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## newsletter

### Financial Services Authority

# Investment research: Conflicts & other issues

July 2002

#### About this newsletter

This Newsletter provides a summary of FSA Discussion Paper – Investment research: Conflicts & other issues

This paper is particularly relevant for authorised firms, listed companies and investors (both retail and institutional).

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## Executive Summary

### Concerns about the independence of investment research

Over recent months there has been considerable debate and international publicity on the independence of investment research. The concern is that research reports and recommendations made by investment analysts, particularly those working for large integrated investment firms, are not always without bias.

We aim to ensure the operation of clean, orderly and efficient markets, and the provision of a fair deal for consumers and this paper promotes that objective. It investigates the conflicts of interest and other issues relevant to producing and giving out (disseminating) research reports and recommendations.

At this stage, and largely because of the need to support and contribute to our existing Committee of European Securities Regulators (CESR) work, we have not focussed on the presentation, content or quality of research. However, we believe there is a need to carry out a more detailed study into how best we can achieve and ensure high standards in these areas, and whether or not regulation has a role to play.

We recognise that many of these perceived problems have been identified in the US, where recent cases have called into question the integrity and independence of analysts in investment banks. They have focussed attention on the objectivity of such recommendations, and views from the rest of Europe seem to suggest that there are perceived issues there too.

It would be naïve to assume that we do not have, at least, the potential for similar problems in the UK. So, we have already undertaken some research to find out whether our existing regulatory framework is adequate in the way it covers this subject. We also hope debate promoted by this Discussion Paper (DP) will provide further information.

The CESR is advising the European Commission on measures to underpin its proposed directive on Market Abuse, which includes analysts' conflicts, and we have contributed to this work. The International Organisation of Securities Commissions (IOSCO) is also undertaking work in this area and will be setting out a range of options for regulators to consider.

### Addressing this issue in the UK

The issues surrounding analysts' independence affect both market confidence and investor protection (and may, indeed, be relevant in relation to financial crime). This is why it is appropriate to examine the position in the UK and ensure that our regulation is adequate, consumers are protected and confidence in markets is supported.

So, this DP has been produced to:

- support our contribution to the current CESR proposals;
- respond to a perceived need to review existing domestic practices in the light of international disquiet;
- address concern in some areas that our principles-based approach may not necessarily give investment firms as much certainty about acceptable standards of conduct as they would like; and
- seek responses from all interested parties, including listed companies and the general public on various options, and specific questions.

#### What this DP covers

The DP outlines our views of the conflicts of interest that can arise in the production of research by analysts working for investment firms, and other potential problems concerning research reports. For example, the paper considers the view of the investing public on the reliability of such reports when making their own investment decisions. It compares our attitude to regulation of such issues with those of regulators in other countries and looks at the action taken by the Securities and Exchange Commission (SEC) in the US, and those under discussion in the EU. The work of IOSCO is also being taken into account.

The paper also reviews the current levels of existing regulation and sets out various market-based options for consideration, assessing the merits of each one.

The options include:

- maintaining the status quo, if it appears that this is adequate, and that market forces are already addressing some of the problem areas;
- consumer education;
- greater disclosure;
- constraints on firms' organisational and operational arrangements; and
- controls on financial analysts themselves.

#### Why this paper should be of interest to consumers

This paper should be of interest to consumers because the issues and problems raised link mainly with market confidence and consumer protection objectives. Consumers need to be confident that their interests will not be disadvantaged by the actions of investment firms producing research material and any trading undertaken ahead of publishing that research.

The financial markets in general and the equity market, in particular, are affected, because of the influence research has on asset prices. Giving out (we sometimes refer to this as information dissemination) of price

sensitive information to the market as a whole without delay is key to the operation of efficient markets. However, we recognise that there may be an uneven playing field in what price sensitive information is given to investors.

Another significant issue is the lack of consumers' understanding of the potential conflicts of interest faced by analysts, investment firms and the subject companies. These conflicts can impact the objectivity of research, which in turn can influence the market both positively and negatively. As such, consumers need to be aware of the implications for financial gains and losses. It is important that consumers understand that research can either have a promotional or marketing purpose, or it may serve as formal investment advice.

Comments by  
30 October 2002

We invite all interested parties, including the general public, to comment on the various options we cover in this paper. These comments will inform further work and recommendations that may be put forward in any subsequent consultation document. The closing date for comments on this DP is 30 October 2002.

Representations in respect of the issues discussed in this document should be made to:

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Business Standards Department  
Conduct of Business Standards Division  
The Financial Services Authority  
25 The North Colonnade  
Canary Wharf  
London E14 5HS

Or by email to: [investment.research.dp@fsa.gov.uk](mailto:investment.research.dp@fsa.gov.uk)

Responses should reach us by 30 October 2002

**It is the FSA's policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise.**

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