Plenary 3

The Regulation of Financial Analysts

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Associazione
Italiana
degli Analisti
Finanziari

Financial Analysts: Independence and Professionalism

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AIAF and EFFAS profile

- AIAF, Associazione Italiana Analisti Finanziari, was established in 1971 and plays an active role in defending the transparency of financial markets and in training financial analysts
- The number of AIAF members exceeds 1,000 members, who mainly work for financial intermediaries, asset management companies and research departments
- In 1972, AIAF became a member of EFFAS (European Federation of Financial Analysts Societies). EFFAS comprises similar associations in 23 European countries
- AIAF has offered the internationally recognised CIIA®, (Certified International Investment Analyst) exam in Italy since 2002. The CIIA designation is awarded by the ACIIA®, an international organisation comprising 25 associations from three continents)

Introduction

- Following the financial markets' post- "internet bubble" crisis and subsequent various corporate scandals…
  - … the independence of financial analysts and the conflicts of interest related to research activity became more problematic…
    - …leading to stricter regulatory rules in many Western and Asian countries…
      - … and to numerous self-regulatory initiatives by financial analysts' associations

The Three Pillars - a

Balancing savings' protection and flexibility

Any regulatory action in the area of financial analysts should aim to establish the correct balance between the **need for investor protection,** in order to re-establish confidence in financial markets, and the **needs of financial intermediaries,** to guarantee operating flexibility

It would be counterproductive to make access to intermediaries' financial expertise, particularly financial analysts' work, **<u>too</u> onerous for** investors

The Three Pillars - b

Dialogue and cooperation between regulators and private sectors

Any **regulatory reform should result from ongoing cooperation between the 'public' and 'private' sectors,** with specific interventions for each financial service segment

In our view, ***effective*** **self-regulation reduces the scope for the application of primary rules**

However, the primary rules must form the basis of self-regulatory enforcement and the application of sanctions in order to strengthen their effectiveness

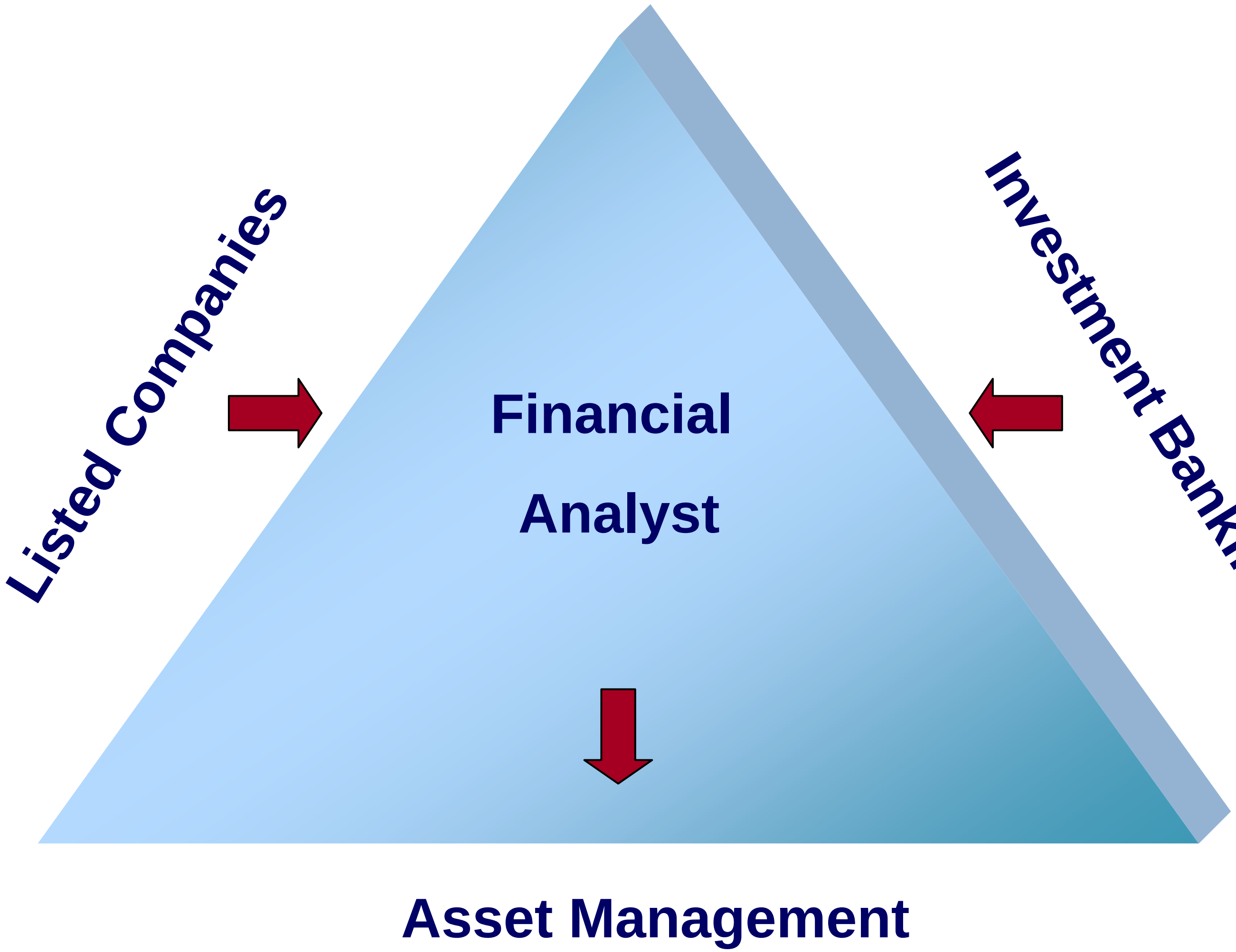
The Three Pillars - c

Analysts as “part of a complex system”

Financial analysts are part of a complex system, in which there are many potential conflicts of interest, involving different subjects and levels of business at the same time

Any regulatory action to protect the analyst’s independence should consider this complexity and cover the whole financial research cycle, from issuing companies to the different kinds of research providers, intermediaries and final customers

Analysts and conflicts of interests: The “Analyst’s Triangle”



How do we get out of it ?

- Putting the blame on the analyst simply does not solve the problem
- A solution must be found at each and every level:

  a. Companies which are subject to financial research and analysis

  b. The corporate finance departments of financial institutions

  c. Financial analysts who must operate according to the market principles of transparency, integrity and ethics

Listed companies

- Strict adherence to the principles of **“fair disclosure”** should guarantee identical access to the financial information of listed companies for both analysts and investors
- The main implications for analysts are:
  1. A substantial improvement in the quality of their work
  2. Less concern about losing “important information” or having restricted or delayed access to it

Investment Banking Departments

- In the short term, a **detailed and effective disclosure of potential conflicts of interest** is desirable. The upcoming Market Abuse Directive in the EU, as well as recent Consob regulations are moving in this direction
- In the medium term, the **organizational separation** between the primary market (corporate advisory) and secondary market (brokerage and asset management advisory and research) activity needs to be strengthened
- EFFAS recommends an effective “Chinese walls” policy by integrated financial firms, so as to protect the analysts’ integrity, and giving a **crucial role to senior management in addressing conflicts of interests**

Financial Analysts

- Various interventions regarding financial analysts:
  a. Formal recognition of their profession
  b. Stricter codes of conduct
  c. Sanctions for non-fulfilment

Financial Analysts

- **A financial analyst is a professional,** who deals with the delicate subject of savings and their use
- It is vital that **whoever provides an investment valuation have proven professional and ethical qualities,** which must be homogeneous for the whole category, and have the necessary experience
- Therefore, we see no difference between financial analysts and other professionals, in terms of adequate training and certification

Works done and works in progress: Self regulation

- Several EFFAS member societies, including AIAF, approved new and stricter **codes of self-regulation** following the equity market crisis and corporate scandals

- At a EU level, EFFAS took an active part in an **EU Group Forum on financial analysts**, at the end of 2003, which formulated operating procedures regarding financial analysts and the management of conflicts of interest to ECOFIN

- At the global level, the **ACIIA**® (the Association of International Investment Analysts) approved its new Code of Ethics in 2004, based on high level principles, complementary to those already applied by national member societies

Works done and works in progress: Regulation

- In Italy, a law regulating financial analysts is under discussion at the Senate's Finance Committee. The bill aims to regulate access to the financial analyst profession, as well as draw up behavioural and organisational rules related to financial analysis
- At the EU level, after the adoption of the **Market Abuse Directive, the presentation of investment recommendations** ("fair and not misleading") and the disclosure of conflicts of interests are going to be monitored and controlled in greater detail
- The forthcoming new **Investment Services Directive** (to be adopted by early 2007) will explicitly include, for the first time, financial analysis among those activities "ancillary" to investment services