IR magazine

Guide #7

Policy for issuer/analyst relations

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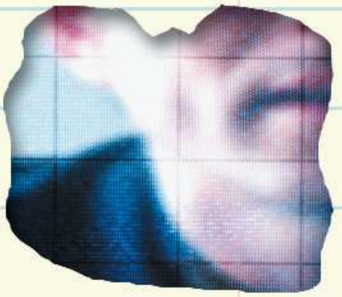


Building trust

The triangular relationship between companies, investors and analysts has come under a lot of stress over the last five years. Problems of selective disclosure prompted Regulation Fair Disclosure (Reg FD), corporate debacles like Enron resulted in the Sarbanes-Oxley Act, and conflicts of interest pushed Wall Street into a global settlement. Even after all the reforms, though, problems are still making headlines.

Consider Altera, the California semiconductor company that apparently blackballed a Wells Fargo analyst after he wrote a negative report with a 'sell' recommendation. The analyst said he was told by both Altera's CFO and its head of IR that it was no longer in Altera's shareholders' interests to 'facilitate' his research. They reportedly said they would no longer take his phone calls or allow him to ask questions on conference calls. After this incident was publicized, Altera issued a formal apology – but not before its reputation had been harmed.

In March a small Minneapolis brokerage, Miller Johnson Steichen Kinnard (MJSK), dropped coverage of Digital River soon after changing its recommendation to a 'sell'. Brokerage executives said Digital River had threatened to sue MJSK unless the securities firm ceased publishing research on it. Just a 'rumor', declared Digital River, though there have also been rumors of other brokers dropping coverage in response to pressure from the company. The *Minneapolis Star Tribune* and *Barron's* published stories about Digital River's actions that undermined the company's reputation and the credibility of the corporate/sell side relationship.

Those are just two of many cases that have garnered media coverage. There are hundreds more that haven't. In *IR magazine's Investor Perception Study, US 2005*, nearly 40 percent of more than 700 sell-side analysts said they felt 'shut out' from a company's communications efforts after downgrading a stock. This finding suggests an epidemic is underway.

Here's a typical comment from one of the study's respondents: 'When a company is downgraded, the reactions of its IR team and management are often exactly the opposite of what they should be: they tend to return calls less or not at all, provide less information, not more, make it uncomfortable to deal with them, nit-pick irrelevant details from reports (to pretend the analyst is wrong or just doesn't understand), and so on. All of this is silly – ratings are by nature fungible, but relationships can take years to put back together or never recover at all. How does that serve shareholders?'

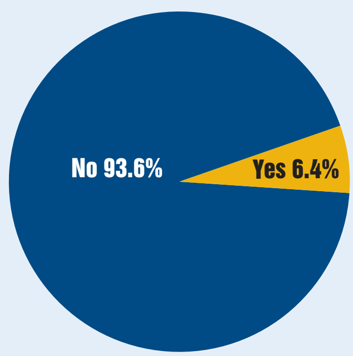
Back in balance

Rebalancing the issuer/analyst relationship was the goal of a joint task force established by the CFA Centre for Financial Market Integrity (the advocacy and standard-setting arm of CFA Institute) and the National Investor Relations Institute (Niri) in June 2003. In December 2004 the task force released 'Best practice guidelines governing analyst/corporate issuer relations'.

Pressure by issuers to influence sell-side analysts' recommendations is one of the oldest skeletons in Wall Street's closet. In the past few years, though, it has been getting a lot of attention at the highest levels. Just as Niri and the CFA Centre were setting up their task force, the SEC asked

Severing ties

This is what 732 sell-side respondents to the *IR magazine*-commissioned *Investor Perception Study, US 2005* said when asked: Has a company ever threatened to suspend its banking relationship with your firm because of a downgrade?



Source: Investor Perception Study, US 2005

A new era

The global settlement reached by the SEC, Eliot Spitzer and other regulators marked a turning point in the sell-side drama. Under the old model, investment bankers would court issuers with the lure of sell-side coverage – and not just coverage, but the implicit promise of rosy coverage. When ratings turned sour, issuers threatened to take their business elsewhere and investment bankers, in turn, leaned on analysts to brighten issuers' investment outlook.

The global settlement required a complete separation between investment banking and sell-side research. Significantly, it banned the practice of compensating analysts on the basis of investment banking business. Where analysts may have been considered by some to be cheerleaders chasing bonuses based on new banking business, the global settlement stressed the obligation to provide honest and objective research.

This change has prompted some disgruntled issuers to take their fight directly to analysts. With no hungry investment bankers to support them, issuers have 'iced' analysts by cutting down or severing contact. According to the guidelines, that is gravely unethical behavior and can permanently tarnish a company's reputation. Moreover, it's a setback to the crucial process of building investor trust.

Corporate retaliation

This is what 732 sell-side respondents to the *IR magazine*-commissioned *Investor Perception Study, US 2005* said are the most common ways they are shut out by companies following a downgrade:

1 Slow IR response
2 Not allowed questions on conference calls
3 Company will not attend conferences
4 Restricted access to management
5 Cold shoulder
6 Less access generally
7 Less data provided
8 Not granted any meetings
9 Subjected to aggressive behavior
10 Management questions professionalism
11 Not invited to events
12 Totally shut off from all contact
13 Will not travel on roadshows
14 Dropped from coverage list
15 Shoveled to junior members of IR team.

Source: Investor Perception Study, US 2005

the stock markets to address the problem. As incoming chairman Christopher Cox was being sworn in this summer, letters were being penned suggesting he tackle the issue again.

The CFA Centre and Niri teamed up partly in response to the increased interest of regulators and exchanges in the issuer/analyst interface. The risk is that the exchanges or the SEC might create strict, one-size-fits-all rules. Over 18 months, with the SEC, the NYSE, NASD and Nasdaq observing, the task force worked to devise an industry-led solution. Although examples of corporate retaliation and other proscribed practices continue to emerge, the CFA Centre and Niri have been quick to point out that best practices are in place, and the organizations' members are expected to follow them.

The task force's deliberations initially focused on the undue influence exerted by issuers on analysts. It soon became clear, however, that analysts may also act inappropriately in pressuring companies for access to information and personnel. For example, a large institutional holder with 10 percent of a stock may demand special access or additional information generally denied to the investing public. Or a sell-side analyst might leverage his or her position and dig for material, non-public information.

Not just companies

So, while the guidelines detail how issuers must not discriminate among or put pressure on analysts, they also address the responsibility of analysts and investors in maintaining fair, open relations with issuers. The task force concluded that issuers and analysts must both endeavor to support independence and objectivity and to advance a mutually beneficial relationship that is in keeping with the best interests of investors.

'Whether it's a conference call or a sell-side conference, our intent is that companies, the buy side and the sell side should have an open dialogue,' says task force co-chair Sam Levenson, senior vice president of investor and corporate relations at Cendant Corporation.

Another task force member, Brad Allen, vice president of corporate communications and investor relations at Imation, explains it this way: 'The task force addressed the range of interactions and relationships between issuers and the financial community, both buy side and sell side. We recognized that each group has sets of interests and there are natural tensions between them. But if everyone approaches these relationships recognizing those interests and tensions and respecting each other's point of view, we can have some rules of the road that keep people focused on what matters. The guidelines are for the whole constellation of relationships between issuers and the financial community.'

Remember: no-one is suggesting that issuers and analysts should be best friends. Indeed, there's as much danger in being too chummy as there is in being enemies. The relationship needs to be neutral and open without one side pressuring the other. If successful, the relationship is mutually beneficial and works to further the investing public's best interests.

New guidelines

'Best practice guidelines governing analyst/corporate issuer relations' from the CFA Centre and Niri is an essential new tool for issuers. But when you get right down to it, there's nothing really new. In fact, the guidelines reflect key points from both the CFA Centre's and Niri's standards of practice.

The guidelines reflect each organization's code of ethics, apply them to the specific context of access to issuers, and match them with responsibilities on the corporate side. They're also a tool for analysts and public companies worldwide who may not be members of either CFA Institute or Niri, and they're an important reference for the SEC, the NYSE, NASD and Nasdaq, all of which participated in task force proceedings.

What *is* new is the recommendation that issuers establish a written policy for analyst relations. Today, most companies' disclosure policies usually include some broad principles for dealing with analysts. But at a recent IR Magazine US Think Tank, only one of approximately 40 senior-level IROs said they had a written policy governing access to senior management.

For more information on the guidelines, see www.niri.org or www.cfainstitute.org.

Stand up to scrutiny

Many top senior management teams don't prioritize questions on conference calls or in group meetings. Leading IROs say a strong company is never afraid to answer difficult points or face off against analysts with negative views, who will still have spent many hours looking at the company and may have an insightful viewpoint. In fact, this viewpoint may be even more helpful than the cheerleaders'.

After all, investors don't want to listen to a mutual backslapping session. They learn much more from hearing a CEO think fast on his or her feet in response to a tough question, or a CFO who clearly has all the numbers at his or her fingertips.

There is no excuse for being unprepared for almost any question you could get on a conference call. Most analysts say they never ask a question they don't already know the answer to. They want to save the most revealing questions for one-on-one meetings so they can gain an edge over their competitors (without crossing the line of insider information or Reg FD). The management team should be well prepared going into a conference call.

Fair access

Most institutional investors rely on dialogue with company management to fully understand the information they receive through annual reports and other publicly accessible means. They also rely on third parties, particularly sell-side analysts.

Beyond the hunt for numbers and other information, investors and analysts consistently rate quality of management as the key non-financial measure in valuing a company. But it's difficult to assess the quality of senior managers without actually meeting and speaking with them. When investment pros meet the management team, they can build their confidence in its ability to execute its strategic plan – or lose confidence.

The principal theme of the CFA Centre-Niri guidelines is that issuers and analysts must work together to nurture healthy working relationships. Most importantly, from the IRO's perspective, a company must never discriminate against anyone on the basis of investment opinions or recommendations, and it must never seek to influence opinions or recommendations by denying access to information or personnel.

Conference calls

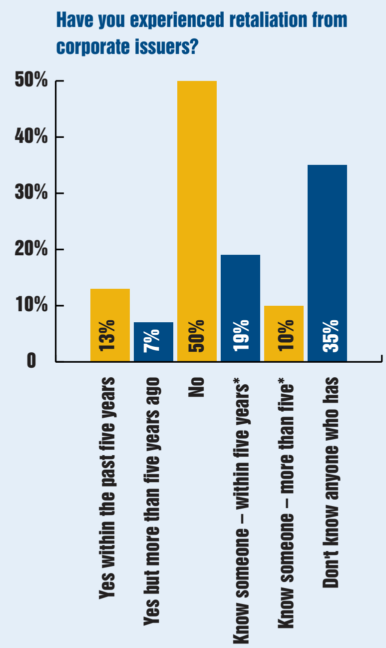
It is now a well-established practice for issuers to hold quarterly conference calls with telephone and web access. Analysts and professional investors are usually invited to dial in and ask questions during the Q&A portion of the call while everyone else can listen to the webcast.

If firms don't follow certain procedures, they could experience a variety of pitfalls. Allegations of restricted access could be leveled even before the call if an analyst isn't invited to participate on the phone. During the call, if an analyst with a question doesn't get to ask it, he or she may feel discriminated against. Problems could also arise from new services offered by some conferencing providers. 'Call management' tools show who's in the question queue, letting the IRO pick and choose who to take questions from, prioritizing bullish analysts and leaving negative ones to the end. If a call has a time limit, analysts known to have negative opinions might never be heard.

The temptation to prioritize questions is understandable. IROs and management want to field incisive questions from big names, not rambling comments from Aunt Edna in Toledo, nor do they want awkward queries from bearish outliers. Levenson believes anyone who wants to ask a question on a conference call should be given the opportunity to do so. 'But that doesn't mean you have to subject your CEO to a heckler,'

Shutting out analysts and investors

CFA Institute recently polled 821 of its members (all portfolio managers and analysts) on the topic of corporate retaliation. This is what they said:



* 'Know someone – within five years' refers to those with an acquaintance who has experienced corporate retaliation in the past five years. 'Know someone – more than five' refers to respondents who know someone who has experienced retaliation from issuers but it happened more than five years ago.

Source: CFA Institute, September 2005

Access criteria

Issuer/analyst policies should clearly define the different levels of access that are available, setting forth the qualifications that persons or entities need to qualify for a particular level of access. Types of access may 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
- Access to the company only through contact with IROs.

After the levels of access are defined, companies are advised to develop criteria for the type of credentials or experience that would qualify individuals (for example, analysts or their employers) to participate at each access level. Companies might consider the following 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)
- Professional credential, such as chartered financial analyst® (CFA®) designation.

Source: CFA Centre-Niri guidelines, December 2004

he adds. Indeed, companies have a right to make sure a question is legitimate and the questioner is qualified to submit it. They also have a right to impose order on the conference call.

One main task of an IRO is to make the best possible use of the time senior management allots to IR while running the company. That means you have to constantly make decisions about which analysts or investors are granted one-on-one or group meetings, and which personnel in the company they meet with.

'The CFO or CEO cannot take every single phone call – that's what IROs are for,' Levenson says. 'And we don't take our CFO or CEO out to teach people the basics of the company; every company should have a professional IR staff to do that. But at some point, large institutional investors and sell-side analysts are going to want to meet management.'

Keeping one-on-ones going

When Reg FD was first drafted, it threatened to end one-on-ones and small group meetings. Partly through Niri's efforts, the SEC was persuaded that such meetings could take place without management revealing new material information. While analysts and investors initially complained of companies pulling back from one-on-ones, the situation has settled down so much that, according to a survey of Niri members, 97 percent of issuers currently conduct one-on-ones with the investment community.

There is no rule forcing companies to hold individual meetings with analysts and investors. But if you do grant meetings, you should have a policy to determine who has access. For example, a junior analyst at a firm that doesn't publish research on your company cannot expect a one-on-one with the CEO but may expect to meet the IRO, attend an occasional group meeting, and have a brief phone conversation with the CFO a few times a year. Conversely, a portfolio manager at an institution with a large, long-term holding may be granted much greater access.

Allen says brokerage firms that don't cover his company have offered him client meetings led by institutional sales teams rather than analysts. It's clear brokerage firms are being compensated for their ability to bring management through clients' meeting rooms. From Allen's point of view, it's a positive phenomenon, being exposed to brokerage clients he might not otherwise meet – with the caveat that they should be investors worth spending his senior managers' time on. A meeting with a high-commission client who will trade in and out of the stock within three months would not be time well spent.

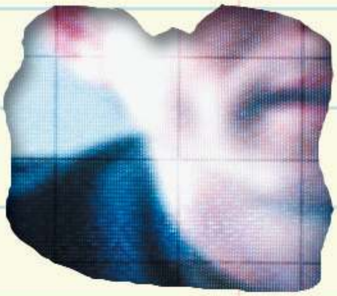
Face to face

'Qualitatively, a researcher ideally wants access to management so he or she can form hypotheses about the fundamental options a company faces in its business lines and with its balance sheet to drive the company in the long term,' wrote Jeff Diermeier, president and CEO of CFA Institute, in the July-August 2005 issue of *CFA Magazine*.

Issuers agree investment pros need to 'eyeball' senior management. But how much face time can they afford in their busy schedules? The CFA Centre-Niri guidelines advise 'as much access as possible' while acknowledging that it depends on company-specific limitations in terms of time and budget.

By devising written policies on granting access to management, companies can avoid allegations of favoritism and reduce the chances of communicating inside information.

A company can take the IR high ground by establishing a minimum level of access. Interested parties, from retail investors to star analysts on Wall Street, should be able to have some direct contact with company representatives. Not only does this help create good working relationships with analysts and investors, but it also helps communicate the company's investment story to a wider audience – the ultimate goal of full and fair disclosure.



Research for dollars

Small and mid-sized companies are in crisis: changes on the sell side over the last few years have resulted in a dearth of analyst coverage. And the buy side still has doubts about the alternative: issuer-paid research.

In a 2003 CFA Institute survey, 85 percent of members who responded said sponsored research was 'average', 'below average' or 'poor in quality'. A quarter of respondents also said the quality of sponsored research has deteriorated since 2000.

The situation may well improve with the launch of the Independent Research Network by Nasdaq and Reuters. The joint venture hopes to solve the problems of independence, credibility and distribution that have plagued the issuer-paid research model.

Allen suggests an alternative approach: 'I rewrote Imation's 10K and made sure it was the best research report possible not just on our company but on our industry, complete with industry drivers and information about competition. IROs have it within their power to be the best sell-side analysts in their respective industries with a plain English 10K as their channel of delivery.'

Creating policy

Two areas covered in detail by the CFA Centre-Niri guidelines are review procedures for draft analyst reports and issuer-paid research. The former has always been a tricky practice. For example, to what extent can an issuer comment on a draft report without risking an 'endorsement' of the analyst's recommendations? And the practice has changed dramatically since the global settlement with sell-side compliance departments now taking a strong role in the process.

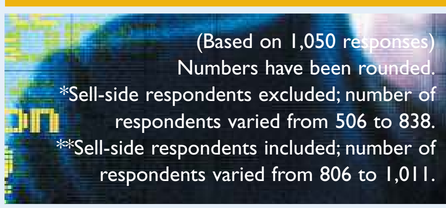
Some issuers simply refuse to review draft reports. But if they do, they must do so in a fair, equitable and consistent manner. It's well worth clearly establishing that practice in your issuer/analyst policy.

Significantly, an analyst must never show the issuer his or her conclusion, recommendation, estimate, valuation or price target, while an issuer must comment only on the accuracy of facts that are already public. By limiting the review to historical facts and other publicly disclosed information, the issuer can avoid its comments being viewed as an endorsement of the report.

According to the CFA Centre-Niri guidelines, a sell-side report should clarify which information is attributed directly to company management and which is the analyst's interpretation of management's comments. Analysts should also clarify any key factors that have been included or

Outside sources

Portfolio managers and buy-side analysts rate their own in-house analysts the highest. Issuer-paid research is considered important by only 13 percent of buy siders and its quality was rated lower than other sell-side research.



	Importance	Quality			Change over past three years	
	Very or extremely important (%)	Good(B) or excellent (A) (%)	Average (C) (%)	Poor (F) or below average(D) (%)	Improved some or a lot (%)	Deteriorated some or a lot (%)
Your employer's in-house analysts *	79%	68%	28%	5%	46%	9%
Data, news and information services**	65%	43%	47%	10%	33%	12%
Outside research purchased from independent research firms*	52%	47%	39%	14%	29%	13%
Credit rating agencies**	50%	39%	41%	21%	27%	20%
Regulators or statutory agencies**	50%	33%	49%	18%	24%	15%
Outside research purchased from broker-dealers/investment banks*	45%	30%	46%	24%	26%	26%
Sponsored research that is commissioned and paid for by the company/issuer*	13%	16%	42%	43%	13%	25%

Source: 2003 AIMR corporate disclosure and corporate communications survey, CFA Institute

excluded from earnings estimates, making it easy for investors to compare estimates with those of other analysts or with an earnings outlook disclosed by the company itself.

Issuer-paid research

Another result of the global settlement is that many sell-side firms have shrunk and fewer analysts are covering fewer companies. However, independent research firms haven't yet fully picked up the slack. According to Reuters, since the beginning of 2002, more than 13 percent of public companies have lost research coverage. Today around half of all companies have two or fewer analysts and 35 percent have none at all.

To fill the gap, many companies, particularly small and mid-sized ones, are resorting to paying research firms for Wall Street-style reports. The process is fraught with conflict, with little chance an analyst would write a negative report about a paying client, or that a company would go back to the same analyst after a negative report.

No wonder, then, that there is a stigma attached to issuer-paid research, and it is still uncertain how much value the buy side places on it. Nonetheless, the phenomenon is spreading, and recently Nasdaq and Reuters announced a high-profile joint venture, the Independent Research Network, to match issuers with research firms and independent analysts. A similar service, the National Research Exchange, was launched in May 2005.

Niri and the CFA Centre recognize that if such research is to achieve credibility, detailed guidance is needed to address the conflicts. For example, the guidelines say an issuer should seek out analysts who will not only produce objective research, but also fully disclose anything that could harm their objectivity. Payment should be in cash and shouldn't depend on the content or conclusions. Nor should the issuer try to influence the research or put any pressure on the analyst to produce positive recommendations.

While task force members agreed on practically all the content of their guidelines, there was considerable debate over whether corporate policy should be distributed only to a select internal audience, sent to a controlled list of analysts and investors, or disseminated publicly.

Again, there is no-one-size-fits-all solution. A policy of fair access has several aspects: avoid giving preferential treatment to analysts with positive ratings, prevent discrimination against analysts with negative ratings, and never put pressure on analysts to change their opinions. Every company has to take into account its size, history, investment audience, analyst coverage and other factors. Still, the CFA Centre feels strongly that any policy needs to be publicly disseminated, perhaps via the web; a policy that no-one sees is no policy at all. Issuers' corporate counsels, however, believe such a document could be a legal liability.

Finalizing policy

In the end, the task force settled on a compromise: an issuer should create a written policy and present it to qualified analysts and investors on request. A firm's existing disclosure policy is the natural home for any new policies governing issuer/analyst relations. The same group of key people should be involved in creating it: the IRO, corporate secretary or general counsel, outside counsel and the CEO and CFO. If you have a board-level disclosure committee, it would likely also have input.

While some companies have made their disclosure policies public, most have created them for internal use. One approach may be to expand on issuer/analyst relations in the existing disclosure policy and then distribute only the new section to investors and analysts who request it.

Broad guiding principles of full, fair and timely disclosure and equitable access are in investors' interests. But what's appropriate for a small or mid-cap company may be very different from what's needed at a large firm with more following by institutions and greater sell-side coverage.

'It comes down to the company's culture and how it wants to deal with Wall Street,' Levenson points out.

Policy determining who gets access, to whom and how much, will vary from company to company. The point is, however, that a policy delineating open, fair access should be in place and access should not be determined ad hoc. By establishing clear expectations among analysts and investors in advance, a company can avoid being accused of discrimination or retaliation.

Reviewing drafts

These days, IROs and analysts are more sensitive about reviewing draft research reports since Reg FD and the global settlement have nearly ended the entire practice. In a Niri survey from August 2004 of senior IROs, 81 percent said they reviewed draft earnings models before Reg FD compared with only 43 percent afterwards. Then the global settlement came along and sell-side compliance departments started imposing strict checks and balances on their analysts.

Still, for an overworked analyst covering a wider universe of companies, it's easy to get a number wrong, or to get confused with past mergers and restatements. Many IROs consider it essential to review draft reports to ensure the accuracy of historical information in the public domain. The guidelines from the CFA Centre and Niri contain detailed do's and don'ts for issuers and analysts.

Sponsor's statement

The CFA Centre for Financial Market Integrity was created to develop timely, practical solutions to global capital market issues, while advancing investors' interests by promoting the highest standards of ethics and professionalism in the investment community worldwide. Established in 2004 by CFA Institute, the CFA Centre builds upon a 40-year history of standards and advocacy work, especially with its code of ethics, standards of professional conduct and the global investment performance standards (GIPS®).

CFA Institute is a 77,000-member organization of investment professionals in 120 countries. The organization's mission is to 'lead the investment profession globally by setting the highest standards of ethics, education and professional excellence.'

CFA Institute is best known worldwide for its rigorous chartered financial analyst® (CFA®) curriculum and examination program. The CFA® designation tells clients, employers and colleagues that the holder has mastered a rigorous curriculum covering a broad range of investment topics, passed three sequential, six-hour examinations, worked as an investment professional for a minimum of three years, and annually reaffirms a commitment to abide by the CFA Institute code of ethics and standards of professional conduct.

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Strengthening bonds

There's only so much analysts can do with publicly available information. Their real job is to dig further and provide additional insights for investors. Time with management is an opportunity to ask questions whose answers are not necessarily material but which, when pieced together with other information – whether other non-material, non-public information or material, publicly available information – help build an investment thesis.

Today, more than ever, sell-side analysts need to demonstrate they have good access to management at the companies they cover. They freely admit that a large part of what they're paid for is bringing corporate management teams out to meet their clients. In various surveys ranking sell-side analysts, institutional money managers consistently say access to management is the most important factor. For some, it's the only thing they're interested in.

Some experts think this trend is partly due to the significant shift of assets into hedge funds, a class of investor historically avoided by issuers. As a result, increasingly powerful hedge funds have asked sell-side analysts to provide them with an introduction to issuers.

Drawing the line

Reg FD helped clarify the formerly blurry line of what companies can say, who they say it to and when they say it. The global settlement also helped reestablish an important line – the one between investment banking and brokerage research.

The issuer/analyst guidelines from the CFA Centre and Niri complete the circle by demarcating the boundaries of relations between companies and the investment community. One of the biggest problems is that management and the financial community take a very short-term view of stock performance. With a longer-term view, management wouldn't be bothered in the least by an analyst with a sell recommendation. After all, a company should want its shares to be fairly valued – not overvalued or undervalued. If a stock is overvalued, an analyst providing a 'sell' recommendation could help move it back to a fair valuation, and this would benefit the company.

Since the era of analysts as star players on the investment banking stage, promising applause-filled research no matter what the reality, they have been exiled as adversaries. Both extremes harm the investing public. The ideal is the middle ground, where analysts are trusted by investors and issuers to produce objective, reliable, relevant research.

A better future

The need for improvement is worldwide, not just in the US. For example, senior management at privatized companies such as China's former state-owned enterprises (SOEs) often have difficulty adjusting to the sell side's scrutiny – where objectivity, especially concerning emerging markets, can be poor.

In Europe's smaller domestic markets or countries such as Australia and South Africa, the complaint, 'Everyone's an insider', stems from over-tight communities of listed companies, institutional investors and sell-side firms.

The guidelines produced by the CFA Centre and Niri have been designed as a tool for issuers and analysts in the US and elsewhere. Different firms must tailor the guidelines according to their unique characteristics. What they all have in common is that a clear policy for issuer/analyst relations, consistently applied, will go a long way toward strengthening trust between issuers and the investment community.