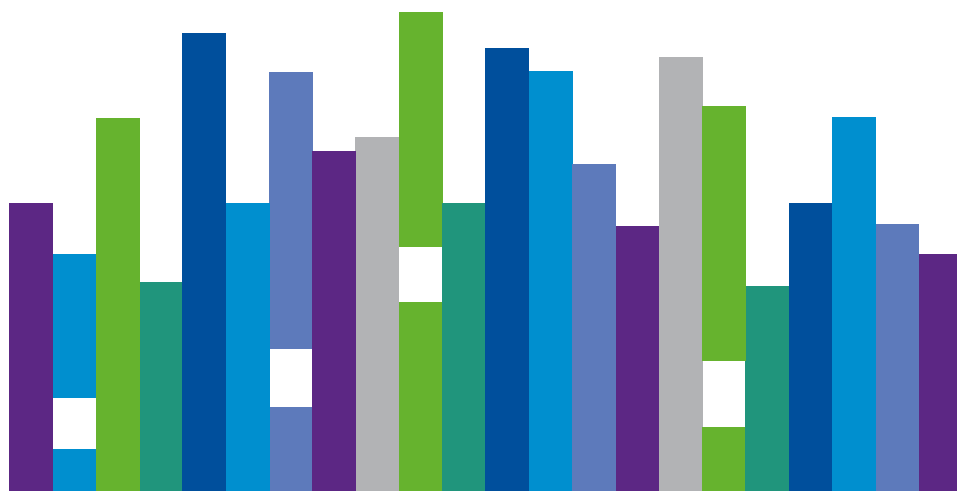


# PUBLIC DISCLOSURE

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UK's Market Integrity  
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Committee

Position paper  
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# PUBLIC DISCLOSURE

This paper describes CFA UK's views on Public Disclosure. Making public statements is part of many investment professionals' role. When making statements or providing commentary in public or through the media, CFA UK members should ensure that they do so in a manner that is aligned with their regulatory obligations and the Code and Standards.

The objective should be to make well intentioned statements that are supported by the appropriate level of due diligence and research. Doing so ensures that recipients of these statements are clear about the context and perspective of the source of this commentary. This in turn can reassure recipients that such commentary does not have an ulterior motive and is supported by an appropriate level of evidence.

For many investment professionals, making public statements is part of their role. When making statements or providing commentary in public or through the media, CFA UK members should ensure that they do so in a manner that is aligned with their regulatory obligations and the Code and Standards. Key to distinguishing between good and poor practice when making any public disclosure will be the intent motivating it and the basis for the commentary.

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As we witnessed during the dotcom years; commentators from large firms were not averse to providing conflicted commentary that placed the interests of their employers ahead of their clients, the public and market integrity<sup>1</sup>. Similar motivations emerged during the inflation of the credit bubble<sup>2</sup>. Even in the wake of the crisis, one large firm has been less than candid in their public disclosures<sup>3</sup> and faced a strong response from the regulator<sup>4</sup>.

## CFA UK MEMBER OBLIGATIONS

CFA UK members should be aware of their responsibility to provide sufficient information to the audience to assess the suitability of an investment in light of their

specific circumstances and constraints. If commenting on the merits on an investment, CFA UK members should remind audience members to judge the suitability of the investment in light of their own unique situation.

The CFA Institute's voluntary Research Objectivity Standards (ROS) are primarily aimed at sell-side analysts. Many of the same themes apply to all investment professionals. Regardless of whether the audience consists of other investment professionals, investing clients or the general investing public, CFA UK members must ensure that the audience has sufficient information to assess the objectivity of any opinion given.

### THE ROS DESCRIBE A PUBLIC APPEARANCE AS:

*'A public appearance includes participation in a seminar; forum (including an interactive electronic forum); radio, television, or other media interview; or other public speaking activity in which a research analyst makes a recommendation or offers an opinion.'*

The ROS states that when making public appearances, members should be prepared to make full disclosure of all conflicts of interest, either their own or their firms', about which they could reasonably be expected to know.

<sup>1</sup>SEC Factsheet on the Global Settlement <http://www.sec.gov/news/speech/factsheet.htm>  
<sup>2</sup>Goldman Sachs to Pay Record \$550 Million to Settle SEC Charges Related to Subprime Mortgage CDO. Firm Acknowledges CDO Marketing Materials Were Incomplete and Should Have Revealed Paulson's Role <http://www.sec.gov/news/press/2010/2010-123.htm>

<sup>3</sup>J.P. Morgan to Pay \$153.6 Million to Settle SEC Charges of Misleading Investors in CDO Tied to U.S. Housing Market <http://www.sec.gov/news/press/2011/2011-131.htm>  
JPMorgan Chase Agrees to Pay \$200 Million and Admits Wrongdoing to Settle SEC Charges. Firm Must Pay \$920 Million in Total Penalties in Global Settlement <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539819965>

<sup>4</sup>Cease and desist proceedings, SEC, September 19th 2013 <http://www.sec.gov/litigation/admin/2013/34-70458.pdf>

CFA UK members that comment on the investment opportunities in a company should make the following disclosures to the interviewer or the audience as appropriate:

1. whether the subject company is a client of the firm;
2. whether their employer has participated, or is participating, in marketing activities for the subject company.
3. whether the speaker or related parties have a position in the subject company's securities.

CFA UK members must abide by the Code of Ethics and Standards for Professional Conduct<sup>5</sup> at all times. Relevant sections of the Code of Ethics with respect to public appearances are:

- » Act with integrity, competence, diligence, respect, and in an ethical manner with the public, clients, prospective clients, employers, employees, colleagues in the investment profession, and other participants in the global capital markets.
- » Place the integrity of the investment profession and the interests of clients above their own personal interests.
- » Use reasonable care and exercise independent professional judgment when conducting investment analysis, making investment recommendations, taking investment actions, and engaging in other professional activities.
- » Promote the integrity of and uphold the rules governing capital markets.

CFA UK members should also take note of the following standards of professional conduct from the CFA Institute and the FCA when making public appearances. Not every situation can be covered in this paper, however the section on case studies provides examples of poor practice, which indicates how a CFA UK member should not conduct themselves when making statements in public.

Table 1 – CFA Institute's Professional Standards and the Financial Conduct Authority (FCA) requirements for Approved Persons.

CFA Institute Standards	FCA Approved Persons Regime (from the regulator's Handbook)
Standard 1 – Professionalism	Statement of Principle 1 -
Standard 2 – Integrity of Capital Markets	An approved person must act with integrity in carrying out his controlled function.
Standard 5 – Investment Analysis, recommendations and actions	Statement of Principle 2 -
Standard 6 – Conflicts of interest	An approved person must act with due skill, care and diligence in carrying out his controlled function.
Standard 7 – Responsibilities as a CFA Institute Member or CFA candidate	Statement of Principle 3 - An approved person must observe proper standards of market conduct in carrying out his controlled function.
Regardless of whether a CFA UK member is an Approved Person they must be aware of their employers' responsibilities to the UK regulatory framework and act accordingly.	

## CASE STUDIES OF INAPPROPRIATE PRACTICE RELATED TO PUBLIC DISCLOSURE<sup>6</sup>

### Case study 1 – Disclosure of Issuer-Paid Research:

*Anthony McGuire is an issuer-paid analyst hired by publicly traded companies to electronically promote their stocks. McGuire creates a website that promotes his research efforts as a seemingly independent analyst. McGuire posts a profile and a strong buy recommendation for each company on the website indicating that the stock is expected to increase in value. He does not disclose the contractual relationships with the companies he covers on his website, in the research reports he issues, or in the statements he makes about the companies in internet chat rooms.*

*Comment: McGuire has violated Standard I(C) because the internet site is misleading to potential investors. Even if the recommendations are valid and supported with thorough research, his omissions regarding the true relationship between himself and the companies he covers*

<sup>5</sup>See page 68 for a summary

<sup>6</sup>Examples 1,3, 4 taken from CFA Institute's Standards of Practice Handbook Tenth Edition 2010, unless otherwise stated.

constitute a misrepresentation. McGuire has also violated Standard VI(A)–Disclosure of Conflicts by not disclosing the existence of an arrangement with the companies through which he receives compensation in exchange for his services.

### **Case study 2: Lack of diligence or reasonable basis for a recommendation**

*"I like CEO Bob Steel, so this stock is a buy."*

CNBC's Jim Cramer recommendation for Wachovia<sup>7</sup> (5th September 2008)

*"I let you down, cause I wasn't skeptical enough. I have to presume when it comes to banking right now there is no objective truth, just negative, just terrible things. I let my judgment of Steel cloud my thinking about Wachovia. Is he to blame? Did he take advantage of me? Perhaps yes. But ultimately I must be a firewall for you and this time I let the firewall down<sup>8</sup>."*

Jim Cramer on Wachovia two weeks after interviewing Wachovia's CEO and making a strong buy recommendation on the bank. (29th September 2008).

Comment: Making any recommendation always carries the risk that it does not turn out as expected. However, whatever the recommendation is, it must be thoroughly researched and supported by the appropriate level of evidence.

Members and Candidates must:

1. Exercise diligence, independence, and thoroughness in analysing investments, making investment recommendations, and taking investment actions.
2. Have a reasonable and adequate basis, supported by appropriate research and investigation, for any investment analysis, recommendation, or action.

Based on the case study it appears that Cramer would have violated Standard V (A) as there is no indication that the buy recommendation was based on appropriate due diligence or a reasonable basis.

### **Case study 3 Independent Analysis and Company Promotion:**

The principal owner of Financial Information Services (FIS) entered into an agreement with two microcap companies to promote the companies' stock in exchange for stock and cash compensation. The principal owner caused FIS to disseminate e-mails, design and maintain several internet sites, and distribute an online investment newsletter—all of which recommended investment in the two companies. The systematic publication of purportedly independent analyses and recommendations containing inaccurate and highly promotional and speculative statements increased public investment in the companies and led to dramatically higher stock prices.

Comment: The principal owner of FIS violated Standard II(B) by using inaccurate reporting and misleading information under the guise of independent analysis to artificially increase the stock price of the companies. Furthermore, the principal owner violated Standard V(A)–Diligence and Reasonable Basis by not having a reasonable and adequate basis for recommending the two companies and violated

Standard VI(A)–Disclosure of Conflicts by not disclosing to investors the compensation agreements (which constituted a conflict of interest).

### **Case study 4 "Pump-Priming" Strategy:**

Sergei Gonchar is chairman of the ACME Futures Exchange, which is launching a new bond futures contract. To convince investors, traders, arbitrageurs, hedgers, and so on, to use its contract, the exchange attempts to demonstrate that it has the best liquidity. To do so, it enters into agreements with members in which they commit to a substantial minimum trading volume on the new contract over a specific period in exchange for substantial reductions of their regular commissions.

Comment: The formal liquidity of a market is determined by the obligations set on market

makers, but the actual liquidity of a market is better estimated by the actual trading volume and bid-ask spreads. Attempts to mislead participants about the actual liquidity of the market constitute a violation of Standard II(B). In this example, investors have been intentionally misled to believe they chose the most liquid instrument for some specific purpose, but they could eventually see the actual liquidity of the contract significantly reduced after the term of the agreement expires. If the ACME Futures Exchange fully discloses its agreement with members to boost transactions over some initial launch period, it will not violate Standard II(B). ACME's intent is not to harm investors but, on the contrary, to give them a better service. For that purpose, it may engage in a liquidity-pumping strategy, but the strategy must be disclosed.

### Case study 5 – Conflicts of interest

"You know everyone thinks I upgraded [AT&T] to get lead for [AT&T Wireless]. Nope. I used Sandy to get my kids in 92nd ST Y pre-school (which is harder than Harvard) and Sandy needed Armstrong's vote on our board to nuke Reed in showdown. Once coast was clear for both of us (ie Sandy clear victor and my kids confirmed) I went back to my normal negative self on [AT&T]. Armstrong never knew that we both (Sandy and I) played him like a fiddle<sup>9</sup>."

Jack Grubman's email to a friend in 2001 that sets out the reasons why he improved his rating on AT&T. During the late 1990s Grubman was an influential analyst. It is reported that the improved rating for AT&T may have helped Weill (co-CEO of Citigroup with John Reed) gain the support of AT&T CEO C. Michael Armstrong (a Citigroup Board member) to oust Reed.

In 2003, Grubman settled a lawsuit with the Securities and Exchange Commission over accusations that his work for investment banking clients led him to publish misleading research reports on companies that his employer, Citigroup, advised. As part of the settlement, in which Mr. Grubman did not admit or deny the allegations, he was barred from the securities industry.

Comment Grubman violated several of the standards. The change in rating was without reasonable basis, it was a conflicted decision and motivated by personal gain rather than acting in the interests of clients. The public statement of an improved rating also contradicted with Grubman's previously held professional negative view of the AT&T.

### Case study 6 – Langbar International - knowingly making false statements<sup>10</sup>

Stuart Pearson, former chief executive of AIM-listed Langbar International (formerly Crown Corporation Ltd ("Crown")) was found guilty in 2011 of three counts of making misleading statements to the market. He was also barred from being a director for five years. Mr Pearson was convicted under section 397 of the Financial Services and Markets Act 2000.

Crown in fact had no money and its shares had no real value. Despite this, it continued to make public statements about its value, via the Stock Exchange's Regulatory News Service, based on the false certificate. Mr Pearson joined Crown, renamed Langbar, in June 2005 and made a number of announcements about the company's cash assets. In September 2005 he issued statements which the court found he knew to be false, misleading or deceptive or was reckless in issuing them. He claimed:

- » the company had an asset value of nearly £357 million
- » it had successfully negotiated the exit of its cash deposits in South America
- » US\$294 million had been transferred to a Langbar account at ABN Amro BV in Holland and this sum had been admitted to the Euroclear and DTCC trading and settlement custody services.

Comment: While this case refers to a corporate executive the lessons still apply with regard to making misleading statements or unjustified public disclosures. The disclosures made by Pearson would have violated the Standards of Practice I – Professionalism in particular I(A) knowledge of the law; I(C) misrepresentation and I(D) misconduct.

<sup>9</sup>Banned Wall Street Analyst Jack Grubman Is Back', Sam Ro, May 31, 2013, Business Insider <http://www.chron.com/technology/businessinsider/article/Banned-Wall-Street-Analyst-Jack-Grubman-Is-Back-4565420.php>

<sup>10</sup>Chief Executive found guilty Chief executive found guilty of making misleading statements, Rebecca Huntsman, Hogan Lovells, July 1 2011 <http://www.lexology.com/library/detail.aspx?g=21896877-e3ef-4156-93e2-3d24b296b39f>



CFA Society  
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