



The UK Society of Investment Professionals



UKSIP is a member society of

FSA Consultation Paper 205:
Conflicts of Interest:
Investment Research and Issues of Securities

Response by
the UK Society of Investment Professionals

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, which was a broadly equivalent to the CFA, can use the designation ASIP.

About this response

UKSIP supports the general approach of the Financial Services Authority (FSA) to managing conflicts of interest by adopting principle-based proposals consistent with European Union directives and developments in the US. It is evident to UKSIP that the FSA has addressed a number of practical concerns raised during the consultation on CP 171. In particular, UKSIP is reassured to note in paragraph 3.34 the statement that the FSA's proposals will not apply to research that is for internal use only. UKSIP notes that a number of the proposals and rules are similar to the guidance provided by AIMR's Research Objectivity Standards (the "ROS"). Among others, the proposal that firms adopt written policies for managing conflicts of interest in investment research is similar to Standard 1.0 of the ROS. Likewise, the prohibitions against dealing ahead of publication of research match closely ROS Standard 7.0 (c).

Managing conflicts of interest

An essential requirement to the effective management of conflicts of interest is the maintenance of high professional standards at both the firm and individual levels. In our response to the FSA's DP 18, UKSIP identified senior management's responsibility for setting the ethical tone of the business. There should also be the expectation that investment research analysts, amongst other, will adhere to high standards of professionalism. The introduction of a professional code of conduct, such as AIMR's Code of Ethics, which must be adopted by all, could be a way forward.¹

Cessation of coverage

UKSIP is in favour of firms notifying clients and companies when they cease to cover a particular organisation. In this way, clients are alerted to the requirement, if appropriate, to seek alternative research analysis. In the absence of such communication, a client may erroneously assume that the company no longer covered by the firm still represents a good investment opportunity. Failure to advise a company of cessation of coverage could be particularly damaging to smaller companies which tend to be analysed by only one or two firms. There is a risk that some Small and Medium-sized Enterprises (SMEs) could unknowingly find that no investment research is provided about them which could have a negative impact on investment in the company. (See also response to Q10)

Quiet Periods

In its submission to the FSA's CP 171, UKSIP supported the proposal to introduce a quiet period. UKSIP assumes that the change in FSA's standpoint on this issue, whereby a quiet period is no longer required, does not mean that the FSA has ruled out the use of quiet periods as the best way to address the possible conflicts of interest arising from this issue. In the absence of a quiet period, senior management's challenge to manage conflicts effectively will increase. Additional record keeping requirements are likely to be necessary and it remains to be seen whether they will provide a cost effective and adequate alternative to the original recommendation for a quiet period. UKSIP would also urge the FSA to ensure that its approach is consistent

¹ AIMR's Code of Ethics and Professional Conduct provides guidance to encourage good ethical behaviour. The Code also requires an annual commitment to comply with its requirements. Failure to do so leads to loss of AIMR membership and of the CFA designation.

with that any decision made by the European Commission following the Forum Group's recommendations in its report "Financial Analysts: Best practices in an integrated European financial Market."

Responses to questions

Q1 *Do you agree with our narrowing the scope of our proposals to investment research held out, or reasonably relied on, as objective?*

Agreed

Q2 *Is the concept of investment research held out, or reasonably relied on, as objective clear enough?*

Yes, this is the best possible definition.

Q3 *Do you agree with our decision not to specify what kinds of investment research must be held as objective and what need not be?*

Agreed, this is in line with a principles-based approach.

Q4 *What kinds of research do you anticipate or intend:*

a) *would be produced under the controls we propose?*

This research would be investment advice as defined by the Regulated Activities Order.

b) *would be produced outside the controls?*

c) This would **not** constitute investment advice and would not be caught by the Regulated Activities Order.

Q5 *How do you think consumers of research or their clients might use the regulatory distinction we are seeking to draw?*

UKSIP considers that little or no distinction will be made between the different types of research.

Q6 *Do you agree that investment research can and should be clear, fair and not misleading even if not produced in line with our guidance for objective investment research?*

Yes, researchers have a duty to ensure that their reports and briefings are accurate.

Standard IV of AIMR's Standards of Professional Conduct, requires that members, among other things: make reasonable and diligent efforts to avoid any material misrepresentation in any research report or investment recommendation; distinguish between facts and opinions in research reports; act for the benefit of their clients and place their clients' interests before their own; and deal fairly and objectively with all clients and prospects when disseminating investment

recommendations and material changes in prior investment recommendations, and taking investment action.

Based on these requirements, UKSIP believes that all investment research, regardless of the intended audience, should, at a minimum, adhere to standards that are similar to those of AIMR's Standards of Professional Conduct.

Q7 Do you agree with our proposal requiring firms providing objective investment research to have and enforce a conflicts management policy, and to make that policy publicly available?

Yes, this provides an essential framework to the ethical culture to which all employees of the firm must adhere. There is no good reason why that policy should not be publicly available. Furthermore, UKSIP believes that written copies of these policies should be given to private investors at the time of initial investment and that existing investors should be notified in writing of any changes to these policies.

Q8 Do you believe that our proposed policy requiring firms to have a conflicts management policy for investment research they hold out as objective can appropriately be applied to investments other than equities.

Yes. As stated in our response to CP 171, similar conflicts apply to investments other than equities and should be managed through the same sort of management arrangements and disclosures as for equity research.

Q9 Do you agree that our proposals should cover conflicts of interest in small firms and non-sell side firms?

Yes, AIMR's Code of Ethics and Professional Conduct also embraces small firms and non-sell side firms.

Q10 Are there any particular difficulties which small firms and non-sell-side firms will have in complying with our revised conflict management standards?

UKSIP notes that instead of providing a carve-out for small firms, the FSA is willing to provide free individual guidance. UKSIP would like to point out that small firms' business is largely deal driven and they would therefore need rapid answers to any queries that they may have if they are not to be disadvantaged in the market place.

If small firms were driven out of the market by these proposals it would have a negative knock-effect upon small companies. As SMEs tend to be researched by just one or two independent research firms, any diminution in the number of these niche firms might result in a loss of research coverage and thereby reduce the level of investment in this sector.

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