CFA Centre for Financial Market Integrity/
National Investor Relations Institute

Best Practice Guidelines Governing Analyst/ Corporate Issuer Relations

CFA INSTITUTE Centre for Financial Market Integrity

National Investor Relations Institute

CFA Institute/NIRI Task Force

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The mission of the CFA Centre for Financial Market Integrity is to be a leading voice on issues of fairness, efficiency, and investor protection in global capital markets and to promote high standards of ethics, integrity and professional excellence within the investment community.

Its sponsoring organization, CFA Institute, is the 70,000-member, non-profit organization that awards the Chartered Financial Analyst® designation worldwide. CFA Institute was known as the Association for Investment Management and Research (AIMR) from 1990 through early 2004, and before that was two separate organizations with roots going back to 1947.

NIRI is dedicated to advancing the practice of investor relations and professional competency and stature of its members.

NIRI is a professional association of corporate officers and investor relations consultants responsible for communication among corporate management, the investing public and the financial community. With over 4,400 members in 35 chapters around the country, NIRI sets the highest standards in education designed to advance the practice of investor relations and meeting the growing professional development needs of those engaged in the field.

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Introduction

Investors benefit when investment professionals, whether analysts or investment managers ("analysts") have a clear and open dialogue with management of corporations that issue publicly traded debt and equity securities ("corporate issuers"). Open communication facilitates fair and consistent information which helps investors make sound decisions and allocate their capital appropriately.

CFA Institute and the National Investor Relations Institute (NIRI) convened a joint task force to develop best practice guidelines governing the relationship between analysts and corporate issuers to ensure the existence of good channels of communication. In pursuing its objective, the task force addressed the following the issues:

- *Information flow between analysts and corporate issuers;*
- *Analysts' conduct in preparing and publishing research reports and making investment recommendations;*
- *Corporate issuers' conduct in providing analysts with access to corporate management;*
- *Review of analyst reports by corporate issuers;*
- *Research that is solicited, paid, or sponsored by the issuer ("issuer paid research").*

Although compliance with these guidelines is not explicitly required by either CFA Institute or NIRI, the underlying core principles parallel certain requirements in each organization's respective code of conduct. Members of each organization should also be aware that violations might result in disciplinary actions. Voluntary compliance by other market participants is strongly encouraged. These are best practice *guidelines*. Firms are encouraged to adopt the guidelines to improve the efficiency and integrity of capital markets.

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Background

In order to make good investment decisions and allocate their capital appropriately, investors need corporate issuers to present information in a fair and consistent manner. Although much of the information about a public company comes to investors from the issuers themselves, another important source is research reports prepared and distributed by financial analysts and their firms. In order to conduct high quality research and make recommendations that have reasonable and adequate bases, analysts must communicate directly with company representatives, especially investor relations officers and senior management. Only through such dialogue can analysts fully comprehend the information in a company's public disclosure documents (e.g., company annual reports).

Because corporate issuers receive requests for information and access to company management from many people — individual shareholders, institutional investors, financial analysts, retail investors and the media — they cannot be expected to fulfill every request for direct access to specific individuals.

Corporate issuers and firms that employ analysts must establish and implement policies that govern the communication between analysts and the subject companies and are aimed at fostering good working relationships. Investors' interests are paramount. Only when analysts and corporate issuers act with integrity and in a cooperative manner, respecting the responsibilities and duties of their respective professions, can an atmosphere conducive to objective research be achieved. Research analysts and corporate officers must put the interests of the investors and the integrity of the capital markets above their own interests.

► Information Flow

Analysts, investors, and corporate issuers must not disrupt, or threaten to disrupt, the free flow of information between each other in an attempt to influence the behavior of those with whom they are communicating.

► Analyst Conduct

A. Analysts must issue objective research and recommendations that have a reasonable and adequate basis supported by thorough, diligent, and appropriate research and investigation.

B. Analysts must distinguish between fact and opinion and ensure that the information contained in their reports is clear and complete.

C. Analysts must not bias their research reports or threaten to use their recommendations in an effort to manipulate their relationship with corporate issuers.

► Corporate Communication and Access

A. Corporate issuers must not:

1. Discriminate among recipients of information disclosed by the issuer based on the recipient's prior research, opinions, recommendations, earnings estimates, or conclusions;

2. Restrict, deny, or threaten to deny information or access to company representatives in an attempt to influence the research, recommendations, or actions of analysts and investment professionals; or

3. Attempt to influence the research, recommendations, or actions of analysts or investment professionals by exerting pressure through other business relationships.

B. Corporate issuers must provide access to knowledgeable company officials, such as corporate management or investor relations officers, to qualified persons, including analysts and investors. Corporate issuers should establish and adhere to policies that set forth how the company will respond to requests for access and should disclose these policies to analysts and investors upon request.

► Reviewing Sell-Side Analyst Reports

A. Prior to publication of their reports, sell-side analysts may only submit to corporate issuers for review for factual accuracy those portions of their research reports that do not contain or disclose conclusions, recommendations, estimates, valuations, or price targets.

B. Prior to the publication of sell-side analysts' reports, corporate issuers may review for factual accuracy, and with the analyst's permission only those portions of a sell-side analyst's research report that do not contain or disclose the conclusions, recommendations, estimates, valuations, or price targets. Corporate issuers must not explicitly or implicitly request information that would disclose the conclusions, recommendations, valuations, or price targets, or comment on these matters. A corporate issuer is only permitted to comment on historical or forward-looking information that is already in the public domain.

► Issuer Paid Research

A. When engaging in research paid for, directly or indirectly, by the corporate issuer, analysts must:

1. Only accept cash compensation for their work and must not accept any compensation contingent on the content or conclusions of the research or the resulting impact on share price.

2. Disclose in the report:

- The nature and amount of the compensation received for drafting the report.
- The nature and extent of any personal, professional, or financial relationship they, their firm or its parent, subsidiaries, agents, or trading entities may have with the subject company, its personnel, parent, subsidiaries, or agents.
- Their credentials, including professional designations and experience that qualifies them to produce the report.
- If it is a one-time report or if the analyst will provide continuing coverage. If the analyst provides continuing coverage, they must disclose how to obtain updates.
- Any matters that could reasonably be expected to impair their objectivity in drafting the report.
- History of recommendations for the subject-company and number and distribution of recommendations for all companies they cover.

3. Certify that the analysis or recommendations contained in the report, if any, represent the true opinions of the author or authors.

4. Refrain from engaging in, or receiving compensation from, any investment banking or corporate finance-related activities with the issuer.

5. Ensure that the analyst(s) do not share information about the subject company or the timing of the release of a research report with any person who could have the ability to trade in advance of ("front run") the release of a report.

6. Refrain from trading in the shares of the subject company in advance of the release of a report or update.

7. Refrain from trading in a manner that is contrary to, or inconsistent with, the employees' or the firm's most recent published recommendations or ratings, except in circumstances of unanticipated extreme financial hardship.

8. Abide by all laws, rules, and regulations that apply to registered or regulated analysts.

B. When hiring analysts to produce research for their company, corporate issuers must:

1. Engage qualified analysts who are committed to producing objective and thorough research that fully discloses any matters that could reasonably be expected to impair their objectivity.

2. Pay for the research in cash and only in a manner that does not influence or seek to influence the content and conclusions of the research.

3. Not attempt explicitly or implicitly to influence the research, recommendations, or behavior of analysts or otherwise pressure analysts to produce research or recommendations favorable to the corporate issuer.

4. Ensure that the disclosures required of the analyst in V(A.2) are included in the research report that are published or distributed, in whole or in part, by the corporate issuer.

► Corporate Communication and Access

Information is the lifeblood of efficient, effective, and fair capital markets. If investors are to make good investment decisions and allocate their capital appropriately, they need transparent information that is fairly and consistently disclosed. Investors receive most of the information they need from prospectuses, quarterly financial statements, regulatory filings, proxies, press releases, conference calls, websites, annual reports and shareholder meetings, and so forth. This is often supplemented by direct communication with company representatives – particularly the investor relations officer – and through conference calls or one-on-one meetings.

Investors may also rely on various investment professionals, principally financial analysts, to assist them in their decision-making process. Although some place more emphasis on the research and analytical process, investors expect analysts to draw conclusions about the valuation and future prospects of a company and to make recommendations. Analysts would fail in their due diligence if they did not seek direct communication with company representatives, especially investor relations and other senior management executives, to fully understand the information in a company's public disclosure documents.
Companies must not discriminate among analysts based on their prior research, opinions, recommendations, earnings estimates or research conclusions. Under no circumstances should a company pressure an analyst to change a recommendation by threatening to withhold information or deny access to management.

Many companies have limited resources, and the primary responsibility of management is to manage the business and they cannot be expected to fulfill every request for direct access to corporate officers. Therefore, it is appropriate for companies to develop written policies establishing general criteria for granting fair levels of access and avoid the perception of favoritism. These policies will allow those who request access to have realistic expectations about the type and frequency of access that is available to them. Equitable access policies ensure that no analyst has a competitive advantage in talking to management, avoids the perception of favoritism, and diminishes the chance of communication of inside information. These policies should be disclosed by the company.

While qualified financial analysts should have equitable access to company representatives, the specific type of access can depend on company-specific resource constraints (e.g., time, budget). To meet the needs of investors and shareholders, however, companies are advised to provide as much access as possible. Companies demonstrate their commitment to good investor communication by establishing a minimum level of access so that any interested party would be able to obtain some direct communication with company representatives. This can be beneficial in developing good working relationships with the investment community and provide for wider dissemination of information about the company to investors.

Assessing the quality of management can also be achieved from in-person analyst meetings. In addition, such meetings present an opportunity to ask questions about results and plans already publicly addressed by the company and assess management's answers. However, analysts must not use these meetings to solicit or accept material nonpublic information. Companies should develop policies as to what type of information management and other employees can discuss outside the firm (one-on-one meetings, industry conferences, etc.) as well as how information will be disseminated to the rest of the market when material nonpublic information is disclosed to a limited audience.[1]

[1] In the United States, companies must follow requirements under Regulation FD to broadly disseminate material non-public information that may have been disclosed in a nonpublic setting.

Sell-side analysts should not solicit investment banking or brokerage trading business when meeting with corporate issuers. Nor should buy-side analysts solicit corporate issuers for investment management business. Likewise, corporate issuers should not use potential investment banking or brokerage business to attempt to induce favorable analyst coverage.

While companies vary widely in size, structure, and methods of handling investor relations, every company is advised to adhere to ethical principles for managing access in a fair, consistent, and efficient manner. Policies must be reasonable and fair and should clearly define the different levels of access that are available, setting forth the qualifications that persons or entities need for a particular level of access. Other types of access can include:

- Direct contact with senior company management as needed or during regularly scheduled meetings or events,
- Direct contact with other company personnel on request,
- One-on-one visits with senior company management on request, and
- Access to the company only through contact with investor relations officers.

After the levels of access are defined, companies are advised to develop criteria for the type of credentials or experience that would qualify individuals (e.g., analysts or their employers) to participate at each access level. Companies might consider the following as part of these criteria:

- Level of experience in financial analysis;
- Demonstrated knowledge about the company and its sector or sectors;
- Quality of previous published research;
- Extent of client base (as a proxy for investment potential); and
- Professional credential (e.g. Chartered Financial Analyst® (CFA®) designation).

Companies must apply their access policies consistently and fairly. Once companies establish their criteria for each level of access, they must not apply it selectively or deny access to qualified individuals or entities nor allow higher levels of access to individuals who do not meet the criteria. After a company discloses and explains its access policy and the reason why a particular level of access is denied, analysts are expected not to try to circumvent the policy.

Corporate issuers must respect an analyst's duty to ask hard questions, point out potential risks, and make fair, unbiased assessments based on facts and their own forecasts. Analysts must be free to develop and publish research that is based on sound, competent analysis, even if that opinion is unfavorable or differs from the view of the company. In turn, companies must do their part in providing a transparent and continuing flow of information to the marketplace and accept analysts' right and responsibility to issue varying opinions. Analysts'conclusions will not be positive in every case. But the free flow of information must never be impeded by differences of opinion or issues that involve the relationship between a company and an analyst.

Corporate issuers must not discriminate against, deny access, or threaten to deny access to any individual or firm based on that individual or firm's opinion, recommendation, earnings estimate, valuation or conclusion about the company or its investment potential. Analysts can have legitimate reasons – macroeconomic factors, changes in management, restructuring, merger and acquisition activity, product failures, etc. – for offering a negative opinion about a company or its investment potential or to change a previously issued recommendation. The valuation methodology used could also change, altering a company's valuation relative to its peers or historical metrics. As long as the analyst has a reasonable basis and the opinion or recommendation is supported by adequate research, companies are advised to recognize the analyst's right to change a rating or recommendation.

Analysts have a responsibility to differentiate between fact and opinion and to be fair and impartial in their analysis. They must not let outside pressures threaten their impartiality or influence their research conclusions or recommendations. In addition, analysts must understand and respect legitimate constraints on dissemination of information by or access to company personnel. It is inappropriate for analysts to change their rating or recommendation:

- Based solely on unsubstantiated rumor or speculation;
- For reasons related to opinion of other analysts or investors;
- To manipulate the stock price by taking advantage of quiet periods;
- To create an unrealistic earnings estimate to justify a subsequent recommendation;
- To manipulate the stock price in front of stock option expiration dates or quarter-ending trade deadlines; or
- To pressure the issuer to disclose material nonpublic information.

All research reports or recommendations must include a certification on the report by the analyst that the content and conclusions are the true opinions of the analyst or analysts who authored the report.

Similarly, buy-side analysts and investors must not use their ownership or potential ownership positions in a subject company to gain preferential treatment for access to company management or material nonpublic information. For instance, threatening to sell securities or vote against management on a proxy issue unless the company provides the analyst or investor with exclusive information or access is inappropriate and unfairly puts pressure on the issuer to act in a discriminatory and unethical manner.

Corporate issuers must avoid pressuring analysts for favorable coverage or pressure investors to vote with management on proxy issues by threatening to cut off communication or deny reasonable access to senior management, withhold access or company information or threaten to withdraw investment banking or other business from the firm. Companies must not discriminate against those investment professionals who vote against management.

► Reviewing Sell-Side Analyst Reports

The management and investor relations professionals for corporate issuers should take special precautions if they are asked to review sell-side research reports prior to publication. Any review must be done only to check factual accuracy of information already in the public domain. While review of the facts may be appropriate, analysts must not provide those sections of the research report that contain the conclusions, recommendations, valuations, or price targets. Otherwise, review or comment on these research reports may be perceived as an attempt by corporate issuers to influence the content of the report and the analyst's conclusion, recommendation, estimate, valuation, or price target.

Sell-side analysts should provide a draft research report to their compliance or legal department before sections are shared with the subject company. If any changes occur as a consequence of the subject company verification, the analyst should provide written justification for any changes and the compliance department should approve such changes prior to publication. Firms should retain supporting documentation including the original report, the sections shared with the subject company, and any subsequent changes to the report or recommendation.

Extensive review and comment on research reports could expose the company to liability under relevant securities regulations or may be viewed as an endorsement of the report and its conclusions. Issuer representatives should take care not to become "entangled" in an analyst's report. This can occur when they become so involved in commenting on and/or reviewing an analyst's report that they can be viewed as having agreed with or endorsed its contents. Issuers can minimize the threat of entanglement by limiting comment or review to discussion or correction of historical fact or other publicly disclosed information.

Best practice is for the issuer to refer analysts to the company's publicly disclosed information so that analysts can pursue further research under the "mosaic" theory. The mosaic theory states that an analyst may use significant conclusions derived from the analysis of public and non-material, non-public information as the basis for investment recommendations and decisions. This is true even if those conclusions would have been material inside information had they been communicated directly to the analyst by the issuer. Under the mosaic theory, analysts are free to act on this collection, or mosaic, of information.
When preparing research reports and developing valuation models, analysts should clearly distinguish between information that the analyst is attributing directly to management and the analyst's interpretation of comments by management. Analysts should clearly identify any significant elements that have been included or excluded from their earnings estimate (e.g., one-time charges or gains, synergies from a merger). This approach allows investors to understand the differences in estimates and facilitates the comparison of estimates made on a similar basis.

► Issuer Paid Research[2]

Many companies, seeking increased visibility in the financial markets and with potential investors, hire firms or analysts to produce research reports analyzing their company. Issuer-paid research refers to the direct hiring of and payment to an analyst or firm by the corporate issuer (or a related third party) to write a research report on the company. Issuer-paid research is a relatively new form of research that has developed, primarily in the United States, as a result of brokerage firms downsizing their research departments. Such issuer-paid research, however, is fraught with potential conflicts. Depending upon how the research is written and distributed, investors can be misled into believing that issuer funded research appears to be from an independent source when, in reality, it is solicited and paid for by the subject company. (Note that these guidelines are not intended to address other practices, such as bond-rating services.)

Best practices require that analysts accept only a flat fee for their work, paid in cash, prior to writing the report, without regard to their conclusions. Any compensation arrangement other than a flat fee is inappropriate because otherwise the content and conclusions of the reports could reasonably be expected to be determined or affected by compensation from the subject companies. Inappropriate compensation can take the form of payment based on the conclusions of the report or more indirect compensation such as stock warrants or other equity instruments that could increase in value based on positive coverage in the report. In such cases, analysts would have an obvious incentive to avoid negative information or conclusions that would diminish their compensation

Analysts who conduct issuer-paid research have the same ethical responsibilities as any analyst to engage in thorough, objective, and unbiased analysis and must fully disclose potential conflicts, including the nature of their compensation, in all communications (including press releases). Otherwise, they risk misleading investors by appearing to produce objective analysis.

[2]In the U.S., issuer-paid research is included under the jurisdiction of the Securities and Exchange Commission (SEC) under section 17(b) of the Securities Act of 1933.

Analysts must disclose all matters that have the potential to bias their research including the nature and extent of the compensation they receive for drafting the report and any personal, professional, or financial relationship they or their firm may have with the subject-company. Such disclosure would include any ownership or recent trading activity in the stock or other securities of the company. It would also be material to investors if the analyst's firm or a related entity provides any investor relations or other service to the issuer.

Also, research may not necessarily be paid for directly by an issuer. Research services could be purchased on behalf of the issuer by entities that have the issuer as a client. Any relationship that could reasonably be expected to bias the research must be disclosed. Issuer-paid analysts must also disclose their qualifications, including professional designation and experience, which makes them competent to produce the report. In addition, similar to sell-side analysts, issuer-paid analysts should disclose a track record and distribution (e.g., number of buy, sell, and hold recommendations) of their recommendations on the subject company. It is recommended that the track record be computed and/or verified by an independent third party performance measurement firm. All disclosures must be prominent, stated in plain language, and made in a manner that communicates the relevant information effectively.

Issuer-paid analysts, like other analysts, must not trade in the securities of the subject company ahead of the release of a research report. Trading restrictions, or "black out" periods, of thirty days before and five days after the release of a report are recommended. In addition, analysts must not trade in a manner that is contrary to their most recent recommendation, except in the case of unanticipated extreme financial hardship.

Finally both analysts and issuers must be aware that, in many cases, the content or conclusions of the report itself may be considered material non-public information, especially where no other research coverage of the company is available. Both the analyst and the company should take steps to ensure equitable distribution of the report and consider blackout periods for appropriate periods to avoid insider trading conflicts.

Research firms should designate a supervisory analyst or director of research to approve all research issued by the firm and ensure that the research conforms to these standards.

► Dispute Resolution

Differences may occasionally arise between issuers and analysts. An issuer may take exception to an analyst's research report because, for example, the issuer believes the report contains factual errors or omissions, the analyst's opinions and conclusions are not supported by the facts, or the analyst has not been independent and objective. In such cases, the issuer should take the following steps:

1. Initially try to reach agreement with the analyst on the facts.
2. If the problem cannot be resolved with the analyst, the issuer should discuss any disagreement or error with the research director.
3. If the issue is still unresolved, the issuer should discuss the disagreement with the compliance officer at the analyst's firm when either the research director does not offer assistance or when the research report's recommendation and the analyst's oral communication with clients are not the same.

Issuers, analysts, and investors are reminded that publicly disputing research reports or airing grievances in media outlets could harm the reputation of both parties.

► Additional Guidance for Corporate Issuers Providing Earnings Guidance

Corporate issuers may choose to provide earnings guidance to analysts and investors. Earnings guidance is considered to be a point estimate, range, revenue estimate or the issuer's own model to forecast earnings. If an issuer provides specific earnings guidance in public documents or forums, then it may have a duty to update or correct that information publicly and in a timely manner when changing facts or circumstances alter the forecasts. Material updates or corrections should be made in a news release before being provided to analysts.

Issuers that choose to give earnings guidance are encouraged to provide the following information:

- The components of earnings, including ranges for all key earnings items (e.g., revenues, expenses, gains, losses, margins, earnings per share, etc.)
- A sensitivity analysis, rather than simply earnings per share forecast

> **Example:** Our projected revenue growth is 7 - 10 percent. Based on our estimated increase of 5 percent in cost of goods sold, we are projecting gross margins in a range of 50 percent to 55 percent, with the low end of the range based on 7 percent revenue growth and the high end based on 10 percent revenue growth. Each 1 percent variance in revenue growth from our projected range results in an XX percent change in gross margin, all other things being equal. Each 1 percent variance from our projection in the increase in COGS would result in an XX percent change in gross margin.

Issuers that choose *not* to provide earnings guidance should consider the following:

- Providing and discussing five-year growth-rate projections to encourage a long term focus. Issuers should ensure that the growth rates are reasonable over that time period.
- Discussing the issuer's business cycle and its relevance to the current quarter and pointing out any obvious omission of fact.
- Discussing each quarter's contribution to the company's long-term strategies.

The magnitude of analysts' earnings estimates or basis used may not match the earnings guidance provided by corporate issuers. If analysts determine to disclose their earnings model, they should identify the components of earnings that are included and/or excluded from their earnings model and explain why each item is included or excluded.

> **Example:** We met with X company management last week and saw a first-hand demonstration of the company's new product line. Management indicated in its earnings release that it has a goal of achieving 10 percent revenue growth and margin improvement this quarter. We believe the revenue growth goal can be achieved based on recent industry growth, market share trends and the strength of the new line. However, we also believe that price competition will intensify in the next 90 days and that margin improvement will be difficult to achieve.
>
> Our EPS estimate for 2004 excludes non-operating gains resulting from the sale of assets, which the company has included in

its guidance. We have excluded these gains because we believe asset sales are not core to the company's business and ongoing earnings-generation power. We have included in our 2004 estimate $0.06 per share attributable to the company's ongoing share repurchase and $0.02 per share resulting from lower interest rates based on the utilization of the proceeds of the asset sale to reduce debt and buy back stock.

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