

Research Analyst Coverage

By Mark Garbowski and R. Mark Keenan

The settlement announced this spring between the SEC, other regulatory bodies, and several brokerage firms regarding the conduct of securities analysts has raised the issue of whether the settling firms can recover for the settlement under their insurance policies. Much of the commentary has focused on public policy, or whether the firms can avoid the application of various exclusions. Before reaching those questions, however, it is necessary to establish that coverage is triggered under a policy's insuring clause.

Under many financial services insurance policies, the insuring agreement makes reference to specific activities, roles, or types of services performed by a financial services firm, such as investment banker, investment advisor, or broker/dealer activities. Under many policies, the best argument for coverage for the research analyst allegations is likely to be under a Security Broker/Dealer provision.

It is appropriate to consider the expectations of the parties, common usage, and in particular the reasonable expectations of the policyholder to determine whether research analyst activities are included within the Security Broker/Dealer coverage grant. Cases and statutes, as well as the common understanding of the industry and its customers treat the activities of research analysts as a component of Broker/Dealer activities.

1. Court Decisions

Courts have recognized that research reports generated by analysts at brokerage firms are an important part of the service provided by brokers. For example:

H.C. Wainwright & Co. is engaged in the securities business as a broker. As an important adjunct to its brokerage business, Wainwright has for nearly forty years provided research for its clients.

H.C. Wainwright & Co. v. Wall Street Transcript Corp. More recently, the Southern District of New York noted the following description of a research analyst in an internal Morgan Stanley document:

Senior Research Analysts (1) are "[r]esponsible for studied of industry groups and specific analysis of individual companies and their securities"; (2) "[p]repare [] regular written research reports which summarize the findings of their analysis including estimates of expected current year business results"; (3) "[c]ommunicate [] their recommendations on the purchase, sale, or holding of securities to institutional clients through the firm's sales force and through direct client contact...

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Rosenthal v. First Unum Life Ins. Co.

2. Statutory Provisions

Federal statutes also support the idea that research analysts act incidentally to and in support of broker/dealers. The Investment Advisers Act of 1940 states that:

(11) "Investment adviser" means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities; but does not include... (C) any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor;...

This definition clearly states that research analyst activities such as "advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities" can be "solely incidental to the conduct of ... business as a broker or dealer."

Second, brokers who are accused of charging excessive commissions for trades can justify their commission rates as "reasonable in relation to the value of the brokerage and research services provided by such member, broker, or dealer..." 15 U.S.C. S 78bb.

3. Consumer Reviews and Promotional Materials

Consumer reviews of brokerage houses routinely measure them by the access they provide to proprietary research. Consistent with this, brokerage houses usually highlight analyst reports in their promotional materials.

The cases and statutory provisions, combined the general perception that investment research is a service provided by brokers to their retail customers, claims involving research analysts should fall within a coverage grant for Broker/Dealer activities. ■

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For more information on these or other Financial Services matters, please contact one of the lawyers listed, each of whom are members of Anderson Kill's Financial Services Industry Coverage Group.

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