



## Integrity Research **Compliance Accreditations**<sup>SM</sup>

### **BEST PRACTICES FOR INDUSTRY CONSULTING FIRMS**

The following compliance “best practices” are consistent with general practices of firms offering industry consulting. Not all practices may apply depending on the nature of the firm and its research.

Best practices are based upon: industry surveys, recent case law, regulator sentiment, applicable laws, rules and regulations<sup>1</sup>, and are intended to reduce risks related to confidential and potentially material, non-public information and other potential compliance-related risks. Key compliance controls are designated by an asterisk (\*) and summarized in the section ‘Key Compliance Controls.’ See ‘Terminology’ for definitions of the terms used in this document.

To receive accreditation, research firms need to demonstrate that they follow each of the key compliance controls summarized below, as well as a majority of the overall best practices.

#### **Key Compliance Controls**

Key practices designated with an asterisk (\*) below are summarized here. Each of these key practices needs to be followed to receive accreditation.

1. Have a **designated compliance professional** who is accountable for the firm’s compliance policies and procedures. (See A.1.)
2. Establish and enforce **information control policies and procedures** written in clear and understandable language. (See A.2.a.)
3. Establish and enforce **trading policies and procedures** written in clear and understandable language. (See A.2.b.)
4. Provide a **regular training program** for all employees. (See A.3.)
5. Firms should **monitor where its employees obtain information**. (See B.1.)
6. Establish **information barriers around consulting practices**. (See B.2.)
7. Have clearly defined and actively used **escalation procedures** for employees. (See B.3.)
8. **Sole proprietorships should engage an external/objective third party provider** to regularly assist the firm with compliance and training. (See C.1.)

#### **A. General Compliance Practices**

1. Each firm should have a **designated compliance professional\*** who is accountable for the firm’s compliance policies and procedures.

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<sup>1</sup> Background sources include: CFA Institute Research Objectivity Standards; NASD Rule 2711; NASD Rule 1120; NASD Notice to Members 04-18 (March 9, 2004); NASD Notice to Members 04-25 (March 2004); NASD Press Release, Sanford C. Bernstein & Co. (Feb. 8, 2006); NYSE Info Memo 04-10 (Mar. 9, 2004); NYSE Info Memo 04-16 (April 1, 2004); NYSE Rule 472; NYSE Rule 344.1; NYSE Rule 351; NYSE Rule 345; FINRA Regulatory Notice 08-55(Oct. 2008); Regulation AC; Stop Trading on Congressional Knowledge (STOCK) Act of 2012; NIRI Best Practice Guidelines; Sarbanes-Oxley; Dodd-Frank; Global Research Analyst Settlement; recent case law; regulator sentiment; industry surveys. However, these **best practices do not incorporate all of the specific requirements detailed in these sources**. In addition, these best practices do not address foreign affiliates, third party research, or the full requirements for registered entities.

2. **Establish and enforce compliance policies and procedures** written in clear and understandable language. Written policies should include:
  - a. **Information control\***: Confidential information and potentially material non-public information, whether pertinent to equity or non-equity financial markets, must be promptly detected and handled appropriately through written policies and procedures that are well-known and consistently followed. The policy should include examples of inside information that are relevant to the type of research conducted, such as confidential information from industry sources.
  - b. **Trading restrictions\***: Securities trading by employees and their dependents should be limited and periodically reviewed to prevent trading violations.
  - c. **Conflicts**: Potential conflicts involving the firm's structure or employee personal or financial conflicts should be vetted and either adequately disclosed or appropriate walling-off procedures should be followed.
  - d. Employees should review and **annually certify their agreement** with the terms of the policies.
  - e. Employees should have **ready access to all compliance policies** and should have the ability to seek clarification from the firm's compliance professional(s).
3. Provide a **regular training program** for all employees\*. Training should include specific examples of confidential and potentially material non-public information that might be encountered in an industry consulting firm.
4. **Compliance changes and updates should be promptly communicated** to employees. Periodically circulate to employees recent examples of regulatory actions or other recent compliance developments.
5. **Periodically 'spot check' employee activity** to ensure that it is consistent with policies.
6. If the firm publishes research, it should have **an editorial process to review and edit all research reports** for the exclusion of information which could be deemed either to be confidential or material and nonpublic.
7. If the firm performs custom research for clients, **the fact that information was previously disclosed should be disclosed if that same information is later included in broadly disseminated reports.**
8. **Retain documents and internal emails** for a minimum of three years.
  - a. Retention should include: compliance-related certifications; records of escalations; communications regarding potential material non-public information; and other compliance-related documents.
9. **Maintain a 'whistleblower' program**, whereby employees can anonymously report potential compliance or legal violations within the firm.

## **B. Information Control/Insider Trading**

The following are procedures to minimize the risk of receiving confidential or potentially material non-public information as part of the analytic process. Key practices are highlighted with an asterisk (\*).

1. Firms should **monitor where its employees obtain information\***. Firms need to develop a process to determine with whom their employees are speaking to gather information and whether employees might be at risk of receiving confidential or potential material non-public information.
  - a. If the firm conducts surveys or channel checks, the firm should maintain records of details of surveys and channel checks conducted by employees. Records should include with whom the employee spoke and the information the employee gathered.
  - b. Information received from employees of publicly traded companies during informal interactions should be handled with care and escalated if the employees receive questionable information.
2. Firms should **establish information barriers around consulting practices\*** to ensure that confidential client information obtained during consulting engagements are not incorporated into the research product.
3. Each firm should have **clearly defined and actively used escalation procedures\*** for employees.
  - a. Maintain records of instances in which employees have escalated issues relating to confidential or potentially material non-public information.
  - b. Records should include who is responsible for follow-up and how each issue is ultimately resolved.
4. **Implement safeguards with external sources:**
  - a. The firm should not provide anything of value to sources.
  - b. Verify at the outset of the firm's relationship with a source, either verbally or in writing that the source will not violate confidentiality obligations or provide to the firm material non-public information.
5. The firm should have **explicit policies and procedures governing use of paid outside consultants**, including:
  - a. Employees' use of paid consultants should be regularly reviewed by compliance, with pre-approval of new consultants.
  - b. Records should be kept of paid consultants used by the firm.
  - c. Paid consultants should be required to agree in writing not to provide confidential information or material non-public information or violate any terms of employment to which the consultant is subject regarding communication of information to third parties, or otherwise violate any contractual or legal obligations.
6. If the firm conducts business in countries outside the U.S., it should have **controls in place to ensure that it does not run afoul of applicable anti-bribery statutes**.
7. **If the firm performs surveys or channel checks conducted by employees, the surveys or channel checks should be reviewed by compliance** to ensure that they conform to best practices, including:
  - a. **Review the survey design** before implementation to verify that it does not carry the risk of generating material non-public information.

- b. **Employees should verify at the outset of each survey interview that the source will not violate confidentiality obligations or provide material non-public information.** Employees should clearly inform the source about the purpose and nature of the survey.
- c. **Sources should not be remunerated in any form** or receive benefits of any kind, including survey results. The only exception is for surveys of end consumers which may include payments for participation.
- d. **Review survey results and findings** for possible material non-public information before incorporating in research or delivery to clients.

### **C. Business Structure**

The following practices are not applicable to research firms which do not have affiliated non-research businesses.

1. **Sole proprietorships** with no employees **should engage an external/objective third party provider** (such as an attorney or compliance business) to regularly assist the firm with compliance and training.\*
2. If the firm has a trading desk or manages money, **these activities must be walled off** physically and functionally from other parts of the firm.
  - a. The firm should ensure that research is not disseminated to the trading desk or money management subsidiary before it is widely distributed to clients.
3. If the firm conducts investment banking activities such as corporate finance, acting as an underwriter, acting as a financial adviser in a merger or acquisition, or serves as placement agent for corporate issuers, the firm should **ensure physical and functional separation from research**, including separate reporting lines.
4. If the firm has a trading desk, **the firm should have trading restrictions in place to prevent insider trading, front running or other trading violations.** At a minimum, the firm should have a policy that prevents staff from trading stocks in which the firm has executed a trade for at least 24 hours.

### **Terminology**

The following are definitions of terms used in this document:

**Industry Consulting Firms:** Firms which monitor trends in specific industries or sectors, providing forecasts and analysis of new products, regulatory actions, mergers, and other industry developments of note. The core customer base for these firms is typically comprised of companies in the followed industry. Unlike fundamental research firms, industry consulting firms rarely analyze securities issued by individual companies in an industry, and usually do not offer ratings, valuations, investment recommendations or price targets.

**Channel Checking:** The practice of examining upstream and downstream trends in a company's or industry's supply chain. Channel checking is a specialized form of market research, and can employ formal or informal survey techniques. Channel checking techniques are often used by research firms that are not principally channel checkers, such as fundamental research firms or industry consulting firms.

**Consulting:** We refer to consulting in these best practices as a separate business line designed to generate revenues from confidential consulting projects undertaken at the request of a

client. Consulting differs from custom research (see below) in that the latter is a bespoke version of the research product rather than a distinct business.

**Custom Research:** Research performed specifically for a client at the client's request. In some cases, custom research may be disseminated to other clients after delivery to the client originally requesting the research.

**Survey:** Soliciting information from multiple sources. Typically surveys are conducted with standardized questions.

**Sources:** The individuals surveyed.

**Outside Paid Consultant:** non-employees paid for advice or information. Outside paid consultants can be recruited by employees of the firm or by expert networks.

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