



The UK Society of Investment Professionals

AIMR draft Research Objectivity Standards

Response by UKSIP



UKSIP is a member society of  **AIMR**[®]

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Introduction

As the AIMR member society for the United Kingdom, the UK Society of Investment Professionals (UKSIP) is pleased to be able to offer its views on AIMR's draft Research Objectivity Standards (AIMR-ROS). UKSIP has over 4000 investment professionals as its members, and the majority of these also belong to AIMR.

Like AIMR, UKSIP – in various former guises – has professional excellence at the core of its objectives. UKSIP continues to run the Investment Management Certificate, the entry-level qualification of choice for those wishing to become investment analysts or fund managers in the UK and for those seeking an introduction to investment management.

AIMR Research Objectivity Standards (AIMR-ROS) overview

UKSIP is in full agreement with the principles underlying AIMR-ROS. During its response UKSIP suggests that AIMR-ROS could, on some issues, be in conflict with the UK's regulatory rulebook. However UKSIP also recognises that a voluntary code need not be wholly compatible with a regulatory rulebook which codifies current, rather than prospective, acceptable behaviour. Wide adoption of AIMR-ROS could lead standards higher and this would not be incompatible with a regulator's role of merely reflecting current good practice.

UKSIP recognises that potential conflicts of interest are likely to apply within UK-based multi-disciplinary banks, although more effort may have been made to address some of these than has been the practice within investment management firms. In his recent review of UK investment management arrangements, Paul Myners recommended that UK pension funds look closely at how much investment managers pay for external research and whether it is of value.

UKSIP notes that AIMR-ROS contains a number of specific recommendations supported by more general guidance. It recognises that this approach is somewhat alien to the US style of regulation which requires adherence to detailed rules and that AIMR-ROS has been introduced in this form to accommodate the various different approaches of non-US regulators. Nonetheless, AIMR-ROS remains significantly more detailed and prescriptive than, say, developing regulatory regimes in some European markets. Admittedly, some markets are moving quickly; the French AIMR Society, for example, updated its ethics code this year.

In the UK the Financial Services Authority (FSA) has shifted the basis of its regulatory practice from compliance with detailed rules to adherence with industry best practice provided, of course, this is being widely followed in the market. Thus, much of AIMR-ROS – so far as the UK is concerned – is covered in conduct of business and dealing rules operated within institutions. This does not mean that AIMR-ROS could not be used as a useful point

of reference by the FSA; however, whilst FSA has jurisdiction over major UK companies this is by virtue of the Listing Rules, a distinctly separate regulatory system of oversight.

AIMR-ROS, if published in their present draft form, might also cause problems for AIMR members and possibly inhibit or diminish the attractiveness of the CFA qualification in some markets. AIMR members could be precluded by their firms from complying with AIMR-ROS and this could place individuals in a difficult position. This is something to which AIMR would need to be sensitive. Global application of detailed requirements relevant to the world's largest and most sophisticated financial market are almost certain to clash with local practices and cultural issues in some markets. This is why UKSIP agrees with AIMR's view that only the principles underlying the details of AIMR-ROS need be adopted at this time.

UKSIP is certain that many institutions and issuing companies would like to be able to sign up to principles underlying AIMR-ROS if at all possible. It would be a very positive step to do so in the context of "corporate social responsibility", a concept of growing importance globally.

If both analysts and companies did sign up, there might be an unexpected but positive outcome. Companies which had received less favourable research reports, might be prepared to be more open with the analyst(s) concerned and by providing greater access, enable individual analysts to more effectively assess their prospects.

The invitation to comment specifically asks that responses address the undermentioned questions:

(1) Are AIMR-ROS sufficiently comprehensive? Or are there additional issues that must be addressed?

UKSIP's view is that AIMR-ROS may be too detailed in some areas and this may inhibit their wide adoption. UKSIP accepts that, as a statement of good practice for the media to consider adopting, AIMR-ROS could be helpful. It has been suggested to UKSIP that, with regard to the media, either AIMR-ROS should be significantly strengthened or the Standards should not attempt to address this problematic area at all.

(2) Will firms, both large and small, and other market participants be able to implement the proposed AIMR-ROS?

Most of AIMR-ROS should be capable of implementation by all firms, over time. They may choose not to do so, however, particularly when they are operating broadly comparable practices and procedures either to meet regulatory requirement or in accordance with their own dealing and other rules.

(3) Can the AIMR-ROS apply uniformly to research reports and recommendations for equity, fixed income and other types of securities?

Yes

(4) Are any of the AIMR-ROS too stringent or too lenient? If so, what specific recommendations would you make to improve the Standards?

On occasion it would seem that AIMR-ROS could be in danger of mandating for firms how they should operate their systems and controls. Examples include 5.0 Research analyst compensation and 11.0 Rating System. Perhaps by necessity AIMR-ROS is too lenient concerning the media – where appropriate, detailed observations are made on each draft standard.

(5) **Will AIMR’s goal of improving the integrity of research reports and recommendations be achieved if firms adopt the AIMR-ROS?**

Whilst UKSIP may have reservations concerning aspects of particular draft standards, adoption of AIMR-ROS by firms would be likely to help meet AIMR’s goal.

(6) **Will the investing public be better served if these AIMR-ROS are adopted worldwide?**

Probably.

The following are observations, on the individual draft standards, where appropriate.

Investment banks, broker-dealers and other firms that sell research

1.0 Research Objectivity Policy

Firms must have:

- (a) **a formal written policy on the independence and objectivity of research (Policy) that must be:**
 - i. **made available to clients and prospective clients (both investing and corporate), and**
 - ii. **disseminated to all firm employees;**
- (b) **Supervisory procedures that reasonably ensure that the firm and its covered employees comply with the provisions of the policy and all applicable laws and regulations; and**
- (c) **A senior officer of the firm who attests annually to clients and prospective clients to the firm’s implementation of, and adherence to, the Policy.**

AIMR is clearly right, in principle, to seek to take the moral high ground on this core issue. The standard, however, is unlikely to be capable of adoption in less developed markets at this time. So far as the UK is concerned, the AIMR-ROS covering Research Objectivity Policy seems likely to duplicate procedures currently in place to meet existing regulatory requirements.

2.0 Public appearances

Firms that permit investment managers and other covered employees to present and discuss their research and recommendations in public appearances must require these employees to disclose fully personal and firm conflicts of interest to the audience.

The underlying principle is supported but this standard may be difficult to meet in practice. In the UK the total extent of a firm's holdings in each class of security should be known on a daily basis. However, the spokesperson may not be aware of very recent transactions by the firm concerned and disclosure of the individual's holdings could be misleading where, for instance, a disposal is imminent. Furthermore, it is quite likely that an institution may hold particular stocks, even though its recommendations about the companies concerned may be negative.

3.0 Reasonable and adequate basis

Firms must require research reports and recommendations to have a basis that can be substantiated as reasonable and adequate. An individual employee (supervisory analyst) or a group of employees (review committee) must be appointed to review and approve all research reports and recommendations.

This standard is consistent with the expectation that reports should be well researched, relevant, accurate and reviewed prior to issue. However, it could lead to delays in assimilating new information or changing views if formal evidence always has to be given.

4.0 Investment banking

Firms that engage in, or collaborate on, investment banking activities must:

- (a) Establish and implement effective policies and procedures that;**
 - i. Segregate research analysts from the investment banking department; and**
 - ii. ensure that investment banking objectives or employees do not have the ability to influence or effect research or recommendations;**
- (b) Implement reporting structures and review procedures that ensure that research analysts do not report to, and are not supervised or controlled by, investment banking or other department of the firm that could compromise the independence of the analyst; and**
- (d) Implement procedures that prevent investment banking or corporate finance departments from reviewing, modifying, approving or rejecting research reports and recommendations on their own authority.**

Clearly this is an important principle with which few would argue, and investment banks are moving as proposed by this standard. The detail, however, may be more or less appropriate dependant upon a number of factors including the market in question and the size of the firm concerned. In reality investment research is bound to be influenced if there is a strong relationship between the investment bank and the company being covered. It is true that the implementation of objectivity standard 4.0 would be likely to mitigate against the worst possible effects of such influences; it does little, however, to change the underlying reality, and may have already been overtaken by changes in practice. Hence, adoption of AIMR-ROS in its present form could reinforce to a change in form - rather than substance - of the relationship.

5.0 Research analyst compensation

Firms must establish and implement salary, bonus, and other compensation for research analyst that:

- (a) Align compensation with the quality of the research and the accuracy of the recommendations over time; and**
- (b) Do not link compensation to investment banking or other corporate finance activities on which the analyst collaborated (either individually or in the aggregate).**

Overall this standard is too prescriptive and UKSIP is not sure that it should be AIMR's role to prescribe, in effect, how firms should run themselves. Also, investment analysts receive, as remuneration, a combination of base salary plus bonus. Part of the bonus element is likely to relate directly to the quality on the analyst's research. It is not uncommon though for the remaining element of the bonus to be related – at least in part – to the overall performance of the firm which will include the contributions from investment banking and other corporate finance activities. Indeed it would be hard – and probably wrong – not to link analyst compensation to the overall success of the organisation in question. UKSIP thinks it unlikely that major investment houses will wish to change existing practices to meet AIMR-ROS and recommends a re-think on this aspect of the Standards.

6.0 Relationships with subject companies

Firms must implement policies and procedures that manage the working relationships that research analysts develop with the management of subject companies.

Research analysts must be prohibited from:

- (a) Sharing with, or communicating to, a subject company, prior to publication, any section or a research report that might communicate the research analyst's proposed recommendation, rating, or price targets; and**
- (b) Directly or indirectly promising a subject company or other corporate issuer a favourable report or a specific price target, or from threatening to change reports, recommendations or price targets.**

UKSIP has some difficulty with this standard as drafted, albeit that the underlying intention of avoiding corruption is self-evidently necessary. Concerning aspects of 6(a), perhaps the analyst may just be doing his job effectively by contacting the issuing company? Also, it is very difficult to keep obvious views from companies; just because an analyst has not given a view to a company, it does not mean that the view is unknown. Previous reports and recommendations would be good indicators!

7.0 Personal investments and trading

Firms must have policies and procedures that;

- (a) Manage covered employees' "personal investments and training activities" effectively;**
- (b) Ensure that covered employees do not share information with any person who could have the ability to trade in advance of "front run" or otherwise disadvantage investing clients;**
- (c) Ensure that covered employees and members of their immediate families do not have the ability to trade in advance of or otherwise disadvantage investing clients relative to themselves or the firm;**
- (d) Prohibit covered employees and members of their immediate families from trading contrary to, or inconsistent with, the employees' or the firm's most recent, published recommendations or ratings, except in circumstances of extreme financial hardship; and**
- (e) Prohibit covered employees and members of their immediate families from purchasing or receiving securities prior to an IPO for subject companies and other companies in the industry or industries assigned.**

7(a), (b) and (c) are unlikely to be contentious. 7(d) may be too detailed and cause potential problems where a firm has decided to "lock in" profits for risk management purposes. Clearly, such actions should always be capable of justification.

8.0 Timeliness of research reports and recommendations

Firms must issue research reports on subject companies on a timely and regular basis.

Organisations or individuals seeking to gain or retain investor interest must clearly put in the necessary amount of research time. There may, of course, be good reasons for delaying or not issuing a report. Where research is not issued, it is arguable that no harm is being caused. However, harm could be caused if information was deliberately suppressed. On balance, this standard is viewed as too prescriptive.

9.0 Compliance and enforcement

Firms must;

- (a) Have effective enforcement of their policies and compliant procedures to ensure research objectivity;**
- (b) Implement appropriate disciplinary sanctions for covered employees, up to and including dismissal from the firm, for violations;**
- (c) Monitor and audit the effectiveness of compliance procedures; and**
- (d) Maintain records of the results of internal audits.**

Most UK firms are understood to have similar sanctions for violating dealing and disclosure policies.

10.0 Disclosure

Firms must provide full and fair disclosure of all conflicts of interests to which the firm or its covered employees are subject

This would be likely to result in far too much detail, suggesting the need for a materiality test. UKSIP would suggest that the types of conflict of interest be disclosed, rather than all the detail.

11.0 Rating system

Firms must establish a rating system that;

- (a) Is useful for investors and for investment decision-making; and**
- (b) Provide investors with information for assessing the suitability of the security to their own unique circumstances and constraints.**

UKSIP is concerned that AIMR-ROS are attempting to tell all firms how they should operate. Rating systems need not be common across the industry, particularly as firms operate in different ways. Of course, comparisons by the user would be easier but that does not mean that the adoption of rating systems should be mandatory.

Investment Management and Other Firms that Take Investment Action

1.0 Research Objectivity Policy

Firms must have:

- (a) a formal written policy on the independence and objectivity of research (Policy) that must be:**
 - i. made available to clients and prospective clients (both investing and corporate), and**
 - ii. disseminated to all firm employees;**
- (b) Supervisory procedures that reasonably ensure that the firm and its covered employees comply with the provisions of the policy and all applicable laws and regulations; and**
- (c) A senior officer of the firm who attests annually to clients and prospective clients to the firm's implementation of, and adherence to, the Policy.**

Research objectivity is probably not the most relevant issue for investment management firms as investment research is rarely seen outside the firm in question. The key issue is how and why investment decisions were reached and the influences on these decisions. Such issues appear, rightly, to be outside the scope of these standards.

2.0 Public appearances

Firms that permit investment managers and other covered employees to present and discuss their research and recommendations in public appearances must

require these employees to disclose fully personal and firm conflicts of interest to the audience.

UKSIP recommends that the disclosure makes it clear that both individuals and their firms can and may own stock without providing the detail of whether they actually do at a particular moment.

3.0 Relationships with Research Analysts at Investment Banks, Broker-Dealers, and Other Firms that Sell Research

Firms must implement policies and procedures that manage the working relationships that covered employees have with research analysts at investment banks, broker-dealers or other firms that sell research.

Covered employees must be prohibited from the following:

- (a) Decreasing or eliminating brokerage, or threatening to do so, unless a research analysts maintains or changes a recommendation;**
- (b) Informing a corporate issuer or an impending change in a recommendation; and**
- (c) Encouraging a corporate issuer or other third party to retaliate against a research analyst for a recommendation or rating or change in a recommendation or rating.**

UKSIP fully supports this standard

4.0 Personal Investments and Trading

Firms must have policies and procedures that:

- (a) Manage covered employees' "personal investments and trading activities" effectively;**
- (b) Ensure that covered employees and members of their immediate families do not have the ability to trade in advance of ("front run") or otherwise disadvantage investing clients relative to themselves or the firm; and**
- (c) Prohibit covered employees and members of their immediate families from purchasing or receiving securities prior to an IPO for subject companies and other companies in the industry or industries in which discretionary investing client funds are invested.**

UKSIP supports this standard and believes that firms should already have similar rules in place.

5.0 Disclosures

Firms must provide full and fair disclosure of all conflicts of interest to which the firm or its covered employees are subject.

As stated in response to standard 10.0 UKSIP would prefer to see a materiality test applied and the types of conflict disclosed, rather than the detail.

6.0 Compliance and Enforcement

Firms must:

- (a) Have effective enforcement of their policies and compliant procedures to ensure research objectivity;**
- (b) Implement appropriate disciplinary sanctions for covered employees, up to and including dismissal from the firm, for violations;**
- (c) Monitor and audit the effectiveness of compliance procedures; and**
- (d) Maintain records of the results of internal audits.**

Most UK firms are understood to have similar sanctions for violating dealing and disclosure policies.

Corporate Issuers

1.0 Research Objectivity Policy

Firms must have:

- (a) A formal written policy statement that supports independent and objective research and recommendations by research analysts employed by investment banks, broker-dealers, or other firms that sell research;**
- (b) Procedures implemented to prohibit retaliatory actions against research analysts for recommendations or ratings; and**
- (d) A senior officer of the corporate issuer who attests annually to shareholders and prospective investors to its implementation of, and adherence to, the Policy.**

UKSIP agrees that it would be helpful to discourage issues from placing undue pressure on analysts or fund managers. The adoption of this standard by an issuing company would be evidence of a constructive attitude towards corporate social responsibility.

Journalists and the Media

1.0 Research Objectivity Policy

The news and editorial media must:

- (a) **Have a formal written policy on handling public disclosure of conflicts of interest by research analysts, investment managers, or other investment professionals who communicate their research results, recommendations, or investment actions to the investing public through the news media;**
- (b) **Disseminate the Policy to all firm employees who interview or collect information from research analysts, investment managers, or other investment professionals in the course of the jobs; and**
- (c) **Establish and implement supervisory procedures that reasonably facilitate such disclosures reaching investors and prospective investors in the media audience.**

UKSIP is concerned that AIMR-ROS do not adequately address concerns related to the media. It is recognised that, in common with many other organisations, AIMR has little, if any, sanction over the media. Nonetheless, the media should either be covered more fully by AIMR-ROS or left out entirely. It will be difficult for AIMR to argue, on the basis of the above standard, that references to the media in AIMR-ROS are a strength.

In the UK the media has been involved in serious abuses such as “front running” and this is just as misleading for the general public as similar practices by analysts.