

Why GAO Did This Study

In 2003 and 2004, the Securities and Exchange Commission (SEC), self-regulatory organizations (SRO), and others settled with 12 broker-dealers to address conflicts of interest between the firms' research and investment banking personnel. The regulators alleged that the firms allowed their investment bankers to pressure equity research analysts in ways that could cause them to issue misleading research to the harm of investors. Under the Global Research Analyst Settlement (Global Settlement), the firms had to undertake reforms designed to sever links between research and investment banking. The SROs also adopted equity research rules to address analyst conflicts across the industry, but these rules were not as stringent in some areas as the Global Settlement. The Dodd-Frank Wall Street Reform and Consumer Protection Act required GAO to study these issues. This report discusses (1) what is known about the effectiveness of the regulatory actions taken to address analyst conflicts and (2) what further actions, if any, could be taken to address analyst conflicts. GAO reviewed empirical studies and SEC and SRO rules, examination findings, and enforcement actions. GAO interviewed SEC and Financial Industry Regulatory Authority (FINRA) staff, and market participants and observers.

What GAO Recommends

GAO recommends that SEC formally assess and document whether any of the Global Settlement's remaining terms should be codified. SEC agreed with the recommendation.

View [GAO-12-209](#). For more information, contact A. Nicole Clowers at (202) 512-8678 or clowersa@gao.gov.

SECURITIES RESEARCH

Additional Actions Could Improve Regulatory Oversight of Analyst Conflicts of Interest

What GAO Found

Existing research and stakeholder views suggest that the Global Settlement and other regulatory actions have helped to address conflicts faced by equity research analysts. The results of the empirical studies that GAO reviewed generally suggest that the Global Settlement and equity research rules adopted by the SROs were associated with improvements in analysts' stock recommendations. FINRA officials and SEC staff told GAO that the regulatory reforms have been effective, citing minor deficiencies in their examinations and the limited number of enforcement actions involving conflicts between research and investment banking as evidence of the reforms' effectiveness. Independent monitors, which were required as part of the Global Settlement, also found that the 12 firms generally were complying with the Global Settlement. Finally, broker-dealers, institutional investors, and others told GAO that the regulatory actions have helped insulate equity research from investment banking influence, although some noted that not all conflicts can be eliminated and certain restrictions can be circumvented.

Although SEC and FINRA have been taking regulatory action to further address conflicts faced by research analysts, additional action is warranted. FINRA has been working to finalize a rule proposal designed to broaden the obligations of firms to identify and manage equity analyst conflicts and better balance the goals of helping ensure objective and reliable research with minimizing regulatory costs and burdens. FINRA also has been working to finalize another rule proposal that would address conflicts faced by debt research analysts. The current SRO research rules do not cover debt research analysts, although these analysts face conflicts of interests similar to those faced by their equity analyst counterparts. In the absence of an SRO debt research rule, the SROs have relied on antifraud statutes and SRO rules requiring ethical conduct. They also have encouraged firms—with limited success—to comply voluntarily with industry-developed principles designed to address debt analyst conflicts. FINRA plans to package its two rule proposals together and submit them to SEC in the first half of 2012. In contrast, SEC and FINRA have not proposed codifying the Global Settlement's remaining terms. At the request of the broker-dealers, a court modified the Global Settlement in 2010 and eliminated settlement terms where, for the most part, comparable SRO rules existed. Nonetheless, some of the Global Settlement's terms that serve to protect investors have not been codified. As a result, the Global Settlement firms continue to be subject to the requirements of the Global Settlement and the SRO research analyst rules, while other firms that provide the same services are subject only to the SRO research analyst rules. As a result, investors may not be provided the same level of protection. GAO has previously reported that a regulatory framework should ensure that market participants receive consistent and useful information as well as consistent protections for similar financial products and services. SEC staff told GAO that they periodically have discussed and analyzed the Global Settlement terms but have not formally assessed and documented whether any of the Global Settlement's remaining terms should be codified. By not formally assessing whether codifying any of the Global Settlement's remaining terms provides an effective way of furthering investor protection, SEC may be missing an opportunity to provide the same level of protection for all investors.