investors should consider whether heightened policies and procedures are necessary to promote investor understanding of the nature of these communications and the potential conflicts that may exist.

#### **4.10 Firms Should Allocate Sufficient Supervisory Resources to Promote the Integrity of the Fixed Income Research Process**

Firms should employ internal mechanisms to identify and address potential conflicts of interest that may unduly influence the research content, publication timing, and investment conclusions of fixed income analysts. Fixed income research supervisors and senior management bear the responsibility for ensuring the adequacy of such controls and procedures. To assist fixed income research supervisors and management in their efforts to identify and address potential conflicts of interest, firms should provide sufficient resources to promote the integrity of the fixed income research process.

#### **4.10.1 Firms Should Establish Appropriate Written Policies and Procedures to Supervise Fixed Income Research Analysts**

Firms should establish appropriate written policies and procedures to ensure appropriate supervision of fixed income research analysts for compliance with applicable rules and regulations and firm policies.<sup>104/</sup> In designing fixed income research policies and procedures, firms should consider the nature of their businesses, the type of fixed income research involved, and the nature and level of sophistication of the investors anticipated to receive their fixed income research reports.

#### **4.10.2 Firms Should Provide Fixed Income Research Analysts, Research Managers, and Investment Banking, Trading, and Sales Personnel with Periodic Training Regarding Fixed Income Research Conflicts of Interest**

Firms should adopt training modules for fixed income research analysts and their supervisors regarding the applicable legal and regulatory framework for fixed income research. Such modules also should address internal policies and procedures regarding potential conflicts of interest. Firms should also adopt training modules for investment banking, trading, and sales personnel regarding the legal and regulatory framework for fixed income research conflicts of interest and firm policy.

## **5. Commentary Regarding the Application of the Guiding Principles to Specific Fixed Income Products and Asset Classes**

The diversity of products, trading venues, asset classes and reference rate benchmarks in the global fixed income markets is a source of strength for our global economy. This diversity has led to a competitive and efficient debt capital raising framework that affords issuers the lowest cost of debt capital and investors with flexible choices to match their risk/return desires. As mentioned previously in these Guiding Principles, the Association does not believe a “one-size-fits-all” framework is either desirable or appropriate to promote the integrity of fixed income research. A principles-based approach, like these Guiding Principles, that serves as a set of recommended guidelines for Association member firms to consider is, therefore, the only workable alternative to achieve some level of standardized practices and behavioral transparency.

This Section 5 provides an overview of fixed income research in various contexts. It does not purport to be exhaustive, nor determinative of whether or not the definitions or the Association’s specific recommendations are applicable in any given context. While some of the Guiding Principles will be directly applicable to the fixed income products and asset classes described below, others will not. Nevertheless, despite the differences within the overall fixed income market -- whether precipitated by historical practices, geographical nuances, market structure, or a firm’s own approach to managing potential conflicts of interest -- the Association strongly believes that the Guiding Principles represent appropriate guidelines for all integrated sell-side institutions to utilize in preparing their own tailored policies and procedures for the preparation and publication of fixed income research.

### **5.1 Investment Grade Sovereigns**

This asset class includes short-term and longer-term bills, notes and bonds, and other direct obligations, of the U.S. government and other investment grade sovereign issuers. The market for these securities is unique, even within the larger fixed income markets, primarily because they have minimal perceived credit risk and generally enjoy an unparalleled degree of secondary market liquidity. They also serve as a vehicle through which central banks, as market participants, facilitate monetary policy.

The relationship between central government issuers of sovereign securities and the financial institutions that facilitate their distribution is similarly unique. Sovereign securities are typically (and in certain jurisdictions, exclusively) sold through auctions or some other competitive bidding process.

There is no equivalent to an underwriting discount in such offerings in the U.S., although there may be an underwriting discount in certain European offerings. Central government issuers generally concentrate their issuance programs around regularly scheduled offerings of fixed-rate instruments of standard benchmark maturities (*e.g.*, 2, 3, 5, and 10 years), although some jurisdictions also issue fixed-rate bonds with maturities of 30 years or longer. At the short end of the maturity spectrum, instruments are issued with maturities of normally less than one year. These bills are typically issued as zero-coupon instruments on a discount basis. Investors in developed government securities markets principally consist of wholesale domestic and foreign institutional investors (including central banks), but also include some retail participants.

Sovereign debt issuers typically rely heavily on a concentrated group of financial institutions who act as “primary dealers” to facilitate the distribution of securities in the primary market. Primary dealers are sometimes contractually obligated to participate actively and to bid meaningfully in any new offering of sovereign debt. However, the main function of intermediaries in the sovereign market is to place securities with investors and provide liquidity to the secondary markets. In many cases, primary dealers are critical participants in the secondary market and often act as market makers in sovereign debt securities.

Research reports in the sovereign market are primarily macroeconomic in nature, focusing on economic conditions, central bank monetary policy, the general interest rate environment (including the future shape of, and relationships between and among, various benchmark yield curves), and supply and demand characteristics in the marketplace as these may relate to instruments of a specified maturity (*e.g.*, 2-year Treasuries) or product structure (*e.g.*, inflation-indexed government bonds). Research reports in this asset class thus typically address market fundamentals, analyses and recommendations regarding particular investment and trading strategies, changes to model portfolios, and relative value commentary regarding other fixed income market sectors. As a consequence, many of these reports likely would fall outside the definition of “fixed income research reports” in the Guiding Principles.

## **5.2 Investment Grade Corporate Debt**

Corporate bonds that are rated BBB- or higher by Standard & Poor’s or Fitch, or Baa3 or higher by Moody’s, are widely considered “investment grade” (or “high grade”). Generally, investment grade bonds are priced in relation to some commonly agreed-upon reference rate and their performance is measured relative to that rate. Prices of investment grade corporate debt securities reflect spreads between their yields and the yield of the reference security or instrument having similar maturity characteristics, and on current

and anticipated changes in interest rates. Investment grade bond pricing is also dependent upon the securities' credit rating, industry group and maturity range, which drive yield and influence spread pricing.

Investment grade corporate research focuses largely on both the credit quality of the individual issuer (that is, the issuer's ability to make all interest and principal payments in full and on schedule) and macroeconomic factors, such as Treasury rates and yield curves. This research covers both individual issuers as well as broader industry sectors, and is principally directed to institutional investors.

### **5.3 High Yield Corporate Debt**

Bonds with a rating below BBB- or Baa3 are widely considered "high yield" bonds. Like investment grade corporate bonds, high yield bonds are generally priced in relation to some reference rate or instrument, although information concerning individual issuers factors more heavily into the determination of high yield bond prices. High yield securities are relatively more sensitive than investment grade bonds to real or perceived changes in the issuer's capacity to service its obligations. By definition, an issuer of high yield securities demonstrates material levels of financial leverage and is therefore more susceptible to external economic factors, such as increases in interest rates or deterioration in the economic environment that may affect its ability to repay principal and interest.

Nevertheless, in comparison to equity research, views expressed by a research analyst about a particular high yield security are relatively less likely to influence its price, because the prices of high yield corporate bonds are still more heavily influenced than equity securities by objective factors such as credit agencies' ratings, market interest rates and yields on other types of debt securities.

In the U.S., the recipients of high yield research are almost exclusively "qualified institutional buyers" ("QIBs") because the vast majority of high yield offerings occur pursuant to Rule 144A under the Securities Act. Similarly, outside the U.S. the recipients of high yield research are almost exclusively institutional investors as most high yield offerings are placed with institutional investors. These recipients typically regard high yield research as only one of many sources of information to consider in making investment decisions, and generally have substantial resources to conduct their own intensive credit analyses.

## 5.4 Emerging Markets Debt

Emerging markets research covers both investment grade and high yield debt, and typically falls into one of two categories: (1) sovereign credit research; or (2) corporate credit research. For the most part, emerging markets sovereign credit research shares the basic characteristics of other macroeconomic sovereign research (see Section 5.1), and emerging markets corporate credit research shares the basic characteristics of high yield corporate research (see Section 5.3).<sup>105/</sup>

Generally, emerging markets sovereign credit research focuses on macroeconomic factors, such as the spread between the sovereign bond's yield and the yield on the reference instrument, and anticipated changes in U.S. and global interest rates, as well as the fundamentals of the issuing country (*e.g.*, political, economic and fiscal). However, unlike the sovereign securities described in Section 5.1, the credit risk and liquidity of emerging markets sovereign securities are more varied. Reports on emerging markets sovereigns thus typically address market fundamentals, analyses and recommendations regarding particular investment and trading strategies and relative value commentary. As a consequence, many of these reports likely would fall outside the definition of "fixed income research reports" in the Guiding Principles.

In contrast to most emerging markets sovereign credit research, emerging markets corporate credit research is, relatively speaking, more focused on fundamentals of issuers and less on macroeconomic factors. Such research is directly analogous to investment grade or high yield corporate credit research discussed above, depending upon whether the issuer's debt carries an investment grade or, more typically, a high yield credit rating and therefore in many circumstances would be considered "fixed income research reports" as that term is defined in the Guiding Principles.

Firms also may conclude that research analysts play a significant and highly useful role in educating emerging markets investors, particularly as to the economic factors affecting the issuer. Thus, a member firm may conclude, in the context of this asset class, that it is consistent with Guiding Principle 4.7.2 for a research analyst to make a presentation at a road show, provided that (1) the presentation is restricted to economic analysis and other remarks that would not constitute a research report, and (2) either the analyst is subject to blackouts on issuing research reports on that issuer or security before and after the road show presentation, or the analyst does not regularly cover the issuer of the securities.



In the U.S. and elsewhere, the recipients of emerging markets research are almost exclusively QIBs or other institutional investors.

## 5.5 U.S. Municipal Securities

The U.S. municipal securities market sector is varied and diverse, encompassing tax exempt and taxable issues, general obligation, revenue, special tax and numerous other types of securities, including private activity bonds. There are more than 50,000 different issuers in this market, ranging from those that have large budgets and are very active issuers of new debt, to tiny localities or sub-governmental units that sell a new bond issue perhaps once a generation, to tax-exempt 501(c)(3) entities of varying levels of sophistication. In addition, in the case of a municipal conduit borrowing where the issuer is not the source of bondholder payments, it may be appropriate for Association member firms to view the underlying, true borrower as the “issuer.”

Most of the municipal securities market consists of investment grade issues, although there are some non-investment grade and unrated transactions. For the last several years, over 50% of the primary market has come with Aaa/AAA credit enhancement in the form of bond insurance. Because interest on U.S. municipal bonds is generally exempt from federal and state taxation, the market for U.S. municipal securities is characterized by significantly higher retail participation than other debt security classes. Heightened procedures may thus be necessary to ensure that these investors are fully informed about the nature and function of fixed income research and trading desk commentary.

Nevertheless, a significant portion of municipal bond issues is sold via competitive bid, in which the issuer receives bids from pre-qualified dealers and selects the lowest net or effective interest rate bid. There is typically no investment banking involvement in competitive bid transactions, greatly reducing the likelihood of conflicts of interest. At most firms, a U.S. municipal research analyst will perform the due diligence review that is required before the underwriter can bid on the competitive transaction. Notwithstanding the fact that Guiding Principle 4.7.3 does not address the appropriateness of fixed income research analyst participation in pre-mandate “due diligence” activities, firms may conclude that such participation in competitive deals is consistent with the Guiding Principles.

Some municipal issuers, in their “requests for proposal,” request prospective underwriters to provide a credit analysis of the issuer. Some firms ask a municipal analyst to prepare that credit analysis. It would not be inconsistent with these Guiding Principles for a firm’s fixed income research policies and procedures to allow an analyst to prepare such analysis as long as: (a) the

credit analysis is provided to the issuer without attribution to the analyst, and (b) the analyst does not receive extra compensation for preparing such credit analysis. Firms should consider whether the analyst should be subject to a blackout period on preparation of research regarding the issuer. This may depend upon whether the request for proposal is a public document and whether the analyst was given access to material non-public information in connection with the preparation of the analysis.

In general, and consistent with other classes of fixed income securities, the new issue market is driven by credit ratings and bond characteristics, rather than investment conclusions and opinions of credit quality, although analyst opinion can be more important in the lower rated and non-rated sectors of the market.

The nature and purpose of research reports generated by U.S. municipal research analysts vary among firms. Some firms' U.S. municipal research departments rarely publish issuer-specific reports, choosing mostly to comment upon sectors or trends generally. As a consequence, these reports would seem to fall outside the definition of "fixed income research reports" in the Guiding Principles. Other firms' U.S. municipal research departments publish issue-specific reports for investors and may or may not assign their own ratings to the subject transactions. Those reports that comment on specific issuers may discuss the likelihood of changes in rating by the credit rating agencies.

## **5.6 Debt of Government Agencies and Government-Sponsored Enterprises**

The market for debt securities issued by the U.S. Federal Agencies ("Federal Agencies") and Government Sponsored Enterprises ("GSEs," and together with one or more Federal Agencies, "Agencies") is distinguished by the large size and relative frequency of new issues ("Agency Securities"), the high credit quality of these securities and the competitive process used by the Agencies to determine the dealers that underwrite, and make secondary markets in, their respective securities ("Agency Dealers"). The larger Agencies are some of the most active issuers in the U.S. fixed income markets because of their significant funding requirements. They must regularly raise substantial capital to fulfill their Congressionally mandated missions, and these very large funding requirements routinely result in *daily* and continuous issuance of one or more new debt securities by the larger GSEs into the primary market. Agency discount notes and debentures are considered to be of very high credit quality, with the senior debt of the GSEs all rated AAA/Aaa.

The relationship between the Agencies and Agency Dealers differs in many material respects from a traditional investment banking relationship between

an issuer and its underwriters. Agencies use various distribution methodologies, including: (1) auction sales; (2) selling group sales; (3) negotiated sales; and (4) syndicated sales. While long-term debentures are generally issued in monthly public sales through both syndicate and auction pricing methodologies, short-term funding needs, in the form of discount note offerings, are primarily effectuated through auctions. The larger GSEs, for instance, regularly issue large, liquid, benchmark debentures based on a pre-announced auction calendar not unlike the U.S. Treasury auction calendar. In addition, most GSEs maintain a reverse-inquiry medium term note (“MTN”) program that accounts for a significant percentage of their total issuance. Many new issues are thus created each day after a “reverse inquiry” in which an institutional investor will indicate its desired terms (quantity, call features and rate) to a particular GSE through an Agency Dealer’s trading desk. Similarly, an Agency Dealer may simply aggregate demand that day from its institutional investor base and seek a GSE that will issue on the terms most widely sought by those customers.

As a result, rather than involving their investment banking personnel in the origination of new Agency Securities, trading desk personnel communicate daily with the various Agencies about the current performance of their outstanding securities, and the potential opportunities to issue additional securities at attractive rates. Given the continuous nature of the primary market and the blurred lines between the primary and secondary market for Agency Securities, most (if not all) Agency Dealers run their Agency new issues business from their Agency Securities trading desks, because this makes the most sense functionally.

Another consequence of the Agencies’ continuous presence in the new issues market, and their high credit ratings, is that underwriting a new offering of Agency Securities is materially and functionally different from underwriting a corporate bond. The lead managers for a new benchmark offering are chosen from a list of firms that have been previously approved to be one of the issuer’s core dealers. Selection as a core dealer is based on objective criteria, including the dealer’s recent performance in distribution of the issuer’s discount notes and MTNs, as well as a proven ability to distribute syndicated deals as part of the selling group. In addition, dealers are judged by their performance as a trading counterparty.

The weekly and sometimes daily research and strategic commentary published by Agency Dealers is primarily focused on broad trends in interest rates and benchmark yield curves, the current and future supply of Agency Securities of a particular duration and structure, and the relative value of certain outstanding Agency Securities vis-à-vis other Agency Securities. This market commentary, which is published for a largely institutional investor base,

including many foreign central banks, generally contains little, if any, credit-related commentary, and only occasionally references a particular security. As a result, many of these reports likely would fall outside the definition of “fixed income research reports” in the Guiding Principles.

In addition, dealer strategic and market commentary on the Agency Securities market assumes the highest credit rating for the issuer’s senior debentures, so traditional credit research concepts and terms generally are not applicable. Rather, and as mentioned earlier, Agency Securities are considered in a relative value framework. Macroeconomic factors are also heavily employed to value these securities, as well as rate levels, quantitative factors such as positive carry and yield curve roll-down, and statistical measures (*e.g.*, historical spreads to the benchmark Treasury and LIBOR curves). This is true for both new issue and secondary trading.

In applying the Guiding Principles to Agency Securities, Association member firms may take into account the special nature of the Agency underwriting process. In determining the extent to which the Guiding Principles should apply to the firm’s research with respect to the securities of supranational agencies (such as the International Finance Corporation and the European Investment Bank) and government agencies and government affiliated enterprises in other countries (such as Kreditanstalt für Wiederaufbau), member firms should consider the factors discussed above, as well as whether the issuer in fact exerts pressure on underwriting firms to publish favorable research.

## **5.7 U.S. Mortgage-Backed Securities**

In the U.S. markets, mortgage-backed securities (“MBS”) is a generic term that refers to debt securities whose payments are backed by principal and/or interest payments made by obligors on mortgages, mortgage pass-through securities, mortgage-backed bonds, mortgage pay-through securities and multi-class mortgage backed securities (*i.e.*, collateralized mortgage obligations (“CMOs”)). These securities are issued and/or guaranteed in large volumes by the GSEs (Fannie Mae and Freddie Mac) and Ginnie Mae, an Agency of the federal government, and to a lesser extent by private companies.

The GSEs are very large corporations that regularly issue new MBS. As noted above, these securities include both pass-throughs, which pass through to bondholders principal and stated coupon payments on underlying pools of mortgages, and CMOs, which are backed by pools of pass-throughs or mortgage loans and which are structured with several classes of bonds having varying payment and maturity characteristics.

There is no underwriting or investment banking relationship that is relevant to the creation and issuance of mortgage pass-through securities. The GSEs serve primarily as guarantors and bond administrators, with loan originators typically paying the GSEs a fee for these services. In addition, due to the presence of the GSE or Agency guarantee, pass-throughs have no perceived credit risk, and therefore no fundamental credit research or analysis is performed.

With respect to CMO issuance, the investment banking relationship is different from the relationship between the issuer and the lead manager of an equity or corporate debt offering. At any given time, a GSE may be issuing several different new issues of CMOs, with each separate new issue being sold through a different dealer. Each dealer will have structured the issuance to meet the needs of the investors purchasing the CMO through it. Dealers pay a guarantee fee to the GSEs. This is in contrast to relationships with traditional issuers, in which issuers pay underwriting fees to financial intermediaries. Since financial intermediaries are not in competition for issuer fees with respect to CMO issuance, the economic incentive to produce biased research is greatly reduced.

The non-governmental (“private label”) CMO market has two types of issuers: large originators that regularly bring new issues to market and that work with multiple dealer firms at the same time on separate new issues, and smaller issuers that are either issuing securities for the first time or that only occasionally originate an issue of securities. Only in the private-label CMO sector does the relationship between an originator and financial intermediaries approach a relationship similar to that between an investment banking firm and a corporate issuer. The large originators may send information on a new collateral pool to several firms and ask that each respond separately with proposed securities structures. In selecting which structure to create, the originator generally selects the dealer firm whose structure will result in the lowest interest cost to the originator. Therefore, in designing fixed income research policies and procedures, Association member firms may want to consider characterizing the GSEs, along with these larger and smaller originators and sellers of mortgage loans into private-label CMOs, as “issuers” of the related securities.

Additionally, the nature of research in the MBS market is different from that found in the corporate bond markets. Research reports in the MBS market address several basic areas, and generally do not discuss specific securities or issuers. The areas addressed include: (1) thematic issues (*e.g.*, the effect of accounting rules or investment regulations); (2) prepayments of principal on mortgage pools; (3) analysis of the features of mortgage pool types; (4) performance of issuer mortgage pools; (5) weekly sector roundups; and (6) GSE

pass-through issues, which are typically based upon broad economic indicators or evaluations of borrower prepayment behavior. Research reports regarding private MBS may, but generally do not, address an issuer's mortgage loan underwriting standards, servicer behavior and performance, and default rate analysis on mortgage pools. Research analysts may produce model portfolios made up of specific securities and weightings. They also might make relative value recommendations with respect to the relation between types of MBS and other benchmark securities. Most relative value MBS analysis is driven by the characteristics of the loans that back the securities, rather than by characteristics of the issuer. Accordingly, notwithstanding the recommendation contained in section 4.3, in connection with the preparation of fixed income research relating to MBS, the Association would not view as inconsistent with these Guiding Principles firm procedures that permit research analysts to share draft research reports with individuals who are responsible for the economic structuring of MBS transactions for purposes of verifying the factual accuracy of draft research reports, whether or not such individuals may otherwise fall within the definition of "investment banking personnel."

Due to the distinct and specialized nature of mortgage-backed securities offerings, the participation of a research analyst is often key to educating the issuer as to matters that are important to investors. Research analysts may also play a significant role in structuring the types and sizes of the tranches of a new issue. When a transaction is ready for market, the issuer will often conduct a road show for institutional investors. Research analyst participation in these situations has typically been limited to introduction of the industry and the underlying asset class, rather than any presentation relating to a particular issuer or debt security. Firms should formulate their policies and procedures for MBS research with reference to the Guiding Principles and the particular characteristics of this market.

## **5.8 Asset-Backed Securities**

Asset-backed securities ("ABS") is a generic term that includes debt securities the payments on which are backed by cash flows generated by non-mortgage loans and other types of consumer and business receivables. These underlying receivables typically include secured and unsecured financial assets, such as automobile loans, home equity loans, commercial real estate loans, trade receivables and payment obligations under credit card accounts.

Research reports in the ABS market generally break into two types: (1) quantitative research addressing the performance of the pool of assets underlying a securities issue, and (2) qualitative research. Qualitative research is generally performed at the industry level or collateral level. For example, a

qualitative research report may address a sector of the ABS market, such as credit card receivable transactions, home equity loan transactions or the like, or it may address macroeconomic trends and borrower behavior (*e.g.*, analysis of payment delinquencies and defaults) with respect to different asset classes.

Issuer-specific research in the ABS market also tends to be quantitative, addressing such matters as deal structure, cash flow, collateral and reserve accounts, and default and recovery rates. Such research may also address credit underwriting standards for the receivables pooled, as well as servicer skill and performance. Specific “buy, sell, hold” type of recommendations are generally not made; instead, this research is characterized by relative value observations comparing an issuer’s securities to others having similar credit quality, duration and performance characteristics.

Origination of asset-backed new issues, while not entirely akin to traditional corporate bond and equity underwriting, does not differ significantly. As described above in the case of MBS, the Association recommends that firms consider including in their fixed income research policies and procedures a definition of “issuers” that includes the operating company that originates and/or deposits assets into the ABS issuance vehicle.

Due to the distinct and specialized nature of asset-backed securities offerings, the participation of a research analyst is often key to educating the issuer as to matters that are important to investors. Research analysts may also play a significant role in structuring the types and sizes of the tranches of a new issue. When a transaction is ready for market, the issuer will often conduct a road show for institutional investors. Research analyst participation in these situations has typically been limited to introduction of the industry and the underlying asset class, rather than any presentation relating to a particular issuer or debt security. Firms should formulate their policies and procedures for ABS research with reference to the Guiding Principles and the particular characteristics of this market.

Additionally, as is the case for MBS, the Association would not view as inconsistent with these Guiding Principles firm procedures that permit research analysts to share draft research reports with individuals who are responsible for the economic structuring of ABS transactions for purposes of verifying the factual accuracy of draft research reports, whether or not such individuals may otherwise fall within the definition of “investment banking personnel.”

## **5.9 Structured Credit Securities Products**

Structured credit securities products include collateralized debt obligations (“CDOs”), collateralized loan obligations (“CLOs”) and similar instruments.

These instruments can generally be characterized as “balance sheet” transactions, designed to securitize loans or debt obligations originated by a financial institution or other holder, or “arbitrage” transactions designed by asset managers or equity-tranche investors to capture the arbitrage between the yield on the underlying collateral and the financing cost of the debt tranches of the CDO or CLO. The collateral underlying a CDO or CLO transaction would typically include one or more of the following types of instruments: asset-backed securities, mortgage-backed securities, commercial mortgage-backed securities, other CDOs or CLOs, real estate investment trusts, corporate loans, corporate bonds, or credit default swaps that enable investors to gain exposure to credit instruments synthetically.

In the U.S., new issues are predominantly offered as Rule 144A offerings to QIBs rather than public offerings. The transactions are originated in several different ways. All, however, employ a structure in which they are issued by a trust or other special-purpose vehicle that holds as collateral certain debt or derivative instruments, and payments on these underlying instruments are used to fund payments on the CDO or CLO debt securities. CDO or CLO issuances generally have multiple tranches, with subordinated tranches effectively providing credit enhancement to more senior tranches. In actively managed transactions, a collateral manager is authorized to sell underlying collateral securities and purchase others with the proceeds as substitute collateral. In passive or “static” transactions, a fixed pool of assets is established at inception as the collateral for the transaction.

While the issuer of the securities is the CDO or CLO vehicle, an investment banking-type relationship can be established with the collateral manager in an actively managed transaction, or with the originator of the collateral pool in a “balance sheet” transaction, or both. Therefore, Association member firms, in designing fixed income research policies and procedures, may wish to consider characterizing the collateral manager or the originator as akin to the “issuer.”

Research in the CDO and CLO arena is primarily educational in nature. The typical research product will discuss the underlying assets and how they compare to that asset class generally. It will also describe the economic and capital structures used in CDO and CLO offerings. The information produced regarding underlying collateral focuses on the performance and default characteristics of the collateral and the potential impact on various types of CDOs and CLOs. Research may also discuss rating agency methodologies for evaluating various types of structured credit securities. As the research product to date is mostly educational, it tends to make references to individual offerings and securities only to illustrate the more general analytical points being made.



Due to the distinct and specialized nature of structured credit products offerings, the participation of a research analyst is often key to educating the collateral manager or originator as to matters that are important to investors. Research analysts also may play a significant role in structuring the types and sizes of the tranches of a new issue. When a transaction is ready for market, the issuer will often conduct a road show for prospective investors. Research analyst participation in these situations has typically been limited to introduction of the asset class and the underlying collateral type, rather than any presentation relating to a particular issuer or CDO or CLO security. Firms should formulate their policies and procedures for structured credit products research with reference to the Guiding Principles and the particular characteristics of this market.

For purposes of this asset class, the Association would not view as inconsistent with the Guiding Principles firm procedures that permit research analysts to share draft research reports with individuals who are responsible for the economic structuring of transactions for purposes of verifying the factual accuracy of draft research reports, whether or not such individuals may otherwise fall within the definition of “investment banking personnel.”

Finally, because the issuer is not an operating company and the credit is a pool of assets, some member firms have elected to have their trading desks originate CDO’s and other structured credit securities. In designing fixed income research policies and procedures, firms should consider the extent to which trading desk personnel who act as originators should be subject to the Guiding Principles applicable to relationships between investment banking and research. For example, it might be appropriate for such traders and research analysts to make joint calls on collateral managers in their capacity as investors, but not to make such calls on collateral managers in their “issuer” capacity.

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<sup>1/</sup> See, e.g., International Council of Securities Associations, ICSA Research Series, *After the Bubble Has Burst: New Rules for Research Analysts and Research Related Conflicts of Interest* (June 3, 2002), available at <http://www.icsa-intl.com/pdf/Analystx.pdf> (“ICSA Research Series Report”); IOSCO Statement of Principles for Addressing Sell-Side Securities Analyst Conflicts of Interest: A Statement of the Technical Committee of the International Organization of Securities Commissions (Sept. 25, 2003), available at <http://www.iosco.org/pubdocs/pdf/IOSCOPD150.pdf> (“IOSCO Statement of Principles”); Report on Analyst Conflicts of Interest: A Report of the Technical Committee of the International Organization of Securities Commissions (Sept. 2003), available at <http://www.iosco.org/pubdocs/pdf/IOSCOPD152.pdf>; Recommendations from the Forum Group to the European Commission services, *Financial Analysts: Best practices in an integrated European financial market* (Sept. 4, 2003), available at [http://europa.eu.int/comm/internal\\_market/en/finances/mobil/finanalysts/docs/finanalysts-report\\_en.pdf](http://europa.eu.int/comm/internal_market/en/finances/mobil/finanalysts/docs/finanalysts-report_en.pdf) (“Recommendations from the Forum Group to the European Commission”), at Annex 3 (summarizing in broad terms the regulatory positions of the Member States of the European Union and Iceland, Norway, and Liechtenstein regarding the preparation of research and conflicts of interest).

<sup>2/</sup> See IOSCO Statement of Principles, *supra* note 1.

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

<sup>4/</sup> See *Testimony Concerning Conflicts of Interest Faced by Brokerage Firms and Their Research Analysts*, Laura S. Unger, Acting Chair, Securities and Exchange Commission, before the U.S. House of Representatives (July 31, 2001), available at <http://www.sec.gov/news/testimony/073101ortslu.htm>. On April 25, 2002, the Commission announced that it had commenced a formal inquiry into market practices concerning equity research analysts and the potential conflicts that can arise from the relationship between equity research and investment banking. This inquiry was conducted jointly with the New York Stock Exchange, Inc. (“NYSE”), the National Association of Securities Dealers, Inc. (“NASD”), New York State Attorney General Eliot Spitzer, the North American Securities Administrators Association, and other state securities regulators. See SEC Press Release, *SEC Launches Inquiry into Research Analyst Conflicts* (Apr. 25, 2002), available at <http://www.sec.gov/news/press/2002-56.htm>. On April 28, 2003, the SEC and SROs, along with other U.S. regulators, announced a global settlement (the “Global Settlement”) of enforcement actions against ten firms. As part of the Global Settlement, the ten firms agreed to an extensive set of undertakings, which are set forth in Addendum A to their respective Final Judgments (“Addendum A”). Addendum A is available on the SEC’s website at <http://www.sec.gov/spotlight/globalsettlement.htm>. See also Joint Press Release, *Ten of Nation’s Top Investment Firms Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking* (Apr. 28, 2003), available at <http://www.sec.gov/news/press/2003-54.htm>.

<sup>5/</sup> See Exchange Act Release No. 45908 (May 10, 2002). The NYSE and NASD recently issued a joint memorandum providing interpretive guidance on their rules governing equity research analysts’ conflicts of interest. See NYSE Information Memo No. 04-10 (March 2004); NASD Notice to Members 04-18 (March 2004).

<sup>6/</sup> See 15 U.S.C. § 78o-6(a). Congress enacted Section 15D on July 30, 2002 as part of the Sarbanes-Oxley Act of 2002. See Pub. L. 107-204, 116 Stat. 745 (2002).

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<sup>7/</sup> See Regulation Analyst Certification, Exchange Act Release No. 47384 (Feb. 27, 2003). Regulation AC also requires broker-dealers to obtain periodic certifications by research analysts in connection with the analyst's public appearances. In a comment letter, the Association expressed its strong support for the adoption of Regulation AC and its application to fixed income research. See Letter from John M. Ramsay, Vice President and Senior Regulatory Counsel, The Bond Market Association, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission (Sept. 23, 2002), available at <http://www.sec.gov/rules/proposed/s73002/jmramsay1.htm>.

<sup>8/</sup> See Exchange Act Release No. 48252 (July 29, 2003).

<sup>9/</sup> Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) ("Market Abuse Directive"), available at <http://europa.eu.int/eur-lex/en/index.html>. The deadline for national implementation of the Market Abuse Directive is 12 October 2004.

<sup>10/</sup> See Commission Directive 2003/125/EC of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest ("Market Abuse Directive implementing measures"), available at <http://europa.eu.int/eur-lex/en/index.html>.

<sup>11/</sup> See Recommendations from the Forum Group to the European Commission, *supra* note 1. In its recommendations to the European Commission, the Forum Group specifically discussed fixed income research. See *id.* at 40-42. See also the European Commission's summary of the responses to the consultation carried out on those recommendations, available at [http://www.europa.eu.int/comm/internal\\_market/en/finances/mobil/finanalysts/docs/contributions-summary\\_en.pdf](http://www.europa.eu.int/comm/internal_market/en/finances/mobil/finanalysts/docs/contributions-summary_en.pdf).

<sup>12/</sup> See Articles 13(3) and 16 of Common Position (EC) No 9/2004 of 8 December 2003 adopted by the Council, acting in accordance with the procedure referred to in Article 251 of the Treaty establishing the European Community, with a view to adopting a directive of the European Parliament and of the Council on financial instruments markets, amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, available at <http://www.europa.eu.int/prelex/apcnet.cfm>.

<sup>13/</sup> See ICSA Research Series Report, *supra* note 1, at 17.

<sup>14/</sup> See Financial Services Authority, Consultation Paper 205, Conflicts of Interest: Investment Research and Issues of Securities (October 2003), available at <http://www.fsa.gov.uk/pubs/cp/cp205.pdf> ("CP205"), and Financial Services Authority, Policy Statement 04/6, Conflicts of Interest in Investment Research - Feedback on CP205 and made Handbook text (March 2004), available at [http://www.fsa.gov.uk/pubs/policy/04\\_06/index.html](http://www.fsa.gov.uk/pubs/policy/04_06/index.html) ("PS04/6"). See also Financial Services Authority, Discussion Paper 15, Investment Research: Conflicts and other issues (July 2002), available at <http://www.fsa.gov.uk/pubs/discussion/dp15.pdf>, and Financial Services Authority, Consultation Paper 171, Conflicts of Interest: Investment Research and Issues of Securities (October 2003), available at <http://www.fsa.gov.uk/pubs/cp/cp171.pdf>.

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<sup>15/</sup> The new rules and guidance adopted by the FSA will be set out in the Conduct of Business Sourcebook (“COB”) in the FSA’s handbook of rules and guidance, *available at* <http://www.fsa.gov.uk/vhb/html/cob/COBtoc.html>. *See* COB 2.2, COB 7.3, COB 7.13 and COB 7.16. The new rules do not include new requirements regarding the disclosures that must accompany research; the FSA expects to consult on these later in 2004 in the context of the implementation of the provisions of the Market Abuse Directive. *See* paras 3.58 to 3.63 of CP205, *supra* note 14, and para 3.13 of PS04/6, *supra* note 14.

<sup>16/</sup> *See generally* ICSA Research Series Report, *supra* note 1.

<sup>17/</sup> In a recent speech, the Director of the SEC’s Division of Enforcement discussed the importance of managing conflicts of interest that are inherent in multi-service financial institutions, including the role of disclosure in that process: “[T]he historic success of the financial services industry has been in properly managing these conflicts, either by eliminating them when possible, or disclosing them.” Stephen M. Cutler, Director, Division of Enforcement, U.S. Securities and Exchange Commission, Remarks Before the National Regulatory Services Investment Adviser and Broker-Dealer Compliance/Risk Management Conference (Sept. 9, 2003), *available at* <http://www.sec.gov/news/speech/spch090903smc.htm>. *See generally* ANDREW CROCKETT ET AL., CONFLICTS OF INTEREST IN THE FINANCIAL SERVICES INDUSTRY: WHAT SHOULD WE DO ABOUT THEM? GENEVA REPORTS ON THE WORLD ECONOMY 5 (Centre for Economic Policy Research, London 2004).

<sup>18/</sup> The Association uses the phrase “conflict of interest” throughout these Guiding Principles to refer to these research-related issues.

<sup>19/</sup> *See, e.g.,* SEC Investor Alert, Analyzing Analyst Recommendations, *available at* <http://www.sec.gov/investor/pubs/analysts.htm> (“Analyzing Analyst Recommendations”) (“[S]everal factors can create pressure on an analyst’s independence and objectivity. The existence of these factors does not necessarily mean that the research analyst is biased.”); IOSCO Statement of Principles, *supra* note 1, at 1 (stating that “[s]ell-side analysts are by no means alone in facing such conflicts of interest” and providing principles and measures to manage and/or eliminate such conflicts).

<sup>20/</sup> *See* Recommendations from the Forum Group to the European Commission, *supra* note 1, at Annex 3 (summarizing in broad terms the regulatory positions of the Member States of the European Union and Iceland, Norway, and Liechtenstein regarding the preparation of research and conflicts of interest). *See also* Letter by John Ramsay, Senior Vice President and Regulatory Counsel, The Bond Market Association, to Sheetal Radia, Business Standards Department, The Financial Services Authority, at Appendix 2 (May 27, 2003), *available at* [http://www.bondmarkets.com/regulatory/Reponse\\_to\\_FSA\\_CP\\_171.pdf](http://www.bondmarkets.com/regulatory/Reponse_to_FSA_CP_171.pdf) (discussing the existing principles, rules, and guidance of the Financial Services Authority for managing conflicts of interest and investor communications). In the U.S., communications with the public are subject to an extensive regulatory regime – most notably, Regulation AC applies to both equity and fixed income research reports. At the most basic level, all communications by securities firms with U.S. investors in connection with the purchase and sale of securities are subject to the far-reaching antifraud standards of the U.S. federal securities laws. In addition, the SROs impose on their member firms strict requirements designed to ensure that a firm’s written and electronic communications with the public occur within a framework that will enhance investor protection.

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<sup>21/</sup> In most cases, regulatory and legislative actions regarding research analysts' conflicts of interests have specifically and appropriately recognized the distinction between fixed income and equity research. The Association continues to support strongly these distinctions, and greatly appreciates the significant thought and effort that regulators have undertaken to date to ensure a focused approach with minimal unintended consequences for fixed income research. In its September 2003 recommendations to the European Commission, the Forum Group also acknowledged the significant differences between fixed income and equity research in recommending that, although ethical principles and internal rules should be observed in fixed income and equity markets alike, they should be adapted to reflect the critical differences between the fixed income and equities markets and the nature of the research for those markets. *See* Recommendations from the Forum Group to the European Commission, *supra* note 1, at 42. The Forum Group also indicated that, "[a] number of structural distinctions between equity and debt markets typically serve to diminish conflicts faced by fixed income analysts as well as mitigating the potentially adverse impact of any research-related conflicts on retail investors." *Id.* at 40. While the rules set out in the FSA's PS04/6 do not specifically distinguish between equity and fixed income research, the FSA states that, while there is scope for conflicts to affect the production of investment research on non-equity securities, "the nature and extent of the conflicts may vary considerably." *See* PS04/6, *supra* note 14, at para 2.16. The FSA has also specifically recognised that the "nature and intensity of conflicts of interest and the precise measures that will be appropriate to manage those conflicts may well differ between asset classes." *See* CP205, *supra* note 14, at para 3.28.

<sup>22/</sup> Investment banking relationships in debt securities offerings are in many material respects different from those in the equity markets. Many debt offerings are conducted by competitive bid and competitive auction as well as by "book building." Issuers are not only corporate entities, but also governmental entities, ranging from sovereigns to small municipalities. As discussed more fully in Section 5 of the Guiding Principles, this diversity results in instances and asset classes for which the conflicts of interest that may be present in the pure corporate environment may be much less likely to arise or, when they do arise, may be less intense.

<sup>23</sup> As discussed in Section 5.5 of the Guiding Principles, this distinction is not as sharp in the U.S. municipal bond market, where more retail investors participate. Consequently, the Association recommends that, in implementing these Guiding Principles, firms pay particular attention to U.S. municipal bond research and other types of research distributed to retail investors in a manner that best addresses the needs of their client base.

<sup>24/</sup> For a discussion of the different characteristics of various types of fixed income securities, *see* Section 5 of the Guiding Principles.

<sup>25/</sup> The importance of issuer fundamentals varies among asset classes. As discussed in Section 5 of the Guiding Principles, issuer fundamentals are less important for pricing U.S. Treasury and other investment grade sovereign debt securities, and relatively more important for high yield/distressed corporate debt and emerging markets corporate and sovereign debt which carries a high yield credit rating.

<sup>26/</sup> Although these Guiding Principles focus on fixed income research reports and research analysts who prepare such reports, Section 4.9 of the Guiding Principles recommends measures designed to ensure that investors understand the distinction between research reports and material

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produced by trading desk personnel as part of the desk's trade execution and/or market making function.

<sup>27/</sup> See Technical Committee of the International Organization of Securities Commissions, Report on the Activities of Credit Agencies (Sept. 2003), *available at* <http://www.iosco.org/pubdocs/pdf/IOSCOPD153.pdf> (generally discussing the important role that credit rating agencies play in many domestic and cross-border transactions). In recognition of the fundamental differences between the credit rating agencies and integrated financial service providers, these Guiding Principles do not intend to speak to the practices of credit rating agencies and/or their processes in producing ratings and research. See generally CROCKETT ET AL., *supra* note 17.

<sup>28/</sup> See Report on the Role and Function of Credit Rating Agencies in the Operation of the Securities Markets, As Required by Section 702(b) of the Sarbanes-Oxley Act of 2002, U.S. Securities and Exchange Commission, at 5 (January 2003), *available at* <http://www.sec.gov/news/studies/creditratingreport0103.pdf> ("SEC Report on Credit Rating Agencies").

<sup>29/</sup> See Paul Saltzman, Executive Vice President and General Counsel, The Bond Market Association, Statement of The Bond Market Association, *SEC Hearing on Credit Rating Agencies* (Nov. 21, 2002), *available at* <http://www.sec.gov/news/extra/credrate/bondmarket.htm> ("SEC Hearing on Credit Rating Agencies").

<sup>30/</sup> For example, CreditSights (<http://www.creditsights.com>) is an independent research platform that provides research on global corporate and sovereign issuers and offers a quantitative tool for scoring an issuer's credit risk. Wrightson ICAP, LLC (<http://www.wrightson.com>) provides analyses of Federal Reserve operations and policy, Treasury financing trends and high-frequency economic data, and Criterion Research Group LLP (<http://www.criterionllc.com>) is another independent provider of both fixed income and equity research.

<sup>31/</sup> See SEC Report on Credit Rating Agencies, *supra* note 28, at 28.

<sup>32/</sup> Most of the significant factors for determining the economic value of any particular credit instrument (such as maturity, yield, call features, and priority vis-à-vis other classes of creditors) can be identified and measured with precision. It is important to note, however, that issuer credit cannot be measured with precision because many of the factors that relate to issuer or counterparty credit (such as the quality of risk controls and the capability and experience of management) require a significant degree of subjective assessment. See SEC Hearing on Credit Rating Agencies, *supra* note 29.

<sup>33/</sup> Of course, there may be other relationships that firms have, or seek to have, with governments, such as privatization mandates or mandates relating to state-owned or controlled enterprises (in the case of non-U.S. governments). Although such relationships may be comparable to those with corporate issuers, the potential for inappropriate influence is significantly diminished in the fixed income markets as compared to the equity markets for the reasons discussed above and in Section 5 of the Guiding Principles.

<sup>34/</sup> In 2002, an estimated 100% of U.S. government bond offerings, 59% of Federal Home Loan Bank Discount Note offerings, 15% of Federal Home Loan Mortgage Corporation offerings, 15% of Federal National Mortgage Association offerings, and 10% of Agency Mortgage-Backed Securities

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offerings were conducted on a competitive basis. Further, approximately 22% of the U.S. municipal bond new issue market by volume, and approximately 33% of total U.S. municipal bond issues, are sold through competitive bids. These percentages have been provided by The Bond Market Association Research Department and represent estimates.

<sup>35/</sup> For example, based on the U.S. flow of funds data published by the Federal Reserve Board, as of March 31, 2003, direct holdings by “households” accounted for approximately 7.8% of marketable U.S. Treasury debt outstanding, 1% of U.S. agency debt, 12% of U.S. corporate and foreign bonds, and 33.8% of U.S. municipal securities. As evidenced by this latter statistic and as noted in Section 5.5 of the Guiding Principles, this distinction is not as sharp in the U.S. municipal bond market, where more retail investors participate.

<sup>36/</sup> As a general matter, the Association expects that, where the intended recipients of fixed income research are retail investors, firms should take appropriate measures to tailor the content and nature of that research to that audience.

<sup>37/</sup> This ease of access to multiple sources of research is exemplified by Internet portals such as Bond Hub (<http://www.bondhub.com>) and Market Axess (<http://www.marketaxess.com>). Through these portals, institutional investors can access credit and strategy research from participating broker-dealers. As noted above, independent research sources are also available to provide fixed income analyses. See note 30.

<sup>38/</sup> For example, many integrated firms have established “Chinese Wall” arrangements and other controls to insulate analysts from investment banking personnel and activity. These arrangements and controls also assist firms in avoiding and managing conflicts of interest that could impair the independence of the research analyst and the impartiality of fixed income research.

<sup>39/</sup> These Guiding Principles (including the discussion of applicable legal and regulatory frameworks) do not constitute and are not intended to provide legal or other professional advice. Association member firms and other readers of the Guiding Principles should consult with their own legal counsel regarding the application of securities laws, regulations and rules (including those promulgated by securities self-regulatory organizations) to their own fixed income research business practices, policies and procedures. In particular, those laws, regulations and rules may impose on Association member firms requirements not reflected in these recommendations. Moreover, these Guiding Principles should in no way be interpreted as restating current law; in fact, in many respects, the Associations’ recommendations go beyond current law in some jurisdictions.

<sup>40/</sup> Individual firms may differ in the extent to which they recognize such differences in applying their own procedures. For example, where all fixed income research is centralized within a single business unit, firms may opt to apply the Guiding Principles more broadly to all research that is produced by the unit.

<sup>41/</sup> Neither the IOSCO Statement of Principles nor the Forum Group Recommendations to the European Commission propose a definition of investment research, although the Forum Group Recommendations to the European Commission noted the existence of a number of different definitions used by different bodies and in legal instruments. See *supra* note 1 at para 4.1. Nor do they seek to define the term “analyst” in a way designed for use in any regulatory text. See the IOSCO

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Statement of Principles, *supra* note 1, at 1 and the Recommendations of the Forum Group Recommendations to the European Commission, *supra* note 1 at para 4.2. The definitions used in the Guiding Principles are consistent with the definitions of “research report,” “research analyst,” “research analyst account,” “Research Department,” and “member of a research analyst’s household” as those terms are used in Section 15D of the Exchange Act, the SEC’s Regulation AC, NYSE Rule 472, NASD Rule 2711, and Addendum A. The requirements of the Market Abuse Directive implementing measures relating to fair presentation and disclosure apply to “recommendations” which are broadly defined to include information produced by a regulated firm that directly or indirectly expresses a particular investment recommendation in respect of a financial instrument or an issuer (including opinions as to the present or future value or price of such instruments) that is intended for the public or for distribution through channels to which a large number of people have access. *See supra* note 10, article 1. The definition of “investment research” adopted by the FSA in October 2003 covers an even broader category of documentary material (other than personal recommendations) which contains the results of research into an investment or issuer, analysis of factors likely to influence the future performance of an investment or issuer or advice or recommendations based on those results or that analysis. *See* CP205, *supra* note 14. This broader definition is of particular relevance for the purposes of the rules adopted by the FSA in October 2003 on promises of favorable research, dealing ahead of research and personal account dealings by analysts. *See* COB 2.2.4AG, COB 7.3 and COB 7.13, *supra* note 15. However, the rules adopted by the FSA in March 2004 requiring an FSA regulated firm to establish and implement a policy for the management of conflicts which may affect the impartiality of investment research only apply in relation to investment research published or distributed by the firm “where either (a) the firm holds it out (in whatever terms) as being an impartial assessment of the value or prospects of its subject matter or (b) it is reasonable for those to whom the firm has published or distributed it to rely on it as an impartial assessment of the value or prospects of its subject matter.” *See* COB 7.16.5R, *supra* note 15.

<sup>42/</sup> Except as discussed in note 41, this definition and the exclusions that follow are consistent with the definition of “research report” in Section 15D(c)(2) of the Exchange Act, Regulation AC, NASD Rule 2711, NYSE Rule 472, and the interpretations issued by the SEC and the SROs. Other than Section 3.2.1.1 of the Guiding Principles, which sets forth an exclusion for certain analyses prepared by non-Research Department personnel, the exclusions from the definition of “research report” have also been explicitly endorsed by the SEC for purposes of Regulation AC and by the SROs for purposes of their equity research analyst rules. However, material falling within these exclusions may still be regarded as research for the purposes of other laws, regulations or rules. For example, there are no corresponding exclusions from the FSA’s broad definition of “investment research” and some of the material covered by the exclusions may still be regarded as investment research that is held out, or is reasonably relied on, as an impartial assessment for the purposes of the specific FSA rules regarding conflict management. *See supra* note 41 *but see* note 44 below. Nevertheless, there is likely to be significantly less potential for conflict of interest in relation to material falling within the exclusions and any conflicts of interest that do arise are likely to be much less intense.

<sup>43</sup> The Association believes that the exclusion in Section 3.2.1.1 of the Guiding Principles is necessary in the context of fixed income research not only to ensure that the Guiding Principles are coherent and internally consistent, but also to target only those types of communications that are commonly understood to be “research reports” and those potential conflicts of interest faced by persons commonly understood to be, and represented to investors to be, “research analysts.”



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<sup>44/</sup> In order to eliminate the possibility that investors may confuse trading desk material with fixed income research reports prepared by a firm's research department, the Association recommends, in Section 4.9 of the Guiding Principles, that firms clearly identify such material as a product of the trading desk. The Association believes that disclosure plays a crucial role in distinguishing fixed income research from other types of communications, and in managing conflicts of interest generally.

<sup>45/</sup> Among firms that provide analyses regarding fixed income securities, there is a variety of organizational models for preparing and disseminating such information. Recognizing that analyses are sometimes provided by employees (such as salespeople and traders) who are not Research Department personnel and who are not engaged principally in the preparation or publication of fixed income research reports, these Guiding Principles define a "research report" to exclude such analyses as long as, among other things, the materials are not held out as being impartial analyses of the subject matter. In doing so, the Association is not endorsing any particular organizational model.

<sup>46/</sup> Trader commentary, including trade ideas and other analyses produced by trading desk personnel, is not prepared in accordance with the Guiding Principles applicable to fixed income research reports. In addition, although trader commentary should represent the honest opinion of the writer, counterparties generally understand that it is part of the trading desk's trade execution and/or market making function and that, because the debt markets are principal markets, trading desk personnel typically write about securities in which the desk has a position and in which it will trade as principal. Accordingly, counterparties understand that the trading desk may have an interest in the securities that are the subject of the trader commentary and that the commentary should not be relied upon as impartial.

<sup>47/</sup> The same numeric exclusion was adopted by the SEC for purposes of Regulation AC and by the SROs for purposes of their equity research analyst rules. A "person" may include an institution or individual client. See Exchange Act Release No. 47384 n.27 (Feb. 20, 2003). However, the definition of "investment research" adopted by the FSA only excludes a "personal recommendation" defined as a recommendation given to a specific person. See CP205, *supra* note 14 and the definitions in the glossary to the FSA's handbook of rules and guidance, available at [http://www.fsa.gov.uk/handbook/hbk\\_glossary.pdf](http://www.fsa.gov.uk/handbook/hbk_glossary.pdf) ("FSA Glossary").

<sup>48/</sup> This definition is consistent with the definition of "securities analyst" in Section 15D(c)(1) of the Exchange Act and the definition of "research analyst" in Regulation AC, NASD Rule 2711, and NYSE Rule 472. In that regard, we would consider "members of staff" to be the equivalent of "associated persons" for U.S. broker-dealers. The FSA's definition of "investment analyst" covers an employee of a firm who prepares investment research or the substance of investment research. See CP205 *supra* note 14. The definition of employee for these purposes includes staff working on a contract for services or seconded to the firm and, in some cases, a firm's appointed representative and its staff. See the definition of "employee" in the FSA Glossary *supra* note 47.

<sup>49/</sup> The Association believes that fully discretionary or managed accounts do not create the inherent conflicts of interest present in other personal trading accounts. This definition is consistent with the definition of "research analyst account" in NASD Rule 2711(a)(5) and NYSE Rule 472.40, except that it expands the exception for "blind trusts" to include all fully discretionary or managed accounts. Similarly, the FSA's rules on "personal account transactions" do not apply to transactions in certain regulated collective investment schemes or discretionary transactions if there is no prior

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communication with the employee and the discretion is not exercised by the firm. *See* the definition of “personal account transaction” in the glossary to the FSA’s handbook of rules and guidance, *available at* [http://www.fsa.gov.uk/handbook/hbk\\_glossary.pdf](http://www.fsa.gov.uk/handbook/hbk_glossary.pdf).

<sup>50/</sup> This definition is consistent with the definition in NASD Rule 2711(a).

<sup>51/</sup> This definition is consistent with the definition in NYSE Rule 472 and NASD Rule 2711, as interpreted in the Joint Memorandum of the NASD and NYSE, dated July 2002. *See* NYSE Information Memo 02-26 (June 26, 2002); NASD Notice to Members 02-39 (June 26, 2002). The corresponding definition of “associate” in the FSA Glossary includes any person (including controlled companies) whose business or domestic relationship with the analyst or any associate might reasonably be expected to give rise to a community of interest between them which may involve a conflict of interest in dealings with third parties. *See* FSA Glossary *supra* note 47. The Forum Group Recommendations to the European Commission suggested that a person should be treated as connected with an analyst for the purposes of the dealing restrictions by reason of a domestic relationship if the analyst has influence over that person’s judgment as to how to invest funds or exercise rights. *See supra* note 1 at 35.

<sup>52/</sup> An “equity line” is generally understood to mean a commitment by the investor to purchase from a public issuer up to a predetermined dollar amount of shares of that issuer’s common stock over a certain period. It is very similar to a bank line of credit in that cash is available to the issuer on an “as needed” basis; the difference is that the issuer repays the investor in stock. The issuer has the right (but not an obligation) to “draw down” on the equity line and sells shares to the investor when it is most favorable for the issuer to do so. When the issuer draws down the line, the shares are sold to the investor at a discount.

<sup>53/</sup> This definition is consistent with the definition in NYSE Rule 472 and NASD Rule 2711. The corresponding definition of “corporate finance business” in the FSA Glossary also covers a broad range of business, including specifically acting on the repurchase, exchange or redemption of securities, demergers, reorganizations or reconstructions, as well as dealings with investors or holders of securities in connection with corporate finance business. *See* FSA Glossary *supra* note 47.

<sup>54/</sup> This definition is consistent with the definition of “Investment Banking” in Addendum A, except that it excludes clerical and administrative employees and describes the kinds of senior managers who are not investment banking personnel. The Association has excluded clerical and administrative employees because it does not believe the promotion of analyst integrity would be furthered by subjecting these individuals to the same restrictions and limitations as investment banking personnel. The Association believes that such restrictions would impose an unnecessary burden on firms’ ability to organize and manage effectively their administrative and clerical staff, particularly at smaller firms where clerical and administrative personnel may overlap departments, providing assistance to both research and investment banking personnel. Note that the SROs’ rules for equity analysts do not define “investment banking” personnel, although they define “investment banking department” as “any department or division, whether or not identified as such, that performs any investment banking service on behalf of a member.” NYSE Rule 472.30 and NASD Rule 2711(a)(2).

<sup>55/</sup> The Association has crafted a definition that it believes appropriately recognizes the variety of fixed income securities and issuers and the diverse underwriting practices related to the offering of debt securities. Limited purpose entities are not operating companies that issue debt securities in the

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traditional sense. Instead, these entities issue debt securities whose payment streams are based upon cash flows generated by a segregated asset or pool of assets (typically financial assets) that have been originated and/or conveyed to the entity by a third party. The operating company that originates and/or conveys the asset(s) to the limited purpose entity is sometimes referred to as the “issuer” of the related securities. For example, a mortgage finance company may be described as the issuer of mortgage-backed securities collateralized by residential mortgage loans that it originates and services, and a commercial bank may be characterized as the issuer of asset-backed securities collateralized by the payment obligations of its credit card holders. The term “issuer” is not defined in Regulation AC, the SRO Rules, or Addendum A. In the FSA Glossary, “issuer” is defined (in relation to a security) simply as the person by whom the security is or is to be issued. *See* FSA Glossary *supra* note 47.

<sup>56/</sup> In its Statement of Principles, IOSCO specifically observed that a prohibition on the promise of favorable research for future business is a core measure for protecting the integrity of research. *See* IOSCO Statement of Principles, *supra* note 1, at 6. This Guiding Principle is reflected in the SROs’ rules for equity analysts, and is a core principle of Regulation AC (which, among other things, requires research analysts, including fixed income research analysts, to certify that the views expressed in their research reports accurately reflect their personal views). *See* NYSE Rule 472(g) and NASD Rule 2711(e). This Guiding Principle is also consistent with the FSA’s guidance on offering favorable investment research. *See* COB 2.2.4AG, *supra* note 15. FSA’s guidance also indicates that a firm should prohibit its analysts or other employees from offering or accepting an inducement to provide favorable investment research. *See* COB 7.16.12G(1) *supra* note 15. This Guiding Principle is not intended, however, to prevent a firm’s commitment committee (or similar organizational group that is responsible for “committing” firm capital to a transaction) from requesting the views of research analysts about specific companies or transactions; such discussions are expressly permitted by Addendum A and would be consistent with this Guiding Principle. *See* Addendum A, at Section I.10.b.

<sup>57/</sup> This Guiding Principle goes beyond the requirements imposed by Section 15D of the Exchange Act and the SROs’ rules for equity analysts, which prohibit firms from retaliating against research analysts for an adverse, negative, or otherwise unfavorable report or public appearance, but do not more broadly prohibit firms from retaliating against analysts for reports or public appearances that may adversely affect the investment banking or sales and trading interests of the firm. *See* NYSE Rule 472(g)(2) and NASD Rule 2711(j). The FSA’s rules and guidance do not contain any specific provision on retaliation.

<sup>58/</sup> The Association believes firms may appropriately include various quality control mechanisms in their policies and procedures governing the conduct and job performance of fixed income research analysts, including reviewing and vetting the analyses and conclusions in fixed income research reports by supervising personnel to assure that the reports meet the firm’s standards of accuracy and quality.

<sup>59/</sup> Neither IOSCO’s Statement of Principles nor the SROs’ rules for equity analysts contains a restriction regarding coverage decisions. This Guiding Principle is therefore more restrictive than IOSCO’s Statement of Principles and the SROs’ rules for equity analysts and more comparable to Addendum A, which imposes restrictions on the involvement of investment banking personnel in coverage decisions. *See* Addendum A, at Section I.7. It is also consistent with the FSA’s guidance, which indicates that it normally will not be appropriate for personnel who has responsibilities that might reasonably be regarded as likely to conflict with the interests of clients to whom the research is

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published or distributed to be responsible for decisions on the subject matter or content of investment research or the timing of its publication. See COB 7.16.9G(2), *supra* note 15.

<sup>60/</sup> The Association believes that it is appropriate for fixed income firms to consider input from various constituencies, including investment banking personnel, in making issuer-specific or category-by-category coverage decisions, provided that ultimate decision-making authority remains with the fixed income research department. This is consistent with the FSA's commentary in paragraph 3.42 of CP205 *supra* note 15. In designing policies and procedures for fixed income research coverage decisions, firms should consider whether additional restrictions on investment banking input are warranted, such as restrictions on consideration of investment banking services revenues or potential revenues when making issue-specific coverage decisions.

<sup>61/</sup> The IOSCO Statement of Principles states that reporting lines for analysts and their compensation arrangements should be structured to eliminate or severely limit actual and potential conflicts of interest. See *supra* note 1 at 7. This Guiding Principle is consistent with the SROs' rules for equity analysts and Addendum A, which prohibit research analysts from being subject to the supervision or control of the firm's investment banking department. See NYSE Rule 472(b)(1) and NASD Rule 2711(b)(1); Addendum A, at Section I.1. This Guiding Principle is also consistent with Section 15D of the Exchange Act, which requires the SROs or the SEC to adopt rules requiring broker-dealers to establish structural and institutional safeguards to assure that equity analysts are separated by appropriate informational partitions from review, pressure or oversight by investment banking personnel. See Section 15D(a)(3). It is also consistent with the FSA's guidance, which states that firms should organize the investment research function in a way which minimizes the potential influence of the commercial interests of the firm, its employees, its associates or its clients on the impartiality of the research. See COB 7.16.7G *supra* note 15.

<sup>62/</sup> Addendum A observes that "the head of Research may report to or through a person or persons to whom Investment Banking also reports, provided that such person or persons have no direct responsibility for Investment Banking or investment banking activities." Addendum A, at Section I.1. The FSA's guidance states that it will not normally be appropriate for any individual (not just a member of the investment banking department) who has responsibilities that might reasonably be considered to conflict with the interests of the clients to whom the investment research is published or distributed to be responsible for the day-to-day supervision of an investment analyst. See COB 7.16.9G(1) *supra* note 15.

<sup>63/</sup> This Guiding Principle is consistent with the SROs' rules for equity analysts and Addendum A. See NYSE Rule 472(b)(1) and NASD Rule 2711(b)(1); Addendum A, at Section I.6. The FSA's guidance states that it will not normally be appropriate for any individual (not just a member of the investment banking department) who has responsibilities that might reasonably be considered to conflict with the interests of the clients to whom the investment research is published or distributed to be responsible for determining the remuneration of an investment analyst. See COB 7.16.9G(3), *supra* note 15. The Forum Group Recommendations to the European Commission stated that investment banking departments should have no involvement in determining analysts' remuneration. See *supra* note 1 at 37.

<sup>64/</sup> This Guiding Principle goes beyond the SROs' rules for equity analysts, which do not address physical separation. This Guiding Principle is consistent with Addendum A, which requires physical

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separation of research and investment banking. *See* Addendum A, at Section I.4. However, the recommendation herein regarding physical separation does not refer to chaperoning. *See* note 68.

<sup>65/</sup> For example, the Association believes that it would be consistent with the Guiding Principles for firms to continue to maintain syndicate desks that are integrated with fixed income research, sales and trading.

<sup>66/</sup> The IOSCO Statement of Principles states that a prohibition on the investment banking function pre-approving analyst reports or recommendations is a core measure to eliminate or limit conflicts of interest, but would allow a review for factual accuracy prior to publication, subject to oversight by compliance or legal personnel. *See supra* note 1 at 7. As discussed in Section 5 of the Guiding Principles, the Association believes that there are particular asset classes in which a firm's procedures may, consistent with the Guiding Principles, appropriately permit investment banking personnel to review draft reports to assure factual accuracy of the description of the security. In addition, the Association recognizes that firms are organized differently, and that some firms may have no formal Research Department or group that produces research reports. In such cases, the Association believes the non-Research Department personnel who are responsible for supervising the research analyst(s) who prepared the research report(s) should be able to review the report for supervisory and quality control purposes. *See* note 58.

<sup>67/</sup> The Association believes that it is appropriate for factual review by non-Research Department personnel (such as traders) to include a review for "market relevance" (*e.g.*, whether the research analyst is accurately representing trading activity, prevailing market prices, and market interest). As noted above, relative value research and other types of fixed income research often focus on macroeconomic factors, market trends and developments, and analyst interaction with trading desk personnel is critical to assuring sound analysis and reasonable investment conclusions based upon prevailing market interest rates, prices and yields.

<sup>68/</sup> This Guiding Principle is consistent with Section 15D of the Exchange Act and the SROs' rules for equity analysts, which impose restrictions on, among other things, the pre-publication clearance or approval of research reports by non-research personnel. *See* Section 15D(a)(1)(A); NYSE Rule 472(b)(2) and NASD Rule 2711(b)(2). However, it goes beyond Section 15D and the SRO's rules by recommending that firms prohibit investment banking personnel from conducting such pre-publication review of draft research reports. This Guiding Principle is also consistent with the FSA's guidance which indicates that firms should not give effective editorial control to someone whose role or commercial interests might reasonably be considered to conflict with the interests of the clients to whom the research is to be published or distributed. In particular, the FSA's guidance indicates that firms should restrict such personnel approving research before issue, although it does also indicate that it may be appropriate for such personnel (not excluding investment banking personnel) to have an opportunity to check the accuracy of the facts relied on in the research. *See* COB 7.16.9G(2) and 7.16.12G(2) *supra* note 15. This Guiding Principle does not reflect the detailed chaperoning requirements in the SROs' rules for equity analysts because the Association believes that, given the great variety of types of fixed income research and the differences between equity and fixed income research, firms should have flexibility to design procedures to restrict or prohibit interactions that could undermine the actual or perceived independence of the analyst's research. The SROs themselves created an exception from chaperoning arrangements for equity analysts at small firms. *See* NYSE Rule 472(m) and NASD Rule 2711(k). Similarly, the Forum Group recognized that, while chaperoning

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arrangements may be one way to manage conflicts, “[i]t is not the only way of setting up an effective conflict management system.” See Recommendations from the Forum Group to the European Commission, *supra* note 1, at 28.

<sup>69/</sup> This Guiding Principle is consistent with the SROs’ rules for equity analysts. See NYSE Rule 472(b)(3) and NASD Rule 2711(c). It is also consistent with the FSA’s guidance. See COB 7.16.12G(2)(b) *supra* note 15. The Recommendations from the Forum Group to the European Commission recommend that companies should be permitted to review research before publication, but should not be informed of the recommendation or valuation. See *supra* note 1 at 34.

<sup>70/</sup> This Guiding Principle is consistent with the SROs’ rules for equity analysts regarding the pre-publication review of research reports that have been submitted to issuers. See NYSE Rule 472(b) and NASD Rule 2711(b). The FSA’s guidance does not specifically comment on the need for mechanisms of this kind, although they would be consistent with the stated principle of requiring arrangements to ensure that research sets out the impartial views of the investment analyst. See COB 7.16.7G, *supra* note 15.

<sup>71/</sup> These factors generally mirror the factors that are to be considered in determining or reviewing a primary research analyst’s compensation under the SROs’ rules for equity analysts and Addendum A. See NYSE Rule 472(h)(2) and NASD Rule 2711(d)(2); Addendum A, at Section I.5. The FSA’s guidance indicates that an investment analyst’s remuneration should be structured so as not to create (or suggest the creation of) an incentive that is inconsistent with the provision of an impartial assessment of the subject matter of research by the analyst. It also states that an analyst’s remuneration may be linked to the profits of the firm. See COB 7.16.10G *supra* note 15. This is also consistent with the Forum Group Recommendations to the European Commission. See *supra* note 1 at p. 37. The SROs’ rules for equity analysts also require a compensation committee that reports to the firm’s board and has no representation from investment banking to review and approve a primary research analyst’s compensation on an annual basis. The Association believes, however, that this Guiding Principle contains appropriate guidelines to ensure that the structure of analysts’ compensation promotes their independence. As such, the Association does not believe that it is necessary to complicate the organizational bureaucracy by specifically recommending that firms establish a formal compensation committee that reports to their boards to review primary analysts’ compensation.

<sup>72/</sup> This factor is consistent with the SROs’ rules for equity analysts, which prohibit firms from considering a primary research analyst’s contributions to the firm’s investment banking business when reviewing and approving compensation. See NYSE Rule 472(h) and NASD Rule 2711(d).

<sup>73/</sup> Section 4.2.2 of the Guiding Principles provides that evaluations of fixed income research analysts should not be performed by, nor should there be input from, investment banking personnel. This Guiding Principle is consistent with the SROs’ rules for equity analysts and Addendum A. See NYSE Rule 472(b) and NASD Rule 2711(b); Addendum A, at Section I.5.a. See also *supra* note 63.

<sup>74/</sup> IOSCO’s Statement of Principles state that a prohibition on directly linking analyst compensation to specific investment banking transactions is a core measure to eliminate or limit analysts’ conflicts of interest. See *supra* note 1 at 7. The SROs’ rules for equity analysts prohibit firms from compensating analysts for specific investment banking services transactions, or receiving an incentive or bonus that is based on a specific investment banking services transaction. See NYSE Rule

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472(h) and NASD Rule 2711(d). The FSA's guidance states that an analyst's remuneration should not be linked to specific transactions, or recommendations contained in investment research. *See* COB 7.16.10G *supra* note 15. The NASD has recognized, however, that, to the extent that an analyst engages in due diligence and other permitted research activities, such activities may be considered as one factor in the compensation determination. *See* Exchange Act Release No. 48252 (July 29, 2003).

<sup>75/</sup> As a general matter, the Association does not believe that every relationship or connection between an issuer and a firm or fixed income research analyst (or member of a fixed income research analyst's household) rises to the level of a "conflict of interest." In addition, the Association recognizes that not all fixed income asset classes and fixed income research raise the same potential for conflicts of interest, and restrictions on trading may not be appropriate in all situations. The FSA's existing COB rules require firms to put in place arrangements to ensure that employees' personal account transactions do not conflict with the firm's duties to its clients. *See* COB 7.13.4R(1), *supra* note 15. The definition of personal account transaction excludes transactions in government and public securities, but includes transactions by certain associates. *See* FSA Glossary *supra* note 47 and *see also supra* note 49. The guidance adopted by the FSA in October 2003 places the responsibility on firms' management to decide how conflicts should be managed appropriately. It indicates that firms may decide whether to impose a complete ban on personal account transactions by investment analysts, to prohibit trading in covered investments or to impose a restriction on trading in a period before and after the issuance of research. *See* COB 7.13.10AG, *supra* note 15. These restrictions apply in relation to all "investment research" distributed by the firm, not just to research that is held out as impartial. *See supra* note 40. Likewise, the Forum Group Recommendations to the European Commission suggested a variety of ways of avoiding, preventing or managing conflicts of interest arising from personal account holdings and dealings, including controlling these through effective policies and procedures. *See supra* note 1 at 35. The IOSCO Statement of Principles also suggests a number of different mechanisms to ensure that analysts' trading activities or financial interests do not prejudice their research and recommendations. *See supra* note 1 at 4.

<sup>76/</sup> Restrictions on trading contrary to published recommendations may not be necessary or appropriate for some types of fixed income research, such as relative value analyses and two-legged trading strategies. In those situations, the recommendation may be relevant only to the specific trading opportunity and may have little or no bearing on an analyst's view of the investment value of the security. Also, published recommendations for an issuer's debt securities may differ from recommendations for the same issuer's equity securities.

<sup>77/</sup> Blackout periods may be impractical for certain types of fixed income research that is not published on a regular schedule and/or that is focused on trading opportunities or market developments. An analyst writing such research may not know what securities will be discussed or recommended in a research report until shortly before the report is prepared; consequently, a thirty-day blackout such as that imposed by the SROs on equity analysts is simply not possible in the fixed income context. Blackout periods also may be unnecessary where research is unlikely to exert a material impact on the price of the particular issuer's outstanding securities.

<sup>78/</sup> *See supra* note 44. The Association is itself committed to comprehensive investor education. *See* <http://www.investinginbonds.com>. In its Statement of Principles, IOSCO identified investor education as a core measure for addressing securities analyst conflicts of interest. *See* IOSCO Statement of Principles, *supra* note 1, at 11. The IOSCO Statement of Principles also emphasizes disclosure as a core

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measure for ensuring that research is not prejudiced by the firm's financial interests or trading activities. *See supra* note 1 at 5. The Forum Group Recommendations to the European Commission places disclosure of conflicts of interest as one of its five core principles. *See supra* note 1 at 16.

<sup>79/</sup> These disclosures, among others, are specifically required by the SROs' rules for equity analysts. *See* NYSE Rule 472(k) and NASD Rule 2711(h). The SROs' rules require other disclosures, which this Guiding Principle does not include because they are not as relevant for fixed income research. For example, the SROs' rules for equity analysts require firms to disclose the percentage of companies within their rating categories for whom they have provided investment banking services within the past 12 months. As discussed above, in contrast to the equity markets, the potential to attract or retain issuer clients through the publication of favorable research is markedly diminished in the fixed income markets. The Association does not believe that the additional disclosures required for equity research are necessary in the fixed income context. The FSA's guidance merely states that firms should consider what information by way of disclosures should accompany the research it publishes or distributes. *See* COB 7.16.15G *supra* note 15. However, the Market Abuse Directive implementing measures will require EU member states to impose a number of additional disclosure requirements which go beyond those set out in the Guiding Principles, such as disclosures as to coverage policy, changes in recommendations in the last 12 months and major shareholdings in issuers. *See also supra* note 15.

<sup>80/</sup> This is consistent with the requirements of the Market Abuse Directive implementing measures. *See* article 6(3).

<sup>81/</sup> The Market Abuse Directive implementing measures will impose a similar requirement. *See* article 6(1)(d).

<sup>82/</sup> The Market Abuse Directive implementing measures will impose a similar requirement. *See* article 6(1)(c).

<sup>83/</sup> The Market Abuse Directive implementing measures will impose a similar requirement. *See* article 4(1)(c).

<sup>84/</sup> In its Statement of Principles, IOSCO recognized that the appropriate content and form of disclosures will vary depending on the market, the relevant laws and regulations, and the nature of the research. *See* IOSCO Statement of Principles, *supra* note 1, at 10.

<sup>85/</sup> The Market Abuse Directive implementing measures contemplate that member states may allow some disclosures to be provided by means of a hyperlink to a public internet site. *See* articles 4(2), 5(3) and 6(5). Under the SROs' rules for equity analysts as interpreted in the Joint Memorandum of the NASD and NYSE, electronic research reports may utilize hyperlinks to this disclosure, provided that the first screen that the investor sees clearly and prominently labels the hyperlinks to the required disclosures. *See* NYSE Information Memo 02-26 (June 26, 2002); NASD Notice to Members 02-39 (June 26, 2002).

<sup>86/</sup> This prohibition is consistent with IOSCO's Statement of Principles and the SROs' rules for equity analysts, Addendum A. The FSA's guidance also recognizes that a firm's policy may allow it to use an investment analyst's knowledge and information to: (1) assist the firm in researching corporate



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finance business opportunities; (2) provide ideas to sales or trading staff; or (3) provide information and advice to the firm's investment clients. Nevertheless, this guidance indicates that it ordinarily will be inappropriate for a firm to (a) use an investment analyst in a marketing capacity (for example in pitches to solicit or obtain corporate finance business from an issuer) if this would give a reasonable perception of lack of impartiality in his investment research or (b) allow an investment analyst to act in a way that appears to be representing the issuer of a relevant investment, for example in roadshows. See COB 7.16.12G *supra* note 15. However, the Association notes that there is no global consensus on the issue of analyst participation in pitches. Notably, the Forum Group to the European Commission did not recommend that firms generally prohibit or restrict research analysts' participation in investment banking pitches; rather, it advised that analysts should not be present when market-sensitive information relating to a new issue or other transaction is being discussed, unless that information becomes public before the analyst provides investment advice, or the analyst refrains from disseminating research opinions for as long as the analyst remains an "insider." According to the Forum Group, analysts may provide valuable contributions by participating in investment banking-related activities because the "analyst's objective knowledge is useful, both to the firm and to the issuer, as it may serve to inform them of the likely market reaction to a proposed transaction." See Recommendations from the Forum Group to the European Commission, *supra* note 1, at 26. In light of the diversity of current practices in, and requirements relating to, EU research, and the apparent lack of consensus among EU market participants, the Association does not believe at this time that it can or should recommend a *per se* restriction on analyst participation in "pitches" in the EU, especially where firms adopt and implement appropriate policies and procedures to protect the integrity of the fixed income research process, e.g., policies and procedures that address, among other things, the need to ensure that a research analyst is given access to material non-public information in connection with a proposed transaction only in accordance with appropriate "wall crossing" procedures and remains subject to the resulting restrictions until they expire.

<sup>87/</sup> These Guiding Principles do not recommend a *per se* prohibition relating to research analysts' participation in meetings with both issuers and bankers (so-called "three-ways") as long as such meetings do not relate to solicitations for investment banking services business, directed marketing efforts with respect to an investment banking services transaction, or research coverage of the issuer. The Association notes that "three-way" meetings are not prohibited by IOSCO's Statement of Principles, Section 15D of the Exchange Act or the SRO's rules for equity analysts. However, firms should be alert to meetings involving fixed income research analysts, investment banking personnel, and issuer representatives that may create the appearance of potential conflicts of interest. Addendum A requires the creation and enforcement of firewalls between research and investment banking departments that are reasonably designed to prohibit all communications between the two, with certain specified exceptions, which do not address three-way communications.

<sup>88/</sup> This Guiding Principle is more restrictive than the SRO's rules for equity analysts, which do not specifically address analyst participation in road shows or other deal marketing efforts. It is consistent with Addendum A, which specifically prohibits analysts from participating in investment banking- or issuer-sponsored road shows related to investment banking transactions, and prohibits investment banking personnel from directing analysts to engage in marketing or selling efforts to investors with respect to an investment banking transaction. See Addendum A, at Section I.11. Also, the FSA's guidance indicates that it would ordinarily be inappropriate for a firm to allow an investment analyst to act in a way that appears to be representing the issuer, for example in road shows. See COB 7.16.11G(3)(b) *supra* note 15.

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<sup>89/</sup> This Guiding Principle is not intended to restrict fixed income research analysts' ability to communicate with the sales force and with investors for the purpose of educating them about a potential investment banking services transaction. As discussed in Section 4.7.3 of the Guiding Principles, the Association believes that communications for the purpose of educating investors are consistent with the Guiding Principles.

<sup>90/</sup> See Analyzing Analyst Recommendations, *supra* note 19.

<sup>91/</sup> According to the SEC's release approving amendments to NYSE Rule 472 and NASD Rule 2711, the SROs have stated that it is permissible for equity research analysts to engage in certain investment banking-related activities that are traditionally associated with research functions within a multi-service securities firm and are separate from solicitation activities. See Exchange Act Release No. 48252 (July 29, 2003). For example, the NASD stated that Rule 2711 would not curtail research analysts from performing activities traditionally associated with research functions that do not involve solicitation of investment banking business, such as helping to screen potential investment banking clients. See *id.* The NYSE also recognized the need for critical financial analysis of a subject issuer by a research analyst during the period after the receipt of an investment banking mandate by the member while an issuer is preparing to engage in a securities offering to the public. See *id.* The FSA's guidance recognizes that a firm may use an investment analyst to research corporate finance business opportunities. See COB 7.16.11G(2) *supra* note 15.

<sup>92/</sup> The SROs' prohibitions on analyst participation in investment banking "pitches" do not apply to any due diligence communications between the research analyst and the subject issuer, the purpose of which is to analyze the business financial condition, results of operations, and prospects of the issuer. The NYSE specifically discussed the important role that analysts play in assisting with certain investment banking-related activities, such as due diligence, in its most recent filing relating to its rules regarding research analyst conflicts of interest: "[I]n the context of a securities offering, a research analyst plays a vital role, on behalf of his or her firm, in analyzing an issuer during this critical due diligence phase which may continue until the commencement of an offering." NYSE Amendment No. 3 Relating to Amendments to Exchange Rules 344, 345A, 351 and 472 with Respect to Research Analysts' Conflicts of Interest, File No. SR-NYSE-2002-49 (July 29, 2003), at 7, available at <http://www.nyse.com/pdfs/2002-49am3.pdf>.

<sup>93/</sup> The Association recognizes that there may be valid reasons why analysts may want to hear information presented at road shows, *e.g.*, to be familiar with the message the issuer is communicating to investors. However, firms should consider implementing additional policies and procedures, with respect to such attendance, to protect the integrity of the research process, even where the analyst is only attending in a passive capacity. In addition, fixed income research analysts occasionally participate in meetings with investors and issuers for the purpose of educating the investors about a particular issuer. In these situations, the Association understands that such meetings are not related to, and do not occur in connection with, a contemplated or pending investment banking transaction. As such, the Association believes that it is appropriate for fixed income research analysts to participate in meetings with issuers and investors, provided that such meetings are not directed or attended by investment banking personnel, and that the research analyst is not soliciting investment banking services business or marketing a particular investment banking services transaction.

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<sup>94/</sup> The SROs' rules for equity analysts do not limit analyst involvement in these efforts, and Addendum A also allows analysts to participate in efforts to educate the sales force about investment banking transactions, including by participating in the preparation of internal-use memoranda for the sales force. *See* Addendum A, at Section I.10.d. The Association also believes that it is consistent with these Guiding Principles for research analysts to communicate with any investors who contact them directly or who are brought to their attention by firm sales and trading personnel.

<sup>95/</sup> The SROs' rules for equity analysts do not limit analysts' ability to attend conferences, and Addendum A allows analysts to attend or participate in a widely-attended conference attended by investment banking personnel or in which investment banking personnel participate, provided that the research personnel do not participate in activities otherwise prohibited by Addendum A. *See* Addendum A, at *see* Section I.10.e.

<sup>96/</sup> This is consistent with the Recommendations from the Forum Group to the European Commission, *see supra* note 1 at 29.

<sup>97/</sup> *See supra* note 86.

<sup>98/</sup> In its Statement of Principles, IOSCO recommended a general prohibition on "improperly trading securities or related derivatives ahead" of research. *See* IOSCO Statement of Principles, *supra* note 1, at 5.

<sup>99/</sup> With respect to any material pending research, firms also should prohibit fixed income research analysts from selectively disclosing to investors or counterparties information regarding the timing of publication and investment conclusions expected to be contained in the material research report. The Association believes that these Guiding Principles are consistent with current U.S. regulatory requirements regarding "trading ahead" of fixed income research reports. The Association recognizes that different U.S. regulatory requirements may apply in the context of equity research reports. *See* NYSE Information Memo 91-8; NASD IM 2110-4.

<sup>100/</sup> As described in Section 1.2.1 of the Introduction and Overview to the Guiding Principles, and in Section 4.3.1 of the Guiding Principles, fixed income research analyst interaction with trading personnel is a common and critical practice in the debt markets. Without a materiality standard for trading ahead, the Association believes that these communications would be severely curtailed and fixed income research analysts would be restricted in their ability to benefit from traders' insights and observations regarding, among other things, interest rates, spreads, trading volume, trading interest, and market prices. As a result, the flow of important information and analyses to the investor or counterparty could be chilled. Moreover, the Association believes that a materiality standard is appropriate for this Guiding Principle because the trader would not gain any advantage by trading prior to the issuance of the research report, and counterparties would not be disadvantaged by such trading, if the research is not expected to materially affect the price of the relevant securities.

<sup>101/</sup> These exceptions are consistent with the NYSE's and NASD's guidance regarding trading ahead of equity research reports. The FSA also permits the following exceptions to its "dealing ahead" prohibition for: (1) good faith transactions in the normal course of market making; and (2) dealing in order to fulfill an unsolicited customer order. *See* FSA COB 3.12 in the FSA's COB Sourcebook.

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<sup>102/</sup> In October 2003, the FSA amended its COB rules regarding dealing ahead of published research. *See* COB 7.3 *supra* note 15. In amending its rules (which apply to fixed income securities as well as equity securities), the FSA eliminated the following exceptions to its dealing ahead prohibition (which now applies where the firm or an associate is issuing “investment research” as broadly defined): (1) where the publication could not reasonably be expected to have a significant effect on relevant prices; (2) where the dealing is done in order to meet anticipated customer demand; and (3) where the firm discloses in the publication that such dealings may occur. The remaining exceptions apply where the transaction is in response to an unsolicited order or in the normal course of the firm’s business as a market maker. *See id.* The Association encourages its member firms to consult with counsel with respect to these recent changes. The Association will continue to work with the FSA to ensure that the new dealing ahead rules do not unduly impair members’ ability to provide liquidity to investors and other market participants.

<sup>103</sup> See Industry Guidance on COB 7.3 issued jointly by the British Bankers’ Association, the London Investment Banking Association, the International Securities Market Association and the International Primary Markets Association on February 9, 2004, *available at* <http://www.bba.org.uk/bba/jsp/polopoly.jsp?d=155&a=1767>.

<sup>104/</sup> This Guiding Principle is more specific than the SROs’ rules for equity analysts with respect to the nature of firms’ supervisory procedures for monitoring the quality and integrity of research, although it provides firms with greater flexibility to establish such procedures than Addendum A. The SROs’ rules for equity analysts, like this Guiding Principle, do not require firms to establish a formal committee, although they require firms to establish procedures reasonably designed to ensure that they and their employees comply with NYSE Rule 472 and NASD Rule 2711, respectively. *See* NYSE Rule 472(c) and NASD Rule 2711(i). Addendum A requires firms to establish an oversight/monitoring committee to, among other things, monitor the overall quality and accuracy of research reports, review all changes in ratings and material changes in price targets contained in research reports, and conduct periodic reviews of research reports to determine whether changes in ratings or price targets should be considered. *See* Addendum A, at Section I.12. The FSA’s rules also require firms to adopt and implement policies for managing conflicts in connection with investment research that is held out, or reasonably relied on, as impartial. However, they go beyond the Guiding Principles by requiring firms to make those policies available to anyone on request (for example, by including it on an appropriate website). *See* COB 7.16.5(2) *supra* note 15. In addition, they also require firms to have policies on the timing and manner of publication and distribution of investment research and of the communication of its substance, which should provide for it to be distributed to clients in an appropriate manner (including restrictions on distribution otherwise than through the firm’s usual channels and the communication of its substance to clients otherwise than in accordance with the policy.) *See* COB 7.16.5R(3)(b)(vi) and 7.16.13G *supra* note 15.

<sup>105/</sup> We note, however, that where a sovereign’s debt carries a high yield credit rating, fixed income research regarding such sovereign credit debt may, like emerging markets corporate credit research, be more focused on issuer fundamentals and less on macroeconomic factors.