

Financial Analysts:

Best practices in an integrated European financial market

Comment by

UK Society of Investment Professionals on Recommendations from the Forum Group to the European Commission Services

About UKSIP

The UK Society of Investment Professionals (“UKSIP”) is a professional body whose main aim is to foster and maintain high standards of professional ability and practice in investment analysis, portfolio management and related disciplines. It currently has over 4,000 members, who work or have an interest in the UK financial services industry. UKSIP is the second largest member society worldwide of the Association for Investment Management and Research (AIMR[®]), and the largest in Europe. AIMR is a global non - profit organisation of more than 67,000 investment professionals, and is best known as the organisation that develops and administers the Chartered Financial Analyst (CFA[®]) Program.

UKSIP also oversees the Investment Management Certificate (“IMC”), the benchmark qualification for those working in investment management in the UK and currently held by over 12,500 investment professionals. UKSIP members who successfully completed UKSIP’s former Associate examination can use the designation ASIP.

About this response

The following comments address those matters felt to be of particular concern to UKSIP’s members. The Society’s response to the following consultations are also relevant:

- FSA DP 18 (An Ethical Framework for financial services)
- FSA CP171 and CP 205 (Conflicts of interest: investment research and issues of securities)

Relationship between companies and analysts (Recommendations 4 & 6)

1. Paragraph 5.6 highlights the potentially invidious relationship between companies and analysts and UKSIP therefore fully supports the Group's view that unaffiliated analysts should be permitted and encouraged to publish independent research about new issues. UKSIP would emphasise that whilst it is important that independent analysts attend financial information meetings it is also crucial that the information provided to these analysts is not limited. Reliable, independent research is not possible if significant information is restricted to corridor meetings.
2. The Report notes that in many jurisdictions, the financial supervisory authorities do not have significant oversight powers over corporate issuers. Failure to implement some form of regulatory control over companies wishing to obtain a listing, such as that contained in recommendation 6 will mean that companies may have little incentive to encourage truly independent research analysis.

Payment of analysts (Recommendations 22 and 23)

3. UKSIP supports the above recommendations. The Society believes that an analyst's pay and benefits can be linked to the overall profitability of a firm. However, to avoid possible conflicts of interest, remuneration should not be based on an analyst's contribution to profits on specific investment banking deals or determined by managers in investment banking or equity sales and trading. UKSIP would also favour firms including details of their remuneration policy in documents such as their Code of Ethics which would cover policies for managing conflicts of interest and maintaining the independence and objectivity of research.
4. UKSIP does not support part (a) of recommendation 21 which prohibits analysts and connected persons from owning securities in sectors on which they are producing research. Clearly, if an analyst does hold shares in an institution covered by that individual, any trades made should be consistent with relevant recommendations. It could be argued that the freedom to deal on one's own account provides an incentive for good analysis. Lastly, why single out analysts when others – such as stockbroker traders – are likely to have a more active promotional role with clients?

Management of conflicts of interest within integrated firms (pp30 & 31)

5. UKSIP agrees in principle with the thinking Recommendation 18 which states that research produced by selling syndicate analysts should be subject to a quiet period immediately after an offering has been priced. In its response to the UK Financial Services Authority's consultation paper CP171, it supported the proposal for a quiet period running from the time the prospectus is published until the securities are admitted to trading and for 30 days thereafter.

Ethics (p24 & 25)

6. UKSIP supports the idea that the regulator should not set specific rules in relation to ethical standards. High ethical standards of conduct – quite rightly – are a set of values to which people and businesses aspire. There is no finite height barrier to such values, a factor which can strengthen their moral force. Ethics mandated by regulators would almost certainly be regarded as a matter of compliance; the grade must be met but not necessarily exceeded. This would not be an ideal approach to ethical considerations.
7. UKSIP also fully endorses the Group's statement that even when procedures are in place to identify, avoid, prevent or manage and monitor, both actual and potential conflicts of interest, senior management's responsibility for overseeing compliance and applying the standards imposed by each firm's own rules is in no way lessened. A firm is a collection of individuals, but its ethical tone is set at the top and can incorporate inherited practices and modes of thought.

EU Passport for investment research

8. UKSIP supports the proposal raised in Section 6 of the report to allow investment analysts to disseminate research throughout the EU and whether independent research should be treated as a core service, and therefore eligible for the EU passport, under the Investment Services Directive.

Qualifications (Section 7.3)

9. Recommendation 8 states that analysts should receive on-going training in market practice and in relevant regional laws and regulation. Whilst the Group unanimously agreed that analysts should be fully trained, it was divided on whether specific analyst qualifications should be mandatory.
10. Recent experience in the UK has shown that it is essential to have well qualified professionals adhering to the highest possible ethical standards. These people need to understand, not only ethical standards, market practice and relevant local laws and regulation but also different products and the varied needs or desires of different investors in other markets. Professional qualifications play an important role in ensuring that these objectives are achieved. To be an AIMR member, an individual must sign up annually to the Statement of Professional Conduct, as well as pay the subscription. A formal education will not prevent an individual from intentionally behaving unethically but it does mean that an individual analyst has less excuse as competent, well qualified practitioners are better placed to identify, analyse and handle ethical issues. They are also likely to have greater confidence in their position when challenging practices in their firms - or in the industry generally - that they consider unethical. UKSIP would therefore advocate that, as in other professions, investment analysts should obtain formal qualifications relevant to both the global and local markets.

11. UKSIP recognises that passing examinations should not be an end in itself; on the contrary, much can be learned through on the job training which can never be taught in the classroom. It should also be recognised that training is an on-going process, as markets, products, regulations etc change, knowledge needs to be constantly updated. Expertise is acquired and maintained through building blocks.
12. In summary, UKSIP supports the view of those members of the Forum in favour of compulsory registration with the local regulator of analysts whose work is disseminated, subject to the possession of a relevant analyst's qualification. Registration and qualification help to maintain high standards and distinguish between professionals and possible sharks.

25 November 2003