

Chapter 12

Investment research



12.2 Investment research and non-independent research

12.2.1 **R** [deleted]

12.2.2 **G** [deleted]

12.2.3 **R** [deleted]

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12.2.5 **R** [deleted]

12.2.5A **G** [deleted]

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12.2.10 **R** [deleted]

12.2.11 **G** [deleted]

12.2.12 **G** [deleted]

12.2.13 **G** [deleted]

Application

- 12.2.14 **G** This section applies to a *firm* that:
- (1) produces, or arranges for the production of, *investment research* that is intended or likely to be subsequently disseminated to *clients* of the *firm* or to the public, under its own responsibility or that of a member of its *group*; or
 - (2) produces or disseminates *non-independent research*.

- 12.2.15 **R** Where this section applies to a *firm* in relation to business other than its *MiFID business*, provisions in this section marked “EU” shall apply as if they were *rules*, other than those that copy out recitals, which shall apply as if they were *guidance*.

- 12.2.16 **G**
- (1) This section applies to both *investment research* and *non-independent research*.
 - (2) *Non-independent research* is not presented as objective or independent and is accordingly considered a marketing communication.
 - (3) Both *investment research* and *non-independent research* are sub-categories of the type of information defined as an *investment recommendation* in ■ COBS 12.4.

Investment research and non-independent research

- 12.2.17 **EU** Article 36(1) of the *MiFID Org Regulation* defines *investment research*.
- 36(1) For the purposes of Article 37 investment research shall be research or other information recommending or suggesting an investment strategy, explicitly or implicitly, concerning one or several financial instruments or the issuers of financial instruments, including any opinion as to the present or future value or price of such instruments, intended for distribution channels or for the public, and in relation to which the following conditions are met:
- (a) the research or information is labelled or described as investment research or in similar terms, or is otherwise presented as an objective or independent explanation of the matters contained in the recommendation;
 - (b) if the recommendation in question were made by an investment firm to a client, it would not constitute the provision of investment advice for the purposes of Directive 2014/65/EU.

- 12.2.18 **EU** Article 36(2) of the *MiFID Org Regulation* deals with the treatment of *non-independent research* with reference to *investment recommendations* as defined in the *Market Abuse Regulation* (see ■ COBS 12.4) and in contrast to *investment research* as defined in article 36(1) (see ■ COBS 12.2.17EU).
- 36(2) A recommendation of the type covered by point (35) of Article 3(1) of Regulation (EU) 596/2014 that does not meet the conditions set out in paragraph 1 shall be treated as a marketing communication for the purposes of Directive 2014/65/EU and investment firms that produce or disseminate that recommendation shall ensure that it is clearly identified as such.

Additionally, firms shall ensure that any such recommendation contains a clear and prominent statement that (or, in the case of an oral recommendation, to the effect that) it has not been prepared in accordance with legal requirements designed to promote the independence of investment research, and that it is not subject to any prohibition on dealing ahead of the dissemination of investment research.

Conflicts of interest

12.2.19 EU

Article 37(1) of the *MiFID Org Regulation* requires firms to apply the conflicts requirements set out in article 34(3) of the *MiFID Org Regulation* to persons involved in the production of *investment research* and *non-independent research*. Recitals 51, 52 and 55 to the *MiFID Org Regulation* relate to the required measures and arrangements.

37(1) Investment firms which produce, or arrange for the production of, investment research that is intended or likely to be subsequently disseminated to clients of the firm or to the public, under their own responsibility or that of a member of their group, shall ensure the implementation of all the measures set out in Article 34(3) in relation to the financial analysts involved in the production of the investment research and other relevant persons whose responsibilities or business interests may conflict with the interests of the persons to whom the investment research is disseminated.

The obligations in the first subparagraph shall also apply in relation to recommendations referred to in Article 36(2).

Recital 51

The measures and arrangements adopted by an investment firm to manage the conflicts of interests that might arise from the production and dissemination of material that is presented as investment research should be appropriate to protect the objectivity and independence of financial analysts and of the investment research they produce. Those measures and arrangements should ensure that financial analysts enjoy an adequate degree of independence from the interests of persons whose responsibilities or business interests may reasonably be considered to conflict with the interests of the persons to whom the investment research is disseminated.

Recital 52

Persons whose responsibilities or business interests may reasonably be considered to conflict with the interests of the persons to whom investment research is disseminated should include corporate finance personnel and persons involved in sales and trading on behalf of clients or the firm.

Recital 55

The concept of dissemination of investment research to clients or the public should not include dissemination exclusively to persons within the group of the investment firm. Current recommendations should be considered to be those recommendations contained in investment research which have not been withdrawn and which have not lapsed. The substantial alteration of investment research produced by a third party should be governed by the same requirements as the production of research.

12.2.20 G

(1) *Firms* which produce, or arrange for the production of, *investment research* or *non-independent research* are also reminded of their obligations under ■ SYSC 10 (Conflicts of interest).

- (2) ■ COBS 12.2.19EU relates to the management of conflicts of interest in relation to *investment research*.
- (3) In relation to *non-independent research*, *firms* may wish to consider whether conflicts arise in relation to:
- (a) *relevant persons* trading in *financial instruments* that are the subject of *non-independent research* which they know the *firm* has published or intends to publish before *clients* have had a reasonable opportunity to act on it (other than when the *firm* is acting as *market maker* in good faith and in the ordinary course of market making, or in the execution of an unsolicited *client* order); and
 - (b) the preparation of *non-independent research* which is intended first for internal use by the *firm* and then for later publication to *clients*.

Measures and arrangements required for investment research

12.2.21 EU

Article 37(2) of the *MiFID Org Regulation* requires *firms* to put arrangements in place around the production of *investment research* to ensure the conditions set out in that article are satisfied. Recitals 53, 54 and 56 relate to those arrangements and the article 37(2) conditions.

37(2) Investment firms referred to in the first subparagraph of paragraph 1 shall have in place arrangements designed to ensure that the following conditions are satisfied:

- (a) financial analysts and other relevant persons do not undertake personal transactions or trade, other than as market makers acting in good faith and in the ordinary course of market making or in the execution of an unsolicited client order, on behalf of any other person, including the investment firm, in financial instruments to which investment research relates, or in any related financial instruments, with knowledge of the likely timing or content of that investment research which is not publicly available or available to clients and cannot readily be inferred from information that is so available, until the recipients of the investment research have had a reasonable opportunity to act on it;
- (b) in circumstances not covered by point (a), financial analysts and any other relevant persons involved in the production of investment research do not undertake personal transactions in financial instruments to which the investment research relates, or in any related financial instruments, contrary to current recommendations, except in exceptional circumstances and with the prior approval of a member of the firm's legal or compliance function;
- (c) a physical separation exists between the financial analysts involved in the production of investment research and other relevant persons whose responsibilities or business interests may conflict with the interests of the persons to whom the investment research is disseminated or, when considered not appropriate to the size and organisation of the firm as well as the nature, scale and complexity of its business, the establishment and implementation of appropriate alternative information barriers;
- (d) the investment firms themselves, financial analysts, and other relevant persons involved in the production of the investment research do not accept inducements from those with a material interest in the subject-matter of the investment research;

(e) the investment firms themselves, financial analysts, and other relevant persons involved in the production of the investment research do not promise issuers favourable research coverage;

(f) before the dissemination of investment research issuers, relevant persons other than financial analysts, and any other persons are not permitted to review a draft of the investment research for the purpose of verifying the accuracy of factual statements made in that research, or for any purpose other than verifying compliance with the firm's legal obligations, where the draft includes a recommendation or a target price.

For the purposes of this paragraph, 'related financial instrument' shall be any financial instrument the price of which is closely affected by price movements in another financial instrument which is the subject of investment research, and includes a derivative on that other financial instrument.

Recital 53

Exceptional circumstances in which financial analysts and other persons connected with the investment firm who are involved in the production of investment research may, with prior written approval, undertake personal transactions in instruments to which the research relates should include those circumstances where, for personal reasons relating to financial hardship, the financial analyst or other person is required to liquidate a position.

Recital 54

Fees, commissions, monetary or non-monetary benefits received by the firm providing investment research from any third party should only be acceptable when they are provided in accordance with requirements specified in Article 24(9) of Directive 2014/65/EU and Article 13 of Commission Delegated Directive (EU) .../... [to be inserted before adoption] of XXX supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits.

Recital 56

Financial analysts should not engage in activities other than the preparation of investment research where engaging in such activities are inconsistent with the maintenance of that person's objectivity. These include participating in investment banking activities such as corporate finance business and underwriting, participating in 'pitches' for new business or 'road shows' for new issues of financial instruments; or being otherwise involved in the preparation of issuer marketing.

12.2.21A G

- (1) The phrase "participating in 'pitches' for new business" in Recital 56 to the *MiFID Org Regulation* would generally include a *financial analyst* interacting with an *issuer* to whom the *firm* is proposing to provide underwriting or placing services (including the *issuer's* representatives outside of the *firm* and any *person* who has an ownership interest in the *issuer*), until both:
 - (a) the *firm* that employs the *financial analyst* has agreed to carry on regulated activities that amount to underwriting or placing services for the *issuer*; and

(b) the extent of the *firm's* obligations to provide underwriting or placing services to the *issuer* as compared to the underwriting or placing services of any other *firm* that is appointed by the *issuer* for the same offering is confirmed in writing between the *firm* and *issuer*.

(2) (a) It may nevertheless be possible, in limited circumstances, for a *financial analyst's* interactions with any such *person* referred to under paragraph (1) to be entirely separate from the *firm's* 'pitches' such that the risk to their objectivity being impaired would be reasonably low.

(b) However, the *FCA* considers that would not be the case where the analyst is aware of the 'pitches', or may have reason to believe that the *firm* is conducting the 'pitches'.

(3) In any case a *firm* should recognise that any situation in which there is a connection between its 'pitches' and a *person* with whom its *financial analyst* interacts can give rise to a conflict of interest (see ■ SYSC 10 (Conflicts of interest) and the relevant provisions of the *MiFID Org Regulation*).

12.2.22 EU Article 37(3) of the *MiFID Org Regulation* provides for exemptions from article 37(1) of the *MiFID Org Regulation* (■ COBS 12.2.19EU).

37(3) Investment firms which disseminate investment research produced by another person to the public or to clients shall be exempt from complying with paragraph 1 if the following criteria are met:

(a) the person that produces the investment research is not a member of the group to which the investment firm belongs;

(b) the investment firm does not substantially alter the recommendations within the investment research;

(c) the investment firm does not present the investment research as having been produced by it;

(d) the investment firm verifies that the producer of the research is subject to requirements equivalent to the requirements under this Regulation in relation to the production of that research, or has established a policy setting such requirements.

12.2.23 G The *FCA* would expect a *firm's conflicts of interest policy* to provide for *investment research* to be published or distributed to its *clients* in an appropriate manner. For example, the *FCA* considers it will be:

(1) appropriate for a *firm* to take reasonable steps to ensure that its *investment research* is published or distributed only through its usual *distribution channels*;

(2) inappropriate for an *employee* (whether or not a *financial analyst*) to communicate the substance of any *investment research*, except as set out in the *firm's conflicts of interest policy*; and

(3) inappropriate for a *financial analyst* or other *relevant person* to prepare *investment research* which is intended first for internal use for the *firm's* own advantage, and then for later publication to its

clients (in circumstances in which it might reasonably be expected to have a material influence on its *clients'* investment decisions).

12.2.24

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The FCA would expect a *firm* to consider whether or not other business activities of the *firm* could create the reasonable perception that its *investment research* may not be an impartial analysis of the market in, or the value or prospects of, a *financial instrument*. A *firm* would therefore be expected to consider whether its *conflicts of interest policy* should contain any restrictions on the timing of the publication of *investment research*. For example, a *firm* might consider whether it should restrict publication of relevant *investment research* around the time of an investment offering.