

## **J.P. Morgan Tells Analysts To Warn of a Downgrade**

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J.P. Morgan Chase & Co.'s head of European research told his team of analysts they must run all changes in European stock recommendations past both the company in question and J.P. Morgan's investment-banking department.

"Both the company and the client banker need to be notified, in advance, of the recommendation change that we plan to make," said the memo, written by Peter Houghton, head of equity research in Europe. "If the company requests changes to the research note, the analyst has a responsibility to either incorporate the changes requested or communicate clearly why the changes cannot be made."

The memo, which a company spokesman described as a global policy for the bank and which was previously reported by the Times of London, represents a rare written edict on a practice that raises questions about analysts' independence.

Wall Street analysts long have been pressured by corporate clients and their own bankers to shun negative research. Some companies penalize analysts or their firms for "sell" recommendations. Investment bankers pressure analysts because they fear any negative research will hamper their chances of winning lucrative underwriting or advisory business from the same corporate client. Thus, many savvy investors ignore much of the research that comes from securities firms.

"It defeats the purpose of research," says Frank Barkocy, director of research at hedge fund Keefe Managers. Mr. Barkocy represents the "buy side," or those who are potential customers for the research of analysts at Wall Street securities firms who are known as the "sell side."

By showing the report first to the company in question, "the way an analyst uses some words might very well be minimized," Mr. Barkocy says. "It's a disservice to the analyst and a disservice to the buy side."

J.P. Morgan Chase maintains the memo merely reiterates a policy it has long followed, and that it reflects practices that are common in the industry. The company says it sent the memo to ensure that several new analysts who came from other firms know the policy. The company maintains that analysts aren't under pressure to change recommendations, but only to make factual changes.

"The point of the memo was to ensure that there's clear communication between analysts and bankers and companies," says Nick O'Donohoe, head of European equities at J.P. Morgan. It is "a normal, common courtesy" to warn a company that an analyst was about to downgrade its stock. Nothing in the memo "compromises the honesty or objectivity or independence of our analysts," he says.

Analysts' practices are coming under increased scrutiny after the Securities and Exchange Commission last October began enforcing Regulation FD, for fair disclosure, a rule that seeks to rein in the flow of privileged information between corporations and the Wall Street analysts who cover them. Wall Street analysts also have been criticized for maintaining "buy" recommendations on once-highflying tech stocks, despite their lack of profits, and long after their stocks had fallen.

The issue came to a head for many European investors in December over the initial public offering for France Telecom's Orange PLC unit. Analysts were barred from a briefing by Orange officials unless they agreed to let the lead banks "fact-check" their reports on the share offering.

Some question whether research can ever be considered objective if the other arm of the firm publishing it is advising the same company on a merger or selling shares. Sebastian Virchow, a fund manager at Deutsche Bank AG's asset-management unit DWS Group in Frankfurt, says his team confirms the earnings and scientific developments of the companies it invests in, rather than

taking analysts' reports at face value. "We read the analyst reports and gather information, but we do our own due diligence and would never just use the reports on their own," he says. "We talk to the companies ourselves and make our own earnings estimates."

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