Summary of responses to the consultation carried out by the European Commission on the report of the Forum Group on Financial Analysts

A working document of DG Internal Market

NOTE TO THE READER

This working document seeks to provide an objective presentation of the comments received by the Commission services in response to the report submitted by the Forum Group on Financial Analysts on 4 September 2003: "Financial Analysts: Best practices in an integrated European financial market".

This presentation does not reflect any judgement on the part of the Commission services as regards the different comments made in the consultation. This document seeks to provide a synthesis of the basic positions advanced by respondents in respect of the recurrent themes in the feedback to the consultation.

In drawing up this summary, the Commission services have been guided not only by the number of respondents expressing a particular point of view, but also by qualitative considerations such as the extent to which the respondents are representative and the arguments advanced by respondents in support of their views. For this reason, the report does not present a systematic statistical/quantitative analysis of the responses provided on each point. It endeavours to present a qualitative assessment of the responses received and of the main arguments underpinning these responses. What follows should therefore be regarded as a summary of statements volunteered by respondents in respect of their perceived priorities on the issues covered in, or relating to, the Forum Group's report.

Where relevant, the report includes histograms indicating the general views of respondents towards certain issues relating to the Forum Group's recommendations. These should be treated and considered with due care since they are inevitably the result of subjective interpretation.

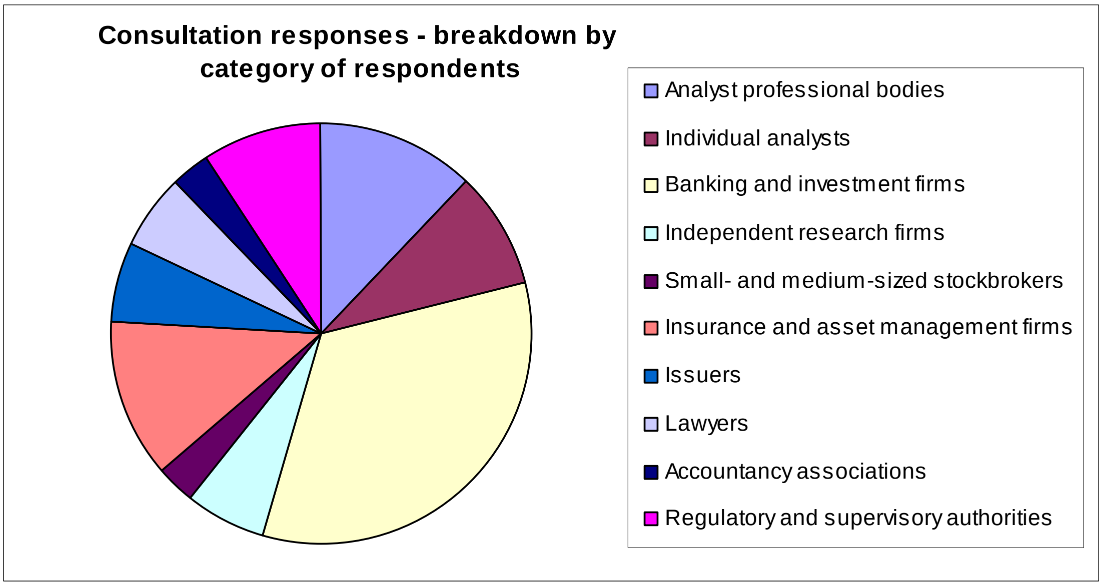
Few respondents answered systematically to all the Forum Group's recommendations. Instead, responses tended to deal extensively with the issues of greatest concern to the respondents in question.

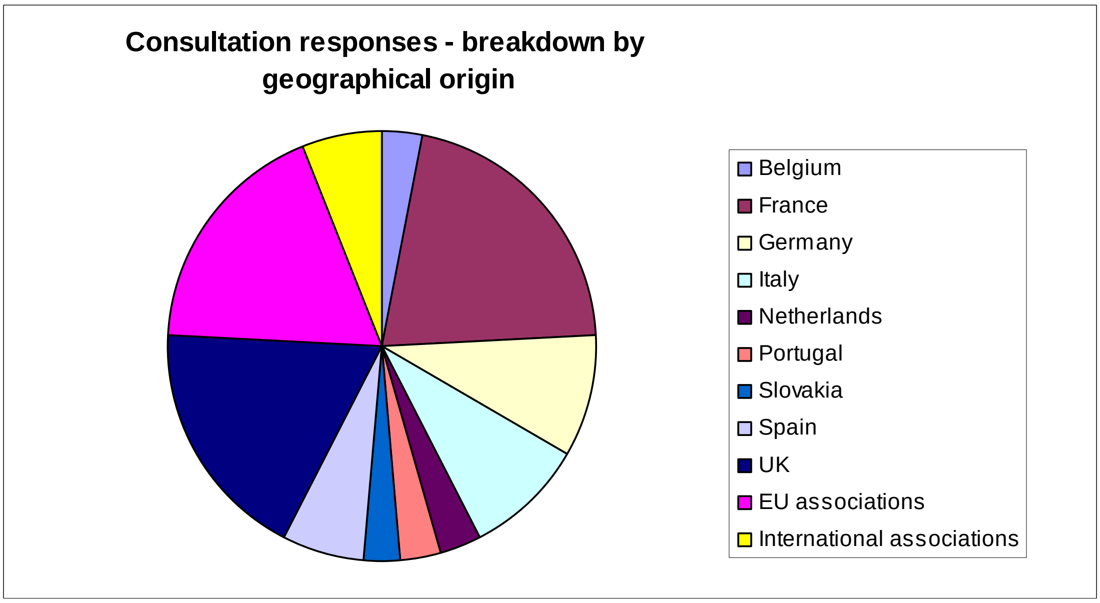
This document begins with a summary of the main themes emerging from the consultation and proceeds to provided further detail of respondents' concerns, grouped on a thematic basis.

1. INTRODUCTION

The document summarises the responses to the public consultation carried out by the European Commission services on the report submitted by the Forum Group on Financial Analysts on 4 September 2003: "Financial Analysts: Best practices in an integrated European financial market". The consultation ran until the end of November 2003.

The Commission received 33 responses from a cross-section of representatives of analysts and their professional bodies, banking and investment firms, independent research firms, institutional investors, issuers, legal and accountancy professionals, and regulatory and supervisory authorities[1]. Responses were received from eight of the current Member States and one accession country, plus a number of replies from EU and international level representative organisations. There was a high level of support for the transparent and consultative process.





[1] See Annex for a full list of responses.

2. MAIN THEMES

- **Overall**, there was a high level of support for the **principles-based approach** suggested by the Forum Group, for its scope, and for many of the Group's recommendations.

- Several respondents would like to see a **definition of investment research**, in particular to make clear that research is an opinion and should not be considered privileged information.

- Responses indicated a certain level of interest in a **European framework** laying down minimum standards for analysts. However, the majority of respondents considered that this should be achieved through **self-regulation** rather than through further legislative initiatives at European level. Some respondents stressed the need for **consistency at international level –** in particular with the principles issued by the International Organisation of Securities Commissions (IOSCO).

- There was broad support among respondents for the approach taken by the group on how **conflicts of interest** might be avoided, prevented or managed within investment firms, with little support for legal separation of research and investment banking into separate entities. Nevertheless, there was a lack of consensus in some areas within this nexus of issues, such as the rules governing analysts' own trading in the shares of companies on which they produce research and on quiet periods. Concerns were also expressed that detailed recommendations relating to quiet periods were unsuitable for application to **debt markets**, where issues may be made to a short timescale.

- On the **disclosure** of conflicts of interest by investment firms, the general view among those commenting was that existing Community legislation (as set out in the Market Abuse Directive and its implementing measures) already provides a sufficient framework.

- There was some support among respondents for some form a best practice code or self-governance rules covering **issuer relations** with analysts.

- Some (though by no means a majority of) respondents would like to see some form of **registration** requirement for analysts, linked to mandatory **qualifications**.

- Views on **independent research** were somewhat divided. Whereas most respondents recognised the value of independent research, there would seem to be little agreement on related issues such as "bundling" and "softing". Nor was there a consensual view expressed on whether investment research should be made a core service in the Investment Service Directive (mirroring the lack of consensus in the Forum Group).

Box: The Forum Group's recommendations

The Commission established the Forum Group following a request from Finance Ministers in April 2002, in the context of a discussion of policy issues raised by the Enron affair, that the Commission should assess the role of financial analysts and possible measures to improve their participation in the market.

The Forum Group's report[2], published in September 2003, sets out **five principles** that the Group considers should underlie the production and dissemination of investment research in Europe:

- **Clarity:** Research should be fair, clear and not misleading.
- **Competence, conduct and personal integrity:** Research should be produced by competent analysts with skill, care, diligence and integrity; and it should reflect the opinion of its author(s).
- **Suitability and market integrity:** Research should be distributed taking into account the different categories of its intended recipients and the need to maintain market integrity.
- **Conflict avoidance, prevention and management:** Analysts' firms should have in place systems and controls to identify and avoid, prevent or manage personal and corporate conflicts of interest.
- **Disclosure:** Conflicts of interest, whether corporate or personal, should be prominently disclosed.

These principles are underpinned in the report by 31 recommendations.

The main focus of report is on avoiding, preventing or managing, monitoring and disclosing conflicts of interest within investment banks, where the Forum Group has placed great emphasis on the role of senior management in ensuring the proper functioning of robust conflict management systems – and on the role of supervisors in ensuring that this happens.

The recommendations focus in particular on conflicts of interest resulting from analyst involvement in securities offerings and other corporate finance work; best practice for companies issuing securities; remuneration of analysts; securities dealing by analysts; qualifications; and the distribution of investment research to the retail market.

3. OVERALL APPROACH, IMPLEMENTATION AND ENFORCEMENT

The responses to the consultation demonstrated a **high level of overall support** for the Group's recommendations, in particular the key recommendations focussing on the management of conflicts of interest.

Strong support was expressed for the **principles-based approach** adopted by the Forum Group, with the vast majority of respondents explicitly endorsing this approach, though some respondents found some of the recommendations overly prescriptive. Some respondents suggested that certain recommendations required further clarification.

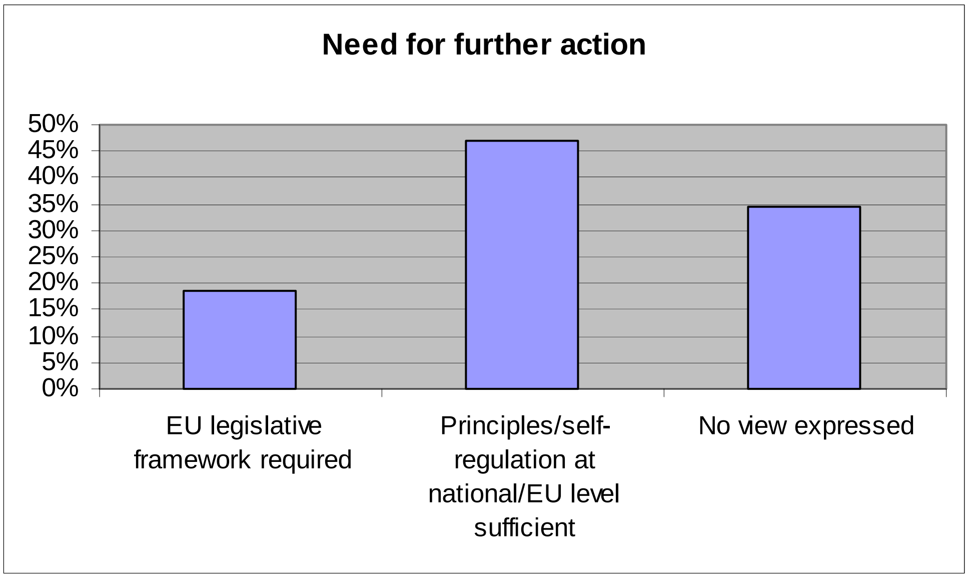
[2] The Forum Group's full report can be accessed at: http://europa.eu.int/comm/internal_market/en/finances/mobil/finanalysts/index_en.htm.

On the means of **implementation**, views were more mixed. Several respondents expressed support for implementation through self-regulation and warned against over-regulation of the production and dissemination of investment research.

Many respondents took the view that no further **regulatory action** was necessary at EU level, whilst several others wanted to see harmonised regulation at EU level, either through legislation or through self-regulation. Some were concerned about multiple levels of regulation.

It was also stressed by some respondents that **EU standards** should, as far as possible, be compatible with the requirements of other major jurisdictions, but without necessarily duplicating the approaches of such jurisdictions. Related to this, some respondents highlighted the importance of determining what would constitute "equivalent" rules where dissemination of research from non-European jurisdictions is permitted (Recommendation 26).

Several respondents stressed the need for consistency with the **IOSCO principles**[3], so as to ensure a level playing field at international level, whilst others were concerned that many of the subsidiary measures relating to this principle reflected the US regulatory approach and were not necessary in Europe.



Some respondents wanted to see stronger self-regulation, others suggested that supervisory authorities should take more preventative action, such as through laying down minimum standards on the presentation of research.

Some respondents wanted to have a clearer idea of where self regulation might be appropriate and where legislative intervention could be required. Others wanted a clearer understanding of how **enforcement** would take place.

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[3] See http://www.iosco.org/pubdocs/pdf/IOSCOPD150.pdf.

4. SCOPE OF THE RECOMMENDATIONS

Many respondents focused on what is meant by the term **investment research**. The Forum Group did not seek to define the term, noting the existence of a number of different definitions and quoting the definition of "research or other information recommending or suggesting investment strategy" used to implement Article 6(5) of the Market Abuse Directive[4]. Whilst some respondents welcomed this, several did not support this definition and wanted to see a clearer distinction made between "research" and "information", particularly privileged information.

Some respondents expressed support for the third principle on **suitability and market integrity** and related recommendations (10 and 11). Some did not wish to see regulatory restrictions on differential treatment of different types of investor, whilst others wanted to ensure that equality of treatment remained permissible. Some respondents believed that institutional investors, as consumers of research, need less protection than retail investors. Some respondents representing institutional investors noted that they used sell-side research as an input to their own research and paid little attention to "headline" recommendations.

Some respondents indicated agreement with the report's conclusion that the **buy-side** did not raise the same inherent conflicts of interest as the sell-side, where there is a single output: asset management. Nevertheless, several respondents agreed with the Forum Group's recommendation (28) that buy-side analysts making recommendations to the public should be subject to the recommendations it has made for sell-side analysts, with some emphasising the need for a consistent approach, in recognition of the fact that some firms engage in both types of activity.

Several respondents (particularly representatives of the banking and investment services sector) indicated agreement with the Forum Group's conclusion that **fixed income research** presented fewer problems in terms of conflicts of interest and, consequently, a light regulatory touch was appropriate. Several suggested that, whilst in general the principles set out in the report could be applied equally well to debt securities as to equities (Recommendation 29), some of the more detailed recommendations, in particular those relating to quiet periods (Recommendations 18 and 19), might prove difficult to apply in practice.

Some respondents supported coverage of **small and medium-sized enterprises (SMEs)** with retail brokerage business. However, it was also suggested that standards aimed at such firms would need to be flexible enough to cater for the fact that many such firms face additional complications relating to their use of multi-tasked investment teams.

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[4] Commission Directive 2003/125/EC of 22 December 2003.
See http://europa.eu.int/eur-lex/pri/en/oj/dat/2003/l_339/l_33920031224en00730077.pdf

5. CONFLICTS OF INTEREST

Structural vs behavioural remedies

There appears to be broad support for the general approach taken by the Forum Group with respect to **avoidance, prevention and management of conflicts of interest** (Recommendations 12 to 17), which itself is broadly similar to that proposed by the Commission for the Investment Services Directive (now renamed the Financial Markets Instruments Directive).

There would seem little support for legal separation of research and investment banking into completely separate entities.

Some respondents suggested that investment firms are better equipped to ensure internal procedures for managing conflicts of interest are adequate and effective; and that suitable ethical standards are applied and enforced by senior management.

Analyst involvement in investment banking

The recommendations in this area (Recommendations 14 to 17) commanded broad support among those responding, with few specific comments on this point. Nevertheless, of those who did make specific comments (mainly those representing investment firms), there were some differences of view.

Some respondents considered the recommendation that research analysts and management should **never report to investment banking** excessive where Chinese walls were in place, whilst others considered that the market would gradually ensure that this became the norm. Others favoured more stringent requirements than the Forum Group, suggesting geographical separation of research and investment banking departments, with communication between the departments taking place only through intermediaries.

Some respondents considered analysts' expertise essential for successful **sales pitches** and for **marketing public offerings**, whilst others noted that the Forum Group's recommendations were less strict than those made by IOSCO. Others focused on the control of non-public sensitive information, considering that this should be subject only to internal procedures and arguing against the Forum Group's recommendation that analysts party to such information should not publish research on the relevant issuer until the information has entered into the public domain.

Research produced before or during public offerings

There were a variety of views on the usefulness of **quiet periods** (Recommendations 18 and 19), which are currently applied in Europe only on a contractual basis. Of those respondents who referred to them in their response, few were in favour of making them a regulatory requirement, with some respondents suggesting that they should be a matter for self-regulation. Some respondents suggested that they might need to be shorter and of varying length for debt instruments.

Some respondents suggested that the Forum Group's recommendation that research produced before an offering has been priced – so-called **"pre-deal" research** – or during a quiet period, should never contain recommendations or price targets, irrespective of whether or not research had previously been produced. Others took the opposite view, suggesting that there should be no such restrictions at all, provided that objectivity is ensured through effective avoidance or management of conflicts of interest.

Analyst remuneration

Very few respondents commented specifically on this issue (Recommendations 22 and 23). Of those who did, some respondents suggested that a certain amount of flexibility might be required in order to accommodate small and medium-sized investment firms, that might find it impossible to ensure that investment banking departments have no role whatsoever in determining analysts' remuneration. Others were supportive of the Forum Group's recommendations, or suggested that analysts' compensation should be independent of an investment firm's activities.

Proprietary dealing

Again, very few respondents specifically addressed this particular potential conflict. Some respondents noted that the Forum Group's recommendations were again less strict in this area (relying on a general duty of the firm to avoid and manage conflicts of interest) than the IOSCO principles (which include a specify ban on trading ahead of issuing research). Others suggested that the solution was to separate research from the proprietary trading department.

Personal account dealing

Views differed on the extent to which analysts should be subject to personal trading restrictions (Recommendation 21). Some respondents supported the second option recommended by the Forum Group, suggesting that analysts should be allowed to own securities in covered companies, subject to the existence of properly supervised internal rules. Others supported stricter rules, such as the ban on such ownership suggested in the first option put forward by the Forum Group. Some respondents suggested that this was a matter already sufficiently dealt with through national rules.

6. DISCLOSURE

Few comments were received on disclosure requirements. Of those respondents that did comment, most took the view that the **Market Abuse Directive**, complemented by the forthcoming Financial Instruments Markets Directive (formerly the Investment Services Directive), will provide the necessary legislative framework for disclosure. Some respondents suggested that, where research was published earlier to institutional investors than retail investors, there should be stronger disclosure to retail investors than that recommended in the Forum Group Report (Recommendations 10, 11 and 24), including disclosure on how research is disseminated.

7. RELATIONS WITH ISSUERS

Few respondents commented on the relationship between the analyst and the covered company, though some respondents considered this a more critical issue than the management of conflicts of interest within investment banks.

Several respondents agreed with the Forum Group's recommendation (3) that companies should be allowed to view research on their securities before publication, though some doubted that it was practical do this without including the recommendation or evaluation. It was suggested by some respondents that it would be desirable to harmonise the rules governing the right of companies to **review research for factual accuracy** before publication, which vary among the Member States. Some respondents added that issuers should have a right of response in the case of significant errors.

Some respondents suggested that the Forum Group's recommendation (4) on provision of information by issuers to analysts should make clear that companies should do so on a non-discriminatory basis but only at the request of the analyst. Others considered that, where confidentiality cannot be guaranteed, it is the issuer's responsibility to communicate information that might impact on the price of its securities and that, where persistent and convergent rumours strongly impact on its share price, it is the issuer's decision as to whether or not to issue a statement.

There was support for the Forum Group's recommendation that issuers should respect certain principles and rules of good conduct. Some respondents (representing issuers) suggested that the development of **corporate governance rules** covering issuer relations with analysts should be shared between professional bodies representing analysts and companies. Others considered that it was not sensible to require companies to develop their own corporate governance rules in this area (Recommendation 5) whilst at the same time making adherence to an **issuer best practice code** a listing requirement (Recommendation 6).

In a comment also related to the avoidance of conflicts of interest, some respondents suggested that analysts and their associates should not serve as officers, directors or members of a covered issuer's advisory board.

A number of references were made to the charter drawn up by the French analyst and issuer associations, Société Française des Analystes Financiers (SFAF) and Cercle de Liaison des Informateurs Financiers en France (CLIFF), covering issuer relations with analysts[5].

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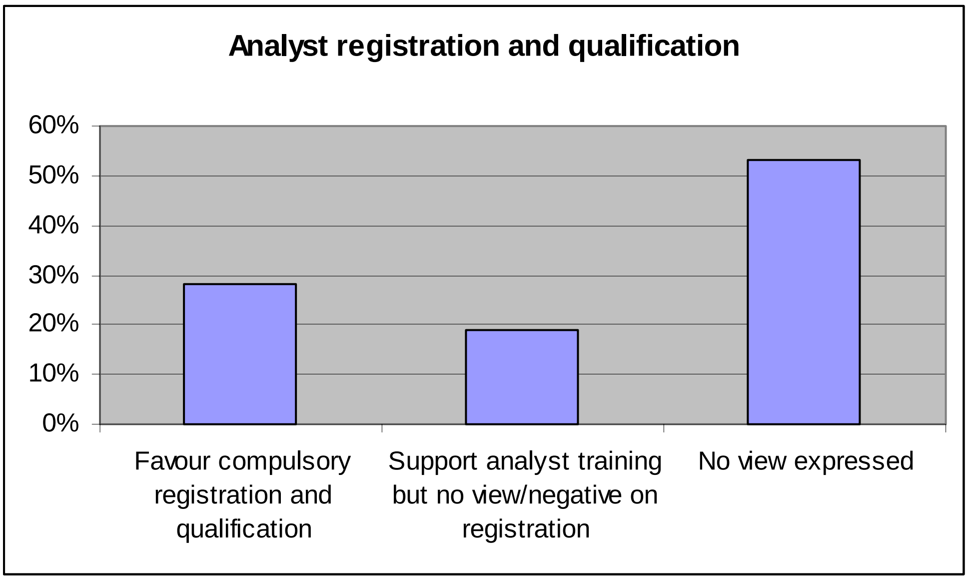
[5] See http://www.cliff.asso.fr/iso_album/charter1.pdf (EN), http://www.cliff.asso.fr/iso_album/charte-cliff-sfaf-avril_1.pdf (FR).

8. ANALYST REGISTATION AND QUALIFICATION

Several respondents (including analyst professional bodies, regulatory bodies and banking industry representatives) favoured **compulsory registration** for analysts, linked to the possession of an appropriate **qualification**. Some wanted this requirement linked to an **EU passport**, which would allow the dissemination of an analyst's research throughout the European Union. A minority favoured prescriptive requirements relating to analyst qualification.

Other respondents, who did not support registration, nevertheless supported the recommendations contained in the report (Recommendations 7 to 9), with some suggesting that employers should determine analyst training requirements, others wanting further clarification of any on-going analyst training obligations. Several respondents chose not to comment on this issue.



9. INDEPENDENT RESEARCH

There was no consensus surrounding the production of investment research by independent research houses.

Several respondents considered it essential that a single set of rules is applied to all analysts, including those working for research houses that are independent of investment banks (Recommendation 31).

Some respondents considered that the Forum Group should consider further the **financing of research**. Some considered that the Forum Group's recommendations would not sufficiently promote the production of research by independents and suggested that the "**bundling**" of services provided by investment banks to asset managers, effectively subsidising their research departments, has created an uneven playing field for independent producers.

Others (representing the asset management industry) were more cautious. Some of these supported the Forum Group in its conclusion that the issues surrounding bundling need to be analysed further before any regulatory conclusions can be drawn, whilst some suggested that bundling was a means of maintaining a viable level of research activity, which led them to conclude that unbundling might not lead to the creation of a level playing field.

Some respondents considered it the responsibility of governments (and the Commission) to create a **level playing field** for independent producers and ensure that consumers can turn to at least one independent research firm in each market.

As in the Forum Group, there was no consensus on whether independent research should be treated as a **core service** under the forthcoming **Financial Markets Instruments Directive**. Some respondents (representing analyst professional bodies) suggested that it should, thus making independents eligible for the EU “passport”, whereas others (representing the regulatory community) disagreed, suggesting that related licensing requirements would make such an option too costly for independent producers and that national regulation should instead be adapted in order to accommodate cross-border independent research.

10. OTHER ISSUES

Some respondents suggested that some services that were not provided by professional analysts were often nevertheless marketed as research, and that this might mislead investors. Others considered that separate regulation was required in order to avoid damage due to the release of false or misleading information by journalists.

ANNEX: LIST OF RESPONSES RECEIVED

Association Française des Entreprises d'Investissement (AFEI)
Association Française des Entreprises Privées (AFEP)
Association Française de la Gestion Financière (AFG)
ASSOSIM (Associazione Italiana Intermediari Mobiliari)
Banca Intesa
Bond Market Association (BMA)
British Bankers Association (BBA)
Bundesverband deutscher Banken (Association of German Banks)
Charles Stanley & Co Ltd
City of London Law Society, Company Law Sub-Committee
Mr Antoine COLONNA (Merrill Lynch Capital Markets, Paris)
Comissão do Mercado de Valores Mobiliário (CMVM, Portuguese Securities Market Commission)
Comité Européen des Assurances (CEA)
Committee of European Securities Regulators (CESR)
European Banking Federation (FBE, Fédération Bancaire de l'Union Européenne)
European Federation of Financial Analysts Societies (EFFAS)
European Federation of Accountants (FEE, Fédération des Experts Comptables Européens)
Fédération Européenne des Fonds et Sociétés d'Investissement (FEFSI)
Fédération Bancaire Française (FBF, French Banking Federation)
Financiële Diensten Amsterdam (FDA, Financial Services Amsterdam)
Instituto Español de Analistas Financieros (IEAF, Spanish Institute of Financial Analysts)
Investment Management Association (IMA)
International Securities Market Association (ISMA)
Mr Kai Klose (IVG Immobilien AG)
Ministry of Finance of the Slovak Republic, Slovak Financial Market Authority, National Bank of Slovakia, Stock Exchange in Bratislava (joint response)
Mouvement des Entreprises de France (MEDEF)
Noesis Análisis Financiero
Société Française des Analystes Financiers (SFAF)
UBS AG
UK Society of Investment Professionals
Mr Bart Van Aelst (Gevaert NV)
Zentraler Kreditausschuss (Federal Association of German Cooperative Banks)
Zini & Associates