Financial Analysts' Interactions with Representatives of Private Companies and/or their Financial Advisers under COBS 12.2.21A G

I. Introduction

The amendments to the Conduct of Business sourcebook ("***COBS***") made by the Financial Conduct Authority ("***FCA***") in PS 17/23 came into force on 1 July 2018. They include, inter alia, new COBS 12 rules comprising COBS 12.2.21A G (1) – (3) (the "***Rules***") (attached as Appendix 1).

This guidance (the "***Guidance***") has been prepared following discussions within the Association for Financial Markets in Europe's ("***AFME***") Research Issues Working Group. This Guidance should be read in conjunction with the Q&A dated 6 August 2018 prepared by AFME after discussions with the FCA in relation to COBS 12.2.21A G (the "***Q&A***") (attached as Appendix 2).

II. Background

Recital 56 of the MiFID Organisational Regulation, to which COBS 12.2.21A G applies, states that "financial analysts should not engage in activities other than the preparation of investment research where engaging in such activities would be inconsistent with the maintenance of that person's objectivity."

Recital 56 also states that activities that would be inconsistent with the maintenance of an analyst's objectivity include "participating in investment banking activities such as corporate finance business and underwriting, participating in 'pitches' for new business or 'road shows' for new issues of financial instruments; or being otherwise involved in the preparation of issuer marketing."

COBS 12.2.21A G (1) defines "participating in 'pitches' for new business" as generally including "a financial analyst interacting with an issuer to whom the firm is proposing to provide underwriting or placing services…., until both

a. the firm that employs the financial analyst has agreed to carry on regulated activities that amount to underwriting or placing services for the issuer; and

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

Notwithstanding the statements made in the Q&A on how the above guidance should be applied, there remains some uncertainty as to which interactions between an analyst and a company (whether private or public) and/or its representatives/advisers/holders of an ownership interest (collectively, the "***Representatives***") amount to an analyst "participating in a pitch".

An analyst may interact a company and/or its Representatives in a wide range of contexts, including as part of his/her regular, research-driven activities or during industry gatherings. Some of these interactions will be independent of any interactions between the analyst's firm's investment banking/corporate finance staff and a private company and/or its Representatives. The contents and the context of any such interaction will be relevant for determining whether they are appropriate in any particular case.

This document sets out a list of scenarios which AFME members consider (as a minimum) should lead to member firms implementing procedures to govern further consultation/escalation by an analyst within his/her firm before a decision is taken as to whether the interaction takes place. These scenarios are in addition to situations where an analyst is aware or may have reason to believe that his/her firm is undertaking pitching or proposing to

undertake pitching activity for an underwriting or placing role. In such situations the analyst may not interact with a company or its Representatives.

III. Scenarios

1. A company requests an interaction with an analyst, which would also involve one or more of that company's Representatives;

2. An interaction request is made by a company that indicates that it is also in contact with investment banking personnel from the analyst's firm;

3. An interaction request is made by any financial sponsor or private equity firm only; or

4. An interaction request is made by a party which indicates that a company is: (a) considering a transaction; (b) evaluating strategic alternatives; (c) seeking a view on valuation; (d) asking how best to position the company with investors; or (e) the subject of the meeting is a potential IPO or other offering.

In addition to the above, an analyst should in all cases escalate an interaction request if in any way he/she has been made aware or may have reason to believe that the company intends to pursue an IPO.

17 September 2018

Appendix 1

COBS 12.2.21A
G
01/07/2018

(1)

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

(a) the *firm* that employs the *financial analyst* has *agreed to carry on regulated activities* that amount to underwriting or placing services for the *issuer*; and

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

(2)

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

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

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

Appendix 2

UK IPO Reform Q&A in relation to COBS 12.2.21AG

Prepared by the Association for Financial Markets in Europe (AFME)

*The amendments to the Conduct of Business sourcebook ("**COBS**") made by the Financial Conduct Authority ("**FCA**") in PS 17/23 come into force on 1 July 2018. They set out new COBS 11A rules (the "**Rules**") and new COBS 12.2 guidance on the MiFID II provisions relating to the identification and management of conflicts of interest (the "**Guidance**" and together with the Rules, the "**Reforms**"). This Q&A (**"Q&A"**) has been prepared by the Association for Financial Markets in Europe ("**AFME**") following discussions with the FCA and addresses certain commonly asked questions in relation to the practical implementation of the Guidance. This Q&A may be subject to review and amendment in light of practice on the implementation of the Rules and to any relevant future FCA guidance in relation to the Rules.*

Q1. COBS 12.2.21A(G) (1) provides that participating in pitches for new business would generally include a financial analyst interacting with an issuer to whom the firm is proposing to provide underwriting or placing services. This has led to some queries in the market as to the point in time at which a firm will be considered to be proposing to provide underwriting or placing services. Firms have asked whether it is acceptable for firms to interpret the proposed provision of such services by reference to whether an issuer has made known that it is actively pursuing a securities offering transaction and where a firm may be intending to pitch. Examples of such circumstances could include where:

- ***The firm has received an RfP or invitation to an underwriter selection process;***
- ***The firm has been informed by the issuer or its representatives or a person who has an ownership interest in the issuer that the issuer has hired deal-related counsel or advisers;***
- ***The issuer or a person who has an ownership interest in the issuer has made a public filing or announcement of its intention to pursue a specific deal (i.e., a review of strategic alternatives would not be considered an announcement of an intention to pursue an IPO);***
- ***The issuer or its representatives or a person who has an ownership interest in the issuer has otherwise informed the firm that the issuer is in the process of evaluating underwriters.***

A1. It is recognised that there are circumstances in which an analyst may have contact with an issuer where there is nothing, such as the factors above, to suggest an IPO is imminent or where an IPO is only one of two or more strategic alternatives that are being considered. Equally, however, there could be an earlier stage in interaction with a company where none of the factors are present but nonetheless discussions with the company around a prospective transaction or transactions are at a point that gives rise to a heightened risk that contact between the analyst and the issuer team could impair the analyst's objectivity and independence. It is also recognised that firms will not necessarily have a complete picture of how advanced a company is in its preparations for a transaction, including whether or not it has effectively excluded alternatives.

Consistent with the policy objective of seeking to support the objectivity and independence of research, the FCA recognises that firms will need to make judgements on a case by case basis. See also the FCA's

commentary in PS 17/23 (p29) (period over which a pitch lasts). They should have reasonable decision-making processes to make these judgments against the policy objective that communications should not take place where the analyst may come under pressure to take a positive view of a company.

Q 2A. COBS 12.2.21A(G)(2) recognises that, in limited circumstances, it may nevertheless be appropriate for analysts to communicate with the issuer and its representatives and/or a person who has an ownership interest in the issuer unless the analyst is aware of the "pitches," "or may have reason to believe that the firm is conducting the pitches."

In such circumstances, firms have suggested that the underlined language should not prevent an analyst from continuing ordinary course communications with an issuer, its representatives and/or a person who has an ownership interest in the issuer, whether or not the issuer has securities already admitted to trading, unless the communicating analyst has actual knowledge that the firm is conducting or proposing to conduct pitching activity for an underwriter role, given that it may always be viewed as being reasonable for an analyst to believe that the firm's investment banking division is in pitching mode to a company. Examples of actual knowledge could include:

- ***communications to the analyst by the issuer or its representatives or a person who has an ownership interest in the issuer which inform the analyst that the firm is involved in pitching for an underwriter role;***
- ***the analyst being aware that the firm has received an RfP or invitation to underwriter selection process;***
- ***the analyst being wall-crossed to discuss a potential offering.***

A2A. The guidance in COBS 12.2.21A(G)(2)(a) is intended to provide firms with some flexibility to continue to have ordinary course contact with companies, particularly where they are existing listed issuers. Firms are expected to have a reasonable decision-making process to assess on a case-by-case basis whether contact with an issuer may give rise to a risk to analyst objectivity and independence as a consequence of pitching activity. As made clear in COBS 12.2.21A(G)(2), a key consideration for the FCA will be whether the analyst had actual knowledge of pitching activity.

The examples given in the bullets are helpful as a guide but should not be viewed as definitive. Further FCA commentary can be found in PS 17/23 (p30) (Application where an issuer already has securities admitted to trading).

Q2B. Is the context and/or content of an analyst's communications with the issuer or its representatives or a person who has an ownership interest in the issuer relevant to the assessment of risk of impairment to the analyst's objectivity as a result of such communication? Examples of where such risk would be reasonably low would include where:

- ***an analyst is sharing his or her industry views at a previously scheduled conference or seminar where the issuer or its representatives or owners may be in attendance;***
- ***an analyst attends and asks questions at a results briefing by an issuer;***

- ***an analyst has ordinary course discussions with a person who has an ownership interest in the issuer where such discussions are not about a potential securities offering by the issuer.***

In all such circumstances described above, the firm would continue to be subject to its FCA Handbook and MiFID II obligations regarding conflicts of interest.

A2B If the analyst has actual knowledge of pitching activity, it should not interact with the issuer or its representatives (see COBS 12.2.21A(G)(2)(b)). However, when the analyst does not have actual knowledge of pitching activity, the context and content of the analyst's communication is relevant to the analysis of whether an analyst's objectivity or independence may be impaired. Discussions which are not about a potential securities offering such as those regarding industry trends or macroeconomic considerations at a previously scheduled conference or seminar or a results briefing may indeed present a low risk to analyst objectivity and independence. The FCA will expect firms to provide a reasoned basis for any decision to allow contact.

Whilst actual knowledge of pitching activity will be a key consideration (see COBS 12.2.21A(G)(2)), the FCA will nevertheless expect a firm's systems and controls to procure that analyst objectivity and independence is not impaired.

Q3. It has been queried whether the reference in COBS 12.2.21A(G)(1) to "the extent of the firm's obligations…is confirmed in writing between the firm and the issuer" is a reference to the firm's role, and that other factors such as underwriting commitment or economics do not have to be confirmed for interaction to be permitted?

A3. The FCA's commentary in PS 17/23 suggests that this is a reference to the firm's role in the syndicate.

Q4. There may be a scenario where confirmation has been given pursuant to COBS 12.2.21A(G)(1) and a firm's analyst(s) have therefore begun to interact with an issuer, but where the firm or its analyst(s) are then given reasonable cause to believe that the issuer or its other representatives or owners are looking, either through the interaction with the firm's analyst(s) or otherwise, to assign or change syndicate roles. In such a scenario, it has been queried whether, while the firm would remain subject to its obligations on management of conflicts under MiFID II and the FCA Handbook, this should not result in a requirement to treat the firm as having reverted to "pitching" status and thereby an obligation being imposed on it to re-establish communication barriers between the analyst and the issuer or its representatives or person who has an ownership interest in the issuer?

Changes to other factors such as underwriting commitment or economics should equally not require the firm to treat itself as having reverted to a "pitching" phase.

A4. Provided that the analyst is unaware that the issuer or its other representatives or owners are looking to assign or change syndicate roles, the risk of impairment of an analyst's objectivity and independence is likely to be considered to be low.

Q5 What standards are required of firms?

A5 If the analyst has actual knowledge of pitching activity, he/she should not interact with the issuer or its representatives (see COBS 12.2.21A(G)(2)(b)). However, when the analyst does not have actual knowledge of pitching activity, firms are expected to have systems and controls in place to assess on a case-by-case basis whether analyst objectivity and independence may be impaired.

The FCA will expect firms to be able to demonstrate that they have exercised reasonable judgments. In circumstances where an analyst does not have actual knowledge of pitching activity, a firm will be expected to illustrate why it believed, based on the information that it had at the time, that the approach taken by it did not compromise analyst objectivity and independence.

Date: 6 August 2018