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Analyst Conflicts of Interests: Are the NASD and NYSE Rules Enough?

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NOTES

ANALYST CONFLICTS OF INTERESTS: ARE THE NASD AND NYSE RULES ENOUGH?

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INTRODUCTION

In recent years, a recurring trend has emerged in the United States financial markets: following a period of seemingly unprecedented market prosperity, a select group of perceived heroes has been transformed almost overnight from being celebrated trendsetters into reviled scapegoats.[1] In the 1980s Michael Milken was the revolutionary junk bond king.[2] Milken was an innovator,[3] but faced his demise with his infamous cohort Ivan Boesky after being jailed for using insider information.[4] Thereafter, in the early 1990s, Long-Term Capital Management and its partners, considered geniuses on Wall Street, suffered their downfall when interest rates took a turn for the worst and the company that seemed foolproof faced financial disaster.[5] Today

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1. *See* Tom Petruno, *Enron and Ivan Boesky: Symbols of Their Eras*, LATIMES.COM, Jan. 13, 2002, *available at* http://www.latimes.com/business/la-000003084jan13.column?coll=la-utilities-business (last visited Feb. 20, 2002).

2. *See* Andrew Gumbel, *The Resurrection; Everyone Thought Michael Milken, the Disgraced Junk Bond King, Was Washed Up. But He's Back—and This Time He's Going to Help Save Mankind*, INDEPENDENT (London), June 9, 1999, at Bus. 1.

3. Milken has often been credited with revolutionizing the capital markets. *See, e.g.*, *Mike Milken's Biography*, *at* http://www.mikemilken.com/mike_bio.html (last visited Mar. 4. 2002).

4. *See* Ian King, *Millions of Us Lose Out*, SUN, Feb. 3, 2000.

5. *See generally* ROGER LOWENSTEIN, WHEN GENIUS FAILED: THE RISE AND FALL OF LONG-TERM CAPITAL MANAGEMENT (Random House Trade

there is a new breed of evil genius on Wall Street, the financial analyst. Financial analysts are so called because the demise of both the Internet stocks and Enron came with little or no warning from these "experts." The result being that the integrity of "name" financial analysts was undermined in the eyes of the public,[6] which in turn made Congress take action by initiating investigations into Wall Street's financial analysts.[7]

In an attempt to mitigate damages the industry responded with self-regulation.[8] Broker-dealers instituted internal procedures that placed restrictions on analysts whom they employ, and the

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Paperbacks 2000) (providing a history of and insight into the financial theories and practices behind Long-Term Capital Management).

6. *See Enron and Wall Street Analysts: Hearings on the Collapse of Enron: The Role Analysts Played and the Conflicts They Face Before the Senate Comm. on Governmental Affairs*, 107th Cong. (2002) (statement of Frank Torres, Legislative Counsel, Consumers Union) [hereinafter Torres Testimony].

7. For Congressional Testimony discussing the Internet bust, see *infra* note 55. Additionally, Congress has recently initiated its investigation into the Enron disaster. *See supra* note 6 & *infra* note 46 (providing examples of testimony taken with respect to Enron); *see also* Andres Rueda, *The Hot IPO Phenomenon and the Great Internet Bust*, 7 FORDHAM J. CORP. & FIN. L. 21, 54–81 (2001) (providing an explanation of the role of the analyst in the internet IPO phenomenon); Marilyn Greewax, *Congress Warns Stock Analysts May Face Regulation*, COX NEWS SERV. (June 14, 2001) (chronicling the Congressional investigation into the role analysts played in the Internet phenomenon); Jaimee Campbell, Comment, *Analyst Liability and the Internet Bubble: The Morgan Stanley/Mary Meeker Cases*, 7 FORDHAM J. CORP. & FIN. L. 235 (2001) (chronicling cases brought against financial analysts as a result of losses suffered in the internet boom); Gretchen Morgenson, *Wall Street's Analysis Put on the Defensive at a Hearing*, N.Y. TIMES, June 15, 2001, at C4 (providing examples of analysts being called unethical at hearings after the internet craze); *Enron Corp. and Wall Street Analysts: Hearings Before the Senate Comm. on Governmental Affairs*, 107th Cong. (2002) [hereinafter Bowman Testimony] (statement of Thomas A. Bowman, CFA, President and Chief Executive Officer of the Association for Investment Management and Research) (stating that the activities at Enron caused financial losses in the market and as a consequence a lack of confidence in financial analysts).

8. *See* Morgenson, *supra* note 7 (explaining that the Securities Industry Association issued voluntary practices for analysts); *see also* Unger Testimony, *infra* note 55 (explaining that Merrill Lynch and Credit Suisse First Boston had put restrictions on their analysts); John Labate, *NYSE Review Its Rules on Analyst Disclosure*, FIN. TIMES (London), Aug. 14, 2001, at 22 (purporting that Goldman Sachs also has put restrictions on its analysts).

Securities Industry Association ("SIA") published a guide for analysts and broker-dealers alike.[9] However, after the Internet bust left many asking questions,[10] the colossal collapse of Enron, when again analysts failed to recognize problems, provoked the industry regulators to take action. In February 2002, the Self Regulatory Organizations ("SROs")[11] entered the fray,[12] making regulatory rule proposals to the Securities and Exchange Commission ("SEC"). The National Association of Securities Dealers ("NASD") proposed a new rule, 2711, and the New York Stock Exchange ("NYSE") proposed amendments to its Rule 472 (Communications with the Public).[13]

To put some realism into the severity of the situation, , more than ten articles relating to the SRO proposals appeared in the Wall Street Journal alone in the month following the publication of the proposals.[14] Moreover, shareholders have brought suits against

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9. *See supra* note 8 (providing examples of the broker-dealer and SIA initiatives).

10. *See* Torres Testimony, *supra* note 6 (stating that after analyst failure and plummeting stock prices in the internet industry, many were left asking "what went wrong," including the media, regulatory community and those on Capital Hill).

11. The Self Regulatory Organizations were promulgated by the federal securities laws and assist in the regulation of the securities and futures industries. *See* Marianne K. Smythe, *Government Supervised Self-Regulation in the Securities Industry and the Antitrust Laws: Suggestions for an Accommodation*, 62 N.C. L. REV. 475, 476–79. They promulgate industry rules that are subject to the approval of the Securities Exchange Commission and the Federal Reserve Board, which are federal agencies. *See* BARRON'S DICTIONARY OF FINANCE AND INVESTMENT TERMS 553 (5th ed. 1998).

12. *See* Labate, *supra* note 8 (explaining that the NYSE was reviewing their rules as well as mentioning the changes by firms Merrill Lynch, Credit Suisse First Boston and Goldman Sachs, not to mention the rules of the NASD).

13. *See* NYSE and NYSE Rulemaking, *Notice of Filing of Proposed Rule Changes by the National Association of Securities Dealers, Inc. and the New York Stock Exchange, Inc. Relating to Research Analyst Conflicts of Interest* (Feb. 2002), *available at* www.sec.gov/rules/sro/34-45526.htm (last visited Mar. 17, 2002).

14. *See* Charles Gasparino, *Merrill Lynch Told to Change Ways*, WALL ST. J., Apr. 9, 2002, at C1; Susan Pulliam, *Analysts to Tell Congress That Skepticism Gets Abuse*, WALL ST. J., Mar. 19, 2002, at C1; Karen Talley, *Merrill May Be Alone in Attempt to Toughen Corporate Reviews*, WALL ST. J., Mar. 8, 2002, at C14; Phyllis Plitch, *Analysts Rush to Put Out Fires of Clients*, WALL ST. J., Mar. 6,

analysts, which until now have been dismissed.[15] The culmination of the backlash occurred on April 9, 2002, when Eliot Spitzer, the attorney general for New York State, won a court order, "forcing Merrill Lynch & Co. to overhaul its research [procedures] . . . ."[16] Spitzer's inquiry has already moved beyond Merrill Lynch.[17]

This Note will respond to the SROs' proposed rules. Part I will review the traditional role of securities analysts. Part II will provide a review of the many conflicts these analysts face. Part III will provide a review of the new rules and their attempt to address each of the conflicts analysts face. Finally, Part IV will analyze these proposed rules, for better or worse.

I. THE TRADITIONAL ROLE OF THE SECURITIES ANALYST

Generally, a financial analyst is a "person in a brokerage house, bank trust department, or mutual fund group who studies a number of companies and makes buy or sell recommendations on the securities of particular companies and industry groups."[18] Basically, analysts review public information in order to make buy or sell recommendations.[19] An analyst will also "actively seek out bits and pieces of corporate information not generally known to the market for the express purpose of analyzing that

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2002, at B4; Karen Talley, *Merrill Lynch Directs Analysts to Look Deeper Than Pro Forma*, WALL ST. J., Mar. 6, 2002, at C1; Tom Hamburger, *Senate Panel Grills Analysts Who Pushed Enron Stock Even As the Firm Faltered*, WALL ST. J., Feb. 28, 2002, at A3; Randall Smith & Debora Solomon, *Salomon May Downgrade Jack Grubman, As Telecom Analyst's Dual Roles Grate*, WALL ST. J., Feb. 28, 2002, at C1; Randall Smith, *Analysts; Picks of Enron Stock Face Scrutiny*, WALL ST. J., Feb. 26, 2002, at C1; Karen Tally, *Some Technical Analysts Fall Off the Charts*, WALL ST. J., Feb. 20, 2002, at B5A; *Goldman Picks New Heads of Research, Sets Stock Ban*, WALL ST. J., Feb. 20, 2002, at C16.

15. *See* Campbell, *supra* note 7, at 235.

16. Gasparino, *supra* note 14, at C1.

17. *See* Alison Taylor, *Investment Banking Probe Widens beyond Merrill Lynch*, WORLD MKTS. ANALYSIS, Apr. 10, 2002.

18. BARRON'S, *supra* note 11, at 24.

19. *See* U.S. Securities and Exchange Commission, *Investor Alert: Analyzing Analyst Recommendations* (2001), *at* http://www.sec.gov/investor/pubs/analysts.htm (last modified July 13, 2001) [hereinafter *Analyzing Analyst Recommendations*].

information . . . ."[20]

More specifically, the analyst will review financial information, and gather both qualitative and quantitative information.[21] An analyst will collect earnings data, information about federal actions, interest rates and social and economic trends.[22] Analysts must review this information for current and future expectations, compare it to the industry and then make future predictions while balancing these predictions against future risks like market risk or cyclical factors.[23] Thereafter, a report is put together which balances all of these factors, including the analyst's opinion and predictions, which are based on experience and logic.[24] Thus, "as you can see the role of the analyst is multifaceted."[25] Given the complexity of the job it seems obvious why most analysts specialize in either a few companies or one industry or sector.[26]

In the U.S. markets, analysts are said to play a key role in promoting efficient market pricing by gathering available information and sorting it out.[27] Indeed the United States Supreme Court recognized this proposition in *Dirks v. SEC*, explaining that the analyst is key to healthy markets because they provide objective evaluations of companies.[28] They do this by, "evaluating, verifying, and researching corporate disclosures required by the securities laws, and in disseminating company-specific information to the market as a whole."[29]

The role of the analyst to broker-dealers is centered on

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20. *In re* Raymond L. Dirks, Exchange Act Release No. 17,480, 47 S.E.C. 434 (Jan. 22, 1981).

21. *See* Frank Fernandez, *The Roles and Responsibilities of Securities Analysts*, 7 RES. REP. 3, 3–4 (2001), *available at* http://www.sia.com/reference_materials/pdf/RsrchRprtVol2-7.pdf (last visited Oct. 19, 2002).

22. *See* Rueda, *supra* note 7.

23. *See id.*

24. *See id.*

25. Fernandez, *supra* note 21, at 4.

26. *See* BARRON'S, *supra* note 11; *Analyzing Analyst Recommendations*, *supra* note 19; Fernandez, *supra* note 21, at 3.

27. *See* Torres Testimony, *supra* note 6.

28. Dirks v. SEC, 463 U.S. 646, 658 (1983).

29. Rueda, *supra* note 7, at 54.

generating revenue; they are not employed as a public service.[30] An analyst's recommendation sells securities and makes the company money.[31] Moreover, as will be discussed later, certain recommendations can assist in bringing in investment banking business for a broker-dealer.[32] Other companies, like mutual funds, use analysts internally to assist in the purchase and sale of securities in their own account.[33] These distinctions are extremely important in the current debate, because the only groups of analysts under fire are the ones working for broker-dealers.[34]

An analyst's employer is an important distinction in understanding the proposed NASD and NYSE rules because most of the conflicts a broker-dealer's analyst faces is as a result of their employer. The three general types of analysts are buy-side, sell-side and independent.[35] The sell-side analysts are the ones at issue in the SROs proposed rules. Typically the sell-side analysts work for a full service broker-dealer.[36] "Many of the more popular sell-side analysts work for prominent brokerage firms that also provide investment banking services for corporate clients—including companies whose securities the analysts cover."[37] This is the root of many conflicts.[38] The buy-side analyst, "typically work[s] for institutional money managers—such as mutual funds, hedge funds, or investment advisors—that purchase securities for their own accounts. They counsel their employers on which securities to buy,

30. *See* David Becker, Analyzing Analysts, Remarks Before the Committee on Federal Regulation of Securities of the American Bar Association (Aug. 7, 2001), *available at* http://www.sec.gov/news/speech/spch510.htm (last modified Aug. 9, 2001).

31. *See id.*

32. *See infra* Part II.A (providing a review of the conflicts of interest facing analysts with regard to the investment banking department).

33. *See Analyzing Analyst Recommendations*, *supra* note 19 (providing a definition of a buy-side analyst).

34. *See infra* Part III (providing a review of the conflicts of interest at issue to the sell-side analyst).

35. *See Analyzing Analyst Recommendations*, *supra* note 19 (providing a definition of the three types of securities analysts).

36. *See id.*

37. *See id.*

38. *See infra* Part II.A (providing a review of the investment banking conflicts faced by financial analysts).

hold, or sell and stand to make money when they make good calls."[39] Finally, independent research analysts typically do their research and publish it on a subscription or other basis.[40]

II. CONFLICTS OF INTEREST FACED BY SECURITIES ANALYSTS

Sell-side analyst conflicts are not a new phenomenon; they are almost "as old as Wall Street."[41] For instance, complaints can be traced to the 1929 crash when again analysts failed to recognize the problems and predict the changing tide of the market in the pre crash economy.[42] However, in recent years there has been an increased amount of conflicts spotlighted. This change is due in large part to three main occurrences. First, the growth in investment banking revenues to broker-dealers has caused an increase in conflicts when an analyst attempts to provide quality research about clients or potential clients of their firm.[43] Second, during the recent bull market, analysts were treated as media stars, getting them lots of exposure, which is good on the upside but when the market suffers a downturn their mistakes are even more pronounced.[44] Finally, there was an explosion in stock market participation by the individual investor and these customers had more access to the information analysts provided.[45]

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39. *See Analyzing Analyst Recommendations*, *supra* note 19.

40. *See id.*

41. Letter from Barbara L. Roper, Director of Investor Protection, Consumer Federation of America, to Barbara Z. Sweeney, Office of the Corporate Secretary, NASD Regulation, Inc., (Aug. 15, 2001), *at* http://www.consumer-action.org/Library/English/Alert/AT-I-12_EN/AT-I-12_EN.html (last visited Mar. 25, 2002) [hereinafter Roper Letter].

42. *See* Fernandez, *supra* note 21, at 6 (providing a quotation from the period 1927-1934 chronicling the loss of prestige of analysts due to the market conditions after the stock market crash of 1929).

43. *See id.*

44. *See id.* at 6; *see also* Simon Goodley, *End of an Era As Blodget Walks*, DAILY TELEGRAPH (London), Nov. 20, 2001, at 30.

45. *See Hearings on Analyst Independence: Hearings Before the Senate Comm. on Governmental Affairs*, 107th Cong. (2002) [hereinafter Glauber Testimony] (statement of Robert R. Glauber, Chairman and Chief Executive Officer, National Association of Securities Dealers, Inc.) (stating that investment activity moved from Wall Street to Main Street and that investors had access to more and more information via various media mediums like television and

Recent studies have illustrated the effect of the abovementioned conflicts of interest. For instance it has been said that in recent years one-third of all recommendations were strong buys or some variation of that top recommendation (since analysts' terminology varies by broker-dealer), one-third buys, and one-third holds.[46] Thus, the sell recommendations represented less than 2% of all recommendations.[47] Another study indicated that sell-side analysts, whose firms have investment banking activities, have 6% higher earnings forecasts and 25% more buy recommendations then do analysts who do not have ties to underwriting activities.[48] Other studies state that recently the buy sell ratio was 66:1 from 6:1 a decade ago.[49] Due to the scarcity of sell recommendations, the industry has come to regard a hold recommendation as a sign to sell, something that many retail customers do not know.[50]

Thus, in an attempt to eliminate these conflicts, the SROs have proposed their rules.[51] The conflicts these rules address can be broken up into three categories, conflicts as a result of investment banking,[52] conflicts resulting from the desire to provide more investment profits for a broker-dealer,[53] and finally, personal conflicts of analysts, their employers, and its institutional

newspapers and the internet); Roper Letter, *supra* note 41.

46. *See Enron Corp. and Wall Street Analysts: Hearings Before the Senate Comm. on Governmental Affairs*, 107th Cong. (2002) [hereinafter Hill Testimony] (statement of Charles L. Hill, CFA, Director of Research, Thomson Financial/First Call); *see also* John C. Coffee, Jr., *Virtue and the Securities Analyst*, N.Y. L.J., July 19, 2001, at 5 (stating that 29% of recommendations were strong buy, 37% buy, 31% hold, 1% sell and .4% strong sell).

47. *See* Coffee, supra note 46, at 5.

48. *See Reporting, Accounting Oversight: Hearings Before the Senate Banking Housing and Urban Affairs Comm.*, 107th Cong. (2002) [hereinafter Coffee Testimony] (statement of John C. Coffee, Jr., Professor, Columbia University School of Law) (citing a CFO Magazine report).

49. Coffee, *supra* note 46, at 5.

50. *See* Fernandez, *supra* note 21, at 7; *Analyzing Analyst Recommendations*, *supra* note 19; *see also* Hill Testimony, *supra* note 46 (stating that most "holds" mean "sell" and that individual investors need to decode this information).

51. *See infra* Part IV (providing a review of the proposed NYSE and NASD rules).

52. *See infra* Part III:A.

53. *See infra* Part III.B.

customers.[54]

A. Conflicts As a Result of Broker-Dealer Investment Banking Activities

The conflicts resulting from investment banking activities are "in large part [due] to a blurring of the lines between research" analysts and a firm's investment banking department.[55] In this category two major conflicts arise. One is when an analyst helps to attract and retain clients of the investment banking department.[56] Second, conflicts are created when an analyst's salary and/or bonus is connected to the success of the investment banking department.[57] It is this conflict that drew the attention of the attorney general, Eliot Spitzer, in his crusade to prosecute broker-dealers for allowing investment banking revenues to conflict with the integrity of the broker-dealer's research departments.[58]

1. Analyst Conflicts Resulting From Drawing and Maintaining Investment Banking Clients.

In the first instance, conflicts present themselves when a broker-dealer either: (1) has an investment banking client who the broker-dealer has already provided underwriting services to and wants to continue the relationship; or (2) the broker-dealer wants to attract new investment banking clients.[59] First, a conflict can simply arise if the analyst participated on the underwriting team that brought the existing client's securities to market.[60] An SEC examination found that there was a significant amount of assistance rendered by analysts to investment banking teams in the

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54. *See infra* Part III.C.

55. *Conflicts of Interest Faced by Brokerage Firms and Their Research Analysts: Hearings on the Quality of Wall Street Research Before the House Subcomm. on Capital Markets, Insurance and Gov't-Sponsored Enterprises*, 106th Cong. (2001) [hereinafter Unger Testimony] (statement of Laura S. Unger, Acting Chairman, U.S. Securities and Exchange Commission).

56. *Id.*

57. *Id.*

58. *See* Gasparino, *supra* note 14, at C1.

59. *See id.*

60. *See id.*

underwriting process.[61] In the past, "Chinese Walls" were erected between the investment banking and research departments.[62] However, recently there has been a trend to bring the analyst over this wall and involve them in the due diligence and marketing of a new offering, making the line between the firm's analyst as a provider of information for the retail customer and as a participant in the investment banking department a very gray area.[63]

It is important to understand the pressures placed on an analyst, from both their employers and its investment banking clients to provide positive recommendations about the clients. The outcome of these pressures has been shown in recent studies providing evidence that recommendations by an analyst whose company underwrote an offering was positively biased as compared to those not involved in the offering.[64] Why are these recommendations skewed? Because the investment banking side of a broker-dealer can provide significant revenues for a broker-dealer and, as such, an analyst would not want to jeopardize an investment banking relationship.[65]

It is most evident when reviewing the IPO process. The investment banking department must attract the new customer. In one study, 20% of CFOs acknowledged that if an analyst issued bad press on the CFO's company, the company would not use the services of that analyst's employer.[66] Furthermore, other studies have shown that the quality of the research department was taken into account by 75% of CEOs and CFOs when choosing a broker-dealer.[67] One reason this is important is because the management will face a lock-up prohibiting them from selling the company's

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61. *See id.*

62. *See generally* BARRON'S, *supra* note 11, at 94 (providing a definition of Chinese Wall).

63. Roni Michaely & Kent L. Womack, *Conflicts of Interest and Credibility of Underwriter Analyst Recommendations*, 12 REV. FIN. STUD. 653, 655 (1999).

64. *Id.* at 653, 656 (citing a 1997 study by Dechow, Hutton and Sloan which also indicated that an underwriting firm's analyst provided more optimistic forecasts than others).

65. *See* Glauber Testimony, *supra* note 45.

66. Coffee Testimony, *supra* note 48 (citing a speech by Laura Unger providing this statistic).

67. Michaely & Womack, *supra* note 63, at 654 (citing a 1992 study by Galant and a 1999 study by Krigman, Shaw and Womack).

stock for a certain amount of time after it is offered.[68] A good research department will support the stock so that it will maintain a good price in the aftermarket and therefore profit management.[69] Thus, "implicit in the underwriter-issuer relationship is the underwriter's intention to follow the newly issued security in the aftermarket: that is, to provide (presumably positive) analyst coverage."[70]

Once the securities are issued, positive reviews will keep the client happy and allow continued business to flow to the broker-dealer.[71] Moreover, after the offering, the broker-dealer may own a significant amount of the issuer's stock and, as such, positive reviews will help bolster the price for the broker-dealer in addition to the management of the company.[72] A Morgan Stanley memorandum confirmed the fact that the company, as a matter of policy, did not make negative or controversial comments about clients.[73] Studies of analysts themselves have further reported that 61% of them have felt pressure to give a positive recommendation or tone down a negative comment.[74]

Not only have analysts felt this pressure, but to make matters worse, their research reports have sometimes been subject to discretion by the investment banking department. For instance, the SEC found that the investment banking department is often given advance notice when there is a change in an analyst's recommendation of a company.[75]

2. Investment Banking Conflicts Resulting from Compensation Practices

Beyond political pressure to make good recommendations,

68. *See* Coffee Testimony, *supra* note 48.
69. *See* Coffee, *supra* note 46.
70. *Id.*
71. *See* Michaely & Womack, *supra* note 63, at 655.
72. NASD, *Understanding Securities Analyst Recommendations* (2002), *at* http://www.nasdr.com/analyst_guide.htm (last visited Mar. 24, 2002) [hereinafter *Understanding Analyst Recommendations*].
73. *See* Michael Siconolfi, *At Morgan Stanley, Analysts Were Urged to Soften Harsh Views*, WALL ST. J., July 14, 1992, at A1.
74. Coffee Testimony, *supra* note 48.
75. *See* Unger Testimony, *supra* note 55.

there can be economic conflicts for a research analyst. Frequently, an analyst's compensation or bonus will be tied to the investment banking division.[76] At some firms, the investment banking department actually reviews analysts to help determine their compensation.[77] All this puts more pressure on analysts to give a good recommendation because a bad rating could lower investment banking revenue and in turn their pay.[78] Moreover, an analyst's reputation is connected to the quality of the research they produce, complicating matters because an analyst's compensation is partially based on their external reputation.[79]

B. Conflicts As a Result of Broker-Dealer Profits

Beyond the investment banking department, analysts face pressure to help their broker-dealers sell securities and thereby produce commissions.[80] A buy recommendation will create more buying and thus more commissions. Finally, a buy in this instance is better than a sell "because all clients can buy a stock, but only existing holders can sell . . . ."[81]

C. Conflicts As a Result of Personal Conflicts of Analysts, Their Employers and Their Customers

The last type of conflict faced by an analyst is based on the fact that the analyst or the broker-dealer may own the stock or stocks in the industry an analyst covers.[82] This would cause the analyst to be biased toward stocks they own for their own profit or stocks their employers own for its own profit.[83] Worse yet, if an analyst contrives a plot to frontrun his recommendation, meaning he would buy or sell the securities before his report is released and

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76. *See* Unger Testimony, *supra* note 55; *Understanding Analyst Recommendations*, *supra* note 72.
77. *See* Unger Testimony, *supra* note 55.
78. *See Understanding Analyst Recommendations*, *supra* note 72.
79. *See* Michaely & Womack, *supra* note 63, at 654.
80. *See* Unger Testimony, *supra* note 55.
81. Coffee Testimony, *supra* note 48.
82. *See Understanding Analyst Recommendations*, *supra* note 72.
83. *See* Coffee, *supra* note 46, at 5.

profit from his inside information, the analyst would be guilty of securities fraud.[84]

This conflict also runs to institutional customers[85] of the broker-dealer.[86] These institutional clients can pressure analysts to bias ratings for their profit. The analysts would likely not comply because they would not want to be responsible for losing these valuable customers.[87] This problem is compounded by the fact that analysts are given industry ratings and institutional investors often give a significant amount of input into these ratings.[88]

III. THE NASD AND NYSE RULES

As a result of Enron and the Internet, many have compared analysts to "glorified salespeople."[89] Thus, in an attempt to remedy this problem, the NASD and NYSE have proposed rules addressing the problematic conflicts analysts face.[90]

A. NASD Proposed Rule 2711

A review of the NASD's rule follows. Broker-dealers must implement the changes required according to this rule, but they also must create supervisory procedures to ensure that the rule is followed. Moreover, a senior officer must attest to the NASD that the supervisory procedures were adopted and implemented on a

84. *See id.*

85. An institutional client is a group trading in large volumes, such as mutual funds, pension funds and labor unions. *See* BARRON'S, *supra* note 11.

86. *See* Unger Testimony, *supra* note 55.

87. *See id.*

88. *See id.*

89. Rueda, *supra* note 7, at 57.

90. *See* U.S. Securities and Exchange Commission, *NASD and NYSE Rulemaking, Notice of Filing of Proposed Rule Changes by the National Association of Securities Dealers, Inc. and the New York Stock Exchange, Inc. Relating to Research Analysts Conflicts of Interest* (Mar. 8, 2002) (providing a statement of purpose for their proposals from both the NASD and NYSE), *available at* www.sec.gov/rules/sro/34-45526.htm (last modified Mar. 12, 2002); *Understanding Analyst Recommendations*, *supra* note 72; Glauber Testimony, *supra* note 45.

yearly basis.[91]

1. Investment Banking Restrictions

The first topic addressed by NASD's proposed Rule 2711 is in connection with the investment banking department.[92] The rule prohibits an analyst from being subject to the supervision or control of any member of the investment banking department.[93] The investment banking department is prohibited from reviewing an analyst's report prior to publication, unless it is to verify factual accuracy or to ascertain if there are any conflicts of interest in the report.[94] Moreover, any written communications between the analyst and investment banking division must be done via or copied to legal or compliance personnel and oral communications must be documented and made through or in the presence of legal or compliance personnel.[95]

The NASD rule also limits a research report from being provided to the subject company prior to publication; it is only to be supplied in order to verify facts.[96] Additionally, the portion containing the rating and price target as well as the research summary cannot be provided to the company at all.[97] Simultaneously, the compliance department must receive a copy of the full report and thereafter if any changes are to be made to the rating or price target the legal or compliance department must approve the changes.[98] Moreover, the rule forbids broker-dealers from notifying an issuer of its intention to change a rating of that issuer prior to publication.[99]

The rule also tries to remove investment banking conflicts by prohibiting analyst compensation from being connected to a

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91. Proposed Rule 2711, Release No. 34-45526, File No. SR-NASD-2002-21, § 2711(i), *available at* www.sec.gov/rules/sro/34-45526.htm (last modified Mar. 12, 2002).

92. *Id.* § 2711(b).

93. *Id.* § 2711(b)(1).

94. *Id.* §§ 2711(b)(1)-(2).

95. *Id.* §§ 2711(b)(3)(A)-(B).

96. *Id.* §§ 2711(c)(1)-(2).

97. *Id.* § 2711(c)(2)(A).

98. *Id.* §§ 2711(c)(2)(B)-(C).

99. *Id.* § 2711(c)(3).

specific investment banking service or transaction.[100] Finally it tries to limit solicitation of clientele by barring any offers for favorable research to companies in consideration for business,[101] and it restricts the bolstering of a stock in the post IPO phase.[102] It does this by imposing a quiet period, during which no research can be released for 40 days for IPOs and 10 days in a secondary offering, for a broker-dealer acting as manager or co-manager of an offering.[103] The member can only issue research during the quiet period if there is significant news or events affecting the company and the legal or compliance department approves such release.[104]

2. *Personal Conflict Restrictions*

The proposed rule imposes the following restrictions on an analyst's trading:

- An analyst cannot purchase or receive securities before an IPO if the analyst covers the company, sector or industry in which the company conducts business;[105]

- An analyst cannot purchase or sell stock for a company the analyst follows, including options and derivatives, for 30 days before and after a research report is released or a change in rating or price target is made. However, a broker-dealer can permit a research analyst to sell all of the securities they hold within 30 days after they begin to follow a company and additionally the broker-dealer can approve a purchase or sale in the 30 days before and after a report based on significant news or events affecting the company is issued;[106]

- An analyst is restricted from purchasing or selling the stock

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100. *Id.* § 2711(d).
101. *Id.* § 2711(e).
102. *Id.* § 2711(f).
103. *Id.* §§ 2711(f)(1)–(2).
104. *Id.* § 2711(f).
105. *Id.* § 2711(g)(1).
106. *Id.* §§ 2711(g)(2)(A)–(B).

> of a company, including options or derivatives on the stock, which is inconsistent with the analyst's recommendation from their most recent published report.[107]

The purchase and sale rules can be circumvented if approved by the legal or compliance department of a broker-dealer but only in the face of "significant personal financial circumstances."[108] Additionally, there are less stringent policies with regard to investment companies and mutual funds owned by an analyst, even though these investments may include securities from a company, sector or industry the analyst covers.[109]

3. Disclosure in the Proposed NASD Rule

Finally, the NASD rule imposes a significant amount of disclosure requirements on an analyst and broker-dealer. It requires disclosure when an analyst makes public appearances and in a research report if: (1) the analyst or anyone in their household has a financial interest in the company; (2) as of five business days from the appearance or report the broker-dealer beneficially owned 1% or more of any class of equity; and (3) any other material conflicts exist for the analyst or broker-dealer are known of.[110]

With regard to the investment banking division, the research report must disclose any compensation received by an analyst preparing the report that was connected to investment banking revenue.[111] Additionally, the report must disclose if the broker-dealer received compensation from the issuer within one year of the report or if it expects to receive such compensation within three months of the report.[112] Finally, in public appearances, if an analyst has reason to know that an issuer is a client of the member, the analyst must disclose this information.[113]

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107. *Id.* § 2711(g)(3).
108. *Id.* § 2711(g)(4).
109. *Id.* § 2711(g)(5).
110. *Id.* § 2711(h)(1).
111. *Id.* § 2711(h)(2)(A)(i).
112. *Id.* § 2711(h)(2)(A)(ii).
113. *Id.* § 2711(h)(2)(B).

The rule also requires disclosure if an analyst, or anyone in their household, is an officer, director or advisory board member of the covered company.[114] An analyst must do this in both the research report and in a public appearance.[115]

The NASD rule also requires disclosure, so that the individual investor can comprehend fully the information in the report. It requires an explanation of the ratings system employed in the report, with plain meaning definitions of each type of recommendation, such as buy, sell or neutral.[116] The research report must disclose what percent of recommendations made by the broker-dealer fall into the defined categories, as well as disclose the percentage of the companies covered that the broker-dealer provided investment banking services for in the previous year.[117] The valuation methods for price targets must be displayed including risks that can prevent the price from reaching that target.[118] The report must include price charts showing the price of the stock during the time the broker-dealer assigned a rating.[119] On the price chart the broker-dealer must indicate any changes in ratings and the date of those changes.[120] Finally, the broker-dealer must disclose if it is a market maker in the company for which it is releasing a research report.[121]

None of the disclosures for the purposes of this rule can be hidden in footnotes or buried in the report.[122] They must be on the front page or the front page must refer the reader to the page where the required disclosures can be found.[123]

B. NYSE Proposed Amendments to Rule 472 and 351

In contrast to the NASD, the NYSE's rules require advance

114. *Id.* § 2711(h)(3).
115. *Id.*
116. *Id.* § 2711(h)(4).
117. *Id.* §§ 2711(h)(5)(A)-(B).
118. *Id.* § 2711(h)(7).
119. *Id.* § 2711(h)(6).
120. *Id.* § 2711(h)(6)(A).
121. *Id.* § 2711(h)(8).
122. *Id.* § 2711(h)(10).
123. *Id.*

approval of a report before distribution by a "member, allied member, supervisory analyst, or qualified person."[124] Additionally, the reports must be prepared or approved by a supervisory analyst, or approved by another supervisory analyst if the analyst's immediate supervisor does not have expertise in the field, and finally, if the firm does not have the expertise, by another broker-dealer who is a member of the NYSE.[125] Moreover, the NYSE requires that these communications be retained and that the person approving the materials must be ascertainable from the records.[126] If anything, the NYSE rule makes more people responsible for a report and hopefully more conscientious.

However, just like the NASD, the NYSE requires written supervisory procedures for the implementation of the proposed rule changes, and requires yearly attestations by a senior officer, or partner.[127] The remainder of the NYSE rule is almost identical to the NASD, the following is review of the rule with notations when there is a divergence from the NASD rule.

1. Investment Banking Rules

The restrictions imposed by the NYSE on investment banking approvals of research reports and company approvals of research reports are basically identical to those imposed by the NASD. They both forbid investment banking from having supervisory, or any other, control over an analyst and prohibit pre-approval by investment bankers except on the basis of verification of accuracy or to find conflicts. Both also require the Legal or Compliance Department to mediate exchanges between analysts and investment bankers in the exact same way.[128] With respect to an issuer, like the NASD, the issuer can only receive portions of the

124. Proposed Rule 472, Release No. 34-45526, File No. SR-NYSE-2002-09, § 472(a)(1), *available at* www.sec.gov/rules/sro/34-45526.htm (last modified Mar. 12, 2002).

125. *Id.* § 472(a)(2).

126. *Id.* § 472(d).

127. *See id.* § 472(c); Proposed Rule 351, Release No. 34-45526, File No. SR-NYSE-2002-09, § 351(f), *available at* www.sec.gov/rules/sro/34-45526.htm (last modified Mar. 12, 2002).

128. Proposed Rule 472, *supra* note 124, §§ 472(b)(1)–(2).

report to verify facts, and exactly like the NASD the compliance department must receive a draft when it goes to the company and must approve all changes in an analyst's recommendation after that time.[129] Finally, just like the NASD it prohibits a broker-dealer from notifying a company of changes in rating until one day prior to the change but only after the close of trading that day.[130]

As with the NASD rule, the NYSE imposes the same quiet period on research reports for broker-dealers who provided investment banking services, 40 days for an IPO and 10 days for secondary offerings, with an exception for extraordinary news or events when prior approval has been given by the legal or compliance department.[131] Like the NASD, the NYSE prohibits promises of favorable research in order to solicit clients.[132] However, the NYSE's compensation rule is a little different than that proposed by the NASD; it does restrict the broker-dealer from compensating or providing bonuses to an analyst for specific investment banking transactions, but specifically allows the broker-dealer to pay for general performance including the analyst's performance with regard to the Investment Banking Department.[133]

2. Personal Conflicts and the NYSE

Like the NASD, the NYSE imposes restrictions on the trading of the analyst. It has many of the same requirements, including: prohibiting the analyst from receiving shares prior to an IPO if the analyst covers the industry,[134] prohibiting purchases and sales for 30 days before a research report and five days after,[135] and prohibiting transactions contrary to the analysts recommendation.[136] The rule also has many of the same exceptions, including changes in financial circumstances, significant news or events regarding the company and ownership in investment companies and mutual

129. *Id.* §§ 472(b)(3)(i)–(ii).
130. *Id.* § 472(b)(3)(iii).
131. *Id.* §§ 472(g)(1)–(3).
132. *Id.* § 472(g).
133. *Id.* § 472(h).
134. *Id.* § 472(e)(1).
135. *Id.* § 472(e)(2).
136. *Id.* § 472(e)(3).

funds.[137] However, the NYSE provides two further exceptions:

- A sale within 30 days of employment, when an analyst is new to the broker-dealer, and if the security was purchased prior to employment;[138]

- A sale within 30 days of a research report if the securities were purchased prior to the broker-dealer initiating its coverage of the company.[139]

3. Disclosures

Like the rest of the NYSE rule, the proposed disclosure for both research reports and public appearances are almost identical. Both require that the disclosures be made on either the front cover or be mentioned there with a page reference.[140] Although the heading for the NYSE's rule states that it is for research reports and *scheduled* public appearances,[141] the text of the rule appears to apply to all public appearances, like the NASD's rule, and not just scheduled appearances.[142] Like the NASD, the NYSE rule requires disclosure in the following circumstances: if a broker-dealer owns more than 1% of stock five days before publication,[143] if the analyst or household member has a financial interest in the issuer,[144] if any other material conflicts exist, and if the analyst is an officer,[145] director, or on the advisory board of the issuer.[146] Additionally, just like the NASD, the NYSE requires disclosure of compensation to a broker-dealer for investment banking activities within the past year and reasonably expected revenues in the following three

137. *Id.* §§ 472(e)(4)(i)-(iii).
138. *Id.* § 472(e)(4)(iii).
139. *Id.* § 472(e)(4)(iv).
140. *Id.* § 472(k)(2).
141. *Id.* § 472(k)(1).
142. *Id.* § 472(k)(1)(i). The text of the rule requires disclosure in a public appearance, not scheduled appearances as indicated in the heading. *Id.*
143. *Id.* § 472(k)(i)(a).
144. *Id.* § 472(k)(i)(b).
145. *Id.* § 472(k)(i)(c).
146. *Id.* § 472(k)(1)(iii).

months,[147] as well as the disclosure of compensation received by an analyst preparing the report related to investment banking revenues.[148]

Finally, the NYSE follows the NASD's rules requiring a significant amount of investor protection disclosures. These include: definitions of the classifications of recommendations, however, the NYSE specifically says that it must be plain meaning and that a hold cannot mean sell,[149] disclosure of percentages of each rating the broker-dealer has and the percent of the total firms from which the broker-dealer received investment banking revenues in the past 12 months,[150] valuation methods with risks that would stop the price from reaching the target,[151] disclosure if the broker-dealer makes a market in a security,[152] and finally the price chart depicting when the broker-dealer had a change in rating.[153]

IV. COMMENTS ON THE PROPOSED RULES

The proposed rules have made a valiant effort at addressing the conflict issues. Some have complained that the rules have created too much red tape for broker-dealers and analysts.[154] These critics feel that the rules inhibit the reporting of timely information by requiring too much involvement from legal and compliance departments.[155] Thus, while it appears that these rules were a good start, issues remain.[156]

A. Clearer Chinese Walls

The rules make an attempt at recreating the "Chinese Wall"

147. *Id.* § 472(k)(1)(ii).
148. *Id.* § 472(k)(2).
149. *Id.* § 472(k)(2)(iii).
150. *Id.* § 472(k)(2)(iv).
151. *Id.* § 472(k)(2)(ii).
152. *Id.* § 472(k)(2)(i).
153. *Id.* § 472(k)(2)(v).
154. *See, e.g.*, John Labate & Juliana Ratner, *Mixed Reaction to Analyst Rules*, FIN. TIMES (London), Feb. 8, 2002, at 30.
155. *See id.*
156. *See infra* Parts IV.A–E (providing a review of some of the problems the rules face).

between the investment banking department and analysts, but is the wall clear enough? Prior to the rule proposals, commentators suggested the need for clearer walls between investment bankers and analysts.[157]

Two ways in which the rules address this conflict are by eliminating the possibility for the investment banking division to exert control or supervision over an analyst and prohibiting analysts' compensation from being tied to specific investment banking transactions or procedures.[158] This does not prevent the analyst from participating in investment banking activities and does not stop analyst's compensation from being tied to general investment banking activities.[159] The NYSE rule even states that the analyst can be compensated for general performance, including their performance with regard to the investment bank.[160] These rules leave the door open for manipulative practices. Commentators have stated that broker-dealers can "veil" compensation for investment banking activity,[161] and while they may not exert control, one commentator has said that a simple raised eyebrow could do the trick.[162]

The truth is, "until the 'Chinese Wall' between research and investment banking is restored at the brokerage houses, there will continue to be a problem with analyst objectivity."[163] There are a few simple rules that could help rebuild the wall. One is to implement a "no-selling" rule.[164] This would stop an analyst from

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157. *See* Jacob H. Zamansky, *Outside Counsel Assessing Analysts' Liability for Securities Fraud*, N.Y. L.J., Jan. 3, 2002, at 1; Bowman Testimony, *supra* note 7; Hill Testimony, *supra* note 46.

158. *See* Proposed Rule 472, *supra* note 124, §§ 472(b)(1), (h); Proposed Rule 2711, *supra* note 9, §§ 2711(b)(1), (d).

159. *See* sources cited *supra* note 158.

160. Proposed Rule 472, *supra* note 124, § 472(h).

161. *See* Becker, *supra* note 30; Coffee Testimony, *supra* note 48.

162. *See* Coffee Testimony, *supra* note 48 ("It is easy to imagine veiled or stylized communications that signal that the investment banking division is displeased and will reduce the analyst's compensation at the next regular salary review. Such signals, even if they consists [sic] only of arched eyebrows, are effectively impossible to prohibit.").

163. Hill Testimony, *supra* note 46.

164. *See* Coffee Testimony, *supra* note 48.

participating in any selling activity.[165] For instance, an analyst would not be able to participate in investment banking activities like road shows.[166] This would be a return to a more traditional "Chinese Wall" from a decade ago, whereby the investment bankers did their due diligence on an issuer, not analysts.[167] While using analysts in the process saves time and money by avoiding duplicative work,[168] bringing an analyst over the wall is a key contributor to the conflicts dilemma. In this scenario, a research analyst would not be assigned to cover an issue until after the investment banking team completed an offering.[169]

A final proposal would be to limit analysts from covering companies who are clients of their employer.[170] While this may cause analysts to use up time in evaluating companies in a sector that they can't issue a report for, it would potentially relieve many of the pressures they face.[171]

B. Disclosure

The rules require lots of clear and concise disclosure that must be prominently displayed.[172] While this disclosure will help, one of the most important issues is investor education.[173] For instance, the disclosures regarding owning shares and the broker-dealer's participation in an offering could serve to confuse individual investors.[174] If an individual investor does not understand the conflicts that an analyst or broker-dealer faces, these disclosures could give the appearance that the analyst and broker-dealer believe in the company and therefore own shares.[175] Moreover, individual investors may not know the meaning of market maker

165. *See id.*
166. *See id.*
167. *See* Michaely & Womack, *supra* note 63, at 655.
168. *See id.*
169. *See id.*
170. *See* Coffee Testimony, *supra* note 48.
171. *See id.*
172. *See supra* Parts III.A.3, III.B.3.
173. *See* Unger Testimony, *supra* note 55.
174. *See* Roper Letter, *supra* note 41.
175. *See id.*

and again disclosure could be misleading.[176] One solution is to provide an additional section aside from the disclosures required by the rules explaining the conflicts that analysts face so individual investors can understand the reason for the disclosures.[177]

Another problem is that while the rules require clear explanations of analyst's buy, sell and hold type ratings,[178] they do not require one system. A more effective way to deal with the situation is to institute a universal ratings system for all analyst reports.[179] This would eliminate confusion for individual investors when they review research reports from different broker-dealers and a broker-dealer would have more trouble veiling negative reports.

Additionally, the rules require disclosures when an analyst makes a public appearance.[180] While this is a great idea, the analyst and broker-dealers do not have control over what the final version of a public statement may be.[181] These disclosures could end up on newsroom floors.[182] Thus, the rule should require that the analyst and broker-dealer use their best efforts to have these disclosures made, requiring certain steps that must be taken so that the media sources clearly understand the importance of this disclosure.

A final problem is that the rules limit who has to make disclosures. Thus, an individual investor who is receiving information from his broker about a research analyst's recommendations on securities does not have to disclose any conflicts.[183] Yet, if the broker is disclosing the analyst's recommendation, the conflicts once again are important pieces to the entire information puzzle. To properly protect investors these types of disclosures should be extended to sales forces in this situation.[184]

176. *See id.*
177. *See id.*
178. *See supra* Parts IV.A.3, IV.B.3.
179. *See* Torres Testimony, *supra* note 6; Bowman Testimony, *supra* note 7.
180. *See supra* Parts III.A.3, III.B.3.
181. *See* Bowman Testimony, *supra* note 7.
182. *See id.*
183. *See* Roper Letter, *supra* note 41.
184. *See id.*

C. Personal and Broker-Dealer Conflicts

While the rules provide limitations on trading by an analyst and his household, they do not restrict the trading of a broker-dealer in its proprietary accounts. Conflicts arise not only from an analyst's holdings in a stock, but also the firm can put pressure on an analyst to issue positive ratings for its own profit.[185] Thus, the trading restrictions imposed by the rules on analysts should extend to the broker-dealer's proprietary accounts.

A broker-dealer may also pressure an analyst for the broker's own personal gain by encouraging buy recommendations.[186] Having an analyst issue positive reports can cause more buying by investors and commissions for the broker-dealer.[187] A possible solution for this is universal ratings systems, so that broker-dealers cannot hide sell recommendations in the guise of holds. However, this issue will almost certainly remain because the true reason that broker-dealers employ analysts is for profit.[188]

D. Participants Outside of the Broker-Dealer

Another issue not contemplated by these rules is that analysts depend on information from sources beyond the broker-dealer.[189] This was partly the problem in Enron, the information the analysts were receiving from Enron was not accurate, causing analysts' forecasts to be skewed.[190] Thus, the SEC needs to regulate these companies to ensure that the information an analyst is reviewing is correct. Hopefully, this type of regulation will be instituted in conjunction with the Enron fallout.[191]

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185. *See* Coffee, *supra* note 46, at 5; *Understanding Analyst Recommendations*, *supra* note 72.

186. *See* Unger Testimony, *supra* note 55.

187. *See id.*; Coffee Testimony, *supra* note 48.

188. *See* Becker, *supra* note 30 (explaining that broker-dealers employ analysts to make money).

189. *See Enron Corp. and Wall Street Analysts: Hearings Before the Senate Comm. on Governmental Affairs*, 107th Cong. (2002) (statement of Curt N. Launer, Managing Director, Credit Suisse First Boston).

190. *See id.*

191. *See id.*

E. Conflicts the Rules Do Not Address That May Never Be Eliminated

There are two conflicts that the rules do not address which may never be eliminated. First, analysts face pressure from institutional investors who are customers of the firm and pressure analysts to create profitable investments.[192] Second, analysts feel pressure from issuers. This pressure occurs even when an issuer is not a client of the firm because the issuer's management could retaliate against a bad report by cutting off the analyst's access to management, or not answering an analyst's questions on conference calls.[193] Moreover, an issuer could carry ill will against the analyst and, in turn, the broker-dealer for whom the analyst works.[194] This could prevent management from using the investment banking services of the broker-dealer in the future.[195]

A radical way to address both of these concerns would be to completely divorce research departments from broker-dealers.[196] Make them an independent group who sells research for a cost and thus is self-sufficient.[197] This would provide the most objective research available and would also remove many of the conflicts addressed by the rules. However, the rules have merely served as "piecemeal reform" by trying to address issues independently.[198]

In addition to divorcing the departments, the SEC needs to draft some kind of anti-retaliation rule;[199] one that covers both retaliation from within a broker-dealer and from issuers outside.[200] This rule should recognize that retaliation can be hidden and hard to prove, thus, arbitration of these type of claims could help to resolve the problem when this type of claim is raised by an

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192. *See* Unger Testimony, *supra* note 55; *see also supra* Part III.C (providing a further explanation of this conflict).

193. *See* Susan Pulliam, *Analysts to Tell Congress That Skepticism Gets Them Abuse*, WALL ST. J., Mar. 19, 2002, at C1; Unger Testimony, *supra* note 55.

194. *See* Coffee Testimony, *supra* note 48.

195. *See id.*

196. *See id.*

197. *See* Torres Testimony, *supra* note 6.

198. *See* Coffee Testimony, *supra* note 48.

199. *See id.*

200. *See id.*

analyst.[201]

Finally, even if the analyst's are not separated from the remainder of a broker-dealer, a "no booster shot" rule would help address the conflicts faced by an analyst whose investment banking department is being considered by an issuer for an IPO.[202] As mentioned, one of the qualities the issuer is looking for is strong analysts who will help support the price of the stock in the after market for this security.[203] Management is particularly interested from a personal prospective because shares issued to management has a lock-up which prohibits them from selling shares for up to six months.[204] The proposed rule only requires a 40 day quiet period,[205] thus, the analyst will be able to provide "booster shots" before the six month management lock-up expires.[206] A more effective rule would prevent the analyst who works for the investment bank representing an issuer from issuing reports during the entire six month lock-up period.[207]

CONCLUSION

The NASD and NYSE's attempts at correcting the current industry problems are a step in the right direction. They should help to alleviate some of the current problems faced by analysts. However, the only solution that would effectively remedy all the problems involves completely removing the research departments from the reach of broker-dealers; make them an independent and self-contained body that is not influenced in any way by either the broker-dealer, its clients, customers and employees. As this will take time, instituting some interim reforms mentioned in Section V could provide an effective short-term solution to analyst conflicts of interests.

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201. *See id.*
202. *See id.*
203. *See id.*
204. *See id.*
205. *See supra* notes 102–103, 131 and accompanying text.
206. *See* Coffee Testimony, *supra* note 48.
207. *See id.*

Notes & Observations