

**CONFLICTS OF INTEREST (INVESTMENT RESEARCH)
INSTRUMENT 2004**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 156 (General supplementary powers); and
 - (3) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force on 1 July 2004.

Amendments to the Conduct of Business sourcebook

- D. The Conduct of Business sourcebook is amended in accordance with Annex A to this instrument.

Amendments to the Glossary

- E. The Glossary is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the Conflicts of Interest (Investment Research) Instrument 2004.

By order of the Board
18 March 2004

Annex A

Amendments to the Conduct of Business sourcebook

In this Annex, underlining indicates new text and striking through indicates deleted text. Where an entire new section of text is being inserted, the place where it goes is indicated and it is not underlined. Text in square brackets is made but not yet in force¹.

1.6.4 R ...

COB	Subject
...	
7.13	...
<u>7.16</u>	<u>Investment research</u>
...	

...

[2.2.4A G An offer or agreement to publish *investment research* which is, or to change a *published recommendation* so that it becomes, favourable to its subject (even if the subject is a *customer* of the *firm*), is an example of offering or accepting an inducement which is likely to conflict to a material extent with the *firm's* duties to its other *customers*. (See also *COB 5.10* in relation to inducements related to *corporate finance*] and *COB 7.16* in relation to *investment research*[.]

...

[5.10.2 G ... It also supplements other provisions in the *Handbook* (see, in particular, *COB 2.2* (Inducements and soft commission)], [~~and *COB 7.1* (Conflict of interest and material interest)~~] and *COB 7.16* (*Investment research*)[].]

...

[7.13.6A G For the purposes of *COB 7.13.6 R* (2), the *FSA* considers that an *investment analyst* is likely to be involved to a material extent in the *firm's designated investment business*.] *Firms* are reminded that there are further provisions relating to the management and activities of *investment analysts* in *COB 7.16*.

After *COB 7.15* insert the following new section:

¹ See the Conflicts of Interest (Corporate Finance and Investment Analysts) Instrument 2003, the commencement date of which was deferred from 1 February 2004 to 1 May 2004 by the Conflicts of Interest (Corporate Finance and Investment Analysts) (Postponement) Instrument 2004

- 7.16 Investment research
- Application
- 7.16.1 R This section applies to a *firm* that prepares *investment research* for publication or distribution to its *clients*, or that publishes or distributes *investment research* to its *clients*.
- Purpose
- 7.16.2 G The purpose of this section is to amplify relevant *Principles*, and set out particular steps a *firm* should take, in relation to *investment analysts* and *investment research*. The *FSA* considers that in this context *Principle 1* (Integrity), *Principle 2* (Skill, care and diligence), *Principle 3* (Management and control), *Principle 5* (Market Conduct), *Principle 6* (Customers' interests), *Principle 7* (Communication with clients) and *Principle 8* (Conflicts of interest) are particularly relevant.
- Conflicts of interest in investment research: general
- 7.16.3 G The *FSA* considers that conflicts of interest are much less likely to arise if *investment research* is solely for a *firm's* own internal use, for example to inform its decisions about managing its proprietary trading or its strategic direction. The *FSA* considers that it is inappropriate for an analyst to prepare research papers or analyses which are intended firstly for internal use for the *firm's* own advantage, and then for later publication to *clients* (in circumstances in which it might reasonably be expected to have a material influence on the *clients'* investment decisions).
- 7.16.4 G The obligations referred to in *COB 7.16.2G* apply to all types of *investment research*. A *firm's* senior management is responsible for ensuring that its systems, controls and procedures are robust and adequate to identify and manage the conflicts of interest which arise in relation to *investment research* or similar publications, and to ensure, as far as practicable, that those arrangements operate effectively. The *FSA* does not consider that these conflicts of interest can be adequately managed by disclosure alone.
- Policies for managing conflicts of interest: impartial investment research
- 7.16.5 R (1) This *rule* applies to a *firm* that publishes or distributes *investment research* and where either:
- (a) the *firm* holds it out (in whatever terms) as being an impartial assessment of the value or prospects of its subject matter; or
 - (b) it is reasonable for those to whom the *firm* has published or distributed it to rely on it as an impartial assessment of the value or prospects of its subject matter.
- (2) If this *rule* applies, a *firm* must:
- (a) establish and implement a policy, appropriate to the *firm*, for managing effectively the conflicts of interest which might affect the impartiality of *investment research* of the type described in (1);
 - (b) make a record of the policy and retain it until at least three years after it ceases to have effect;
 - (c) take reasonable steps to ensure that it and its *employees* comply with the policy;

- (d) make available to any *person* in writing, on request, a copy of the policy (for example, by including it on an appropriate website); and
 - (e) take reasonable steps to ensure that the policy remains appropriate and effective.
- (3) The policy must identify the types of *investment research* to which it applies, and must make provision for systems, controls and procedures (making clear the extent to which the *firm's* policy relies on *Chinese walls* or other information barriers within the *firm*):
- (a) to identify conflicts of interest which might affect the impartiality of the *investment research* to which the policy relates; and
 - (b) to manage effectively conflicts of interest, to the extent that they arise or might arise within the *firm*, in relation to at least the following:
 - (i) the supervision and management of *investment analysts*;
 - (ii) the remuneration structure for *investment analysts*;
 - (iii) the extent to which *investment analysts* may become involved in activities other than the preparation of *investment research*;
 - (iv) the extent to which (if at all) inducements offered by *issuers*, or others with a material interest in the subject matter of *investment research*, may be accepted by *investment analysts* or senior *employees* of the *firm*;
 - (v) who may comment on draft *investment research* before publication, and the process for taking account of their comments;
 - (vi) the timing and manner of publication and distribution of *investment research* and of the communication of its substance; and
 - (vii) what information or disclosures are appropriate to include in the *investment research* (taking due account of matters required by law).

- 7.16.6 G (1) *Investment research* may be held out as impartial in various ways, for example if it is labelled with that term or similar terms like ‘independent’ or ‘objective’. Even without this kind of labelling on the *investment research* itself, it may still be held out as impartial if, for example, the *firm's* representatives state that it is so (in writing or orally), or behave in a way that reasonably gives that impression.
- (2) The policy a *firm* makes available under COB 7.16.5R(2) is likely to be implemented by detailed procedures and operational arrangements. Those detailed procedures and operational arrangements need not be published.

Policy content: general

- 7.16.7 G *Firms* should organise the *investment research* function (including the way in which their *investment analysts* are supervised and remunerated) in a way which minimises the potential influence of the commercial interests of the *firm*, its *employees*, its *associates*, or its *clients*, on the impartiality of its *investment research*.

- 7.16.8 G A *firm's* policy under COB 7.16.5R should be appropriate for its own structure and business. The policy will therefore need to take account of the following factors (further *guidance* on what an appropriate policy might cover is set out in COB 7.16.9G to 7.16.15G, not all of which will be relevant to every *firm*):
- (1) the *firm's* size and organisational structure;
 - (2) the classification under COB 4.1 of its *clients*, to whom the *investment research* is published or distributed, and their experience and expertise;
 - (3) the nature of the *investments* in relation to which (or in relation to the *issuers* of which) the *firm* publishes or distributes *investment research*; and
 - (4) the nature of the business which it conducts with or for its *clients* and on its own account.

Policy content: supervision and remuneration of analysts

- 7.16.9 G If an individual (such as someone involved in raising capital for a corporate *client*) has responsibilities that might reasonably be considered to conflict with the interests of the *clients* to whom the *investment research* is published or distributed, it will not usually be appropriate for him to be responsible for:
- (1) the day to day supervision or control of an *investment analyst*;
 - (2) decisions on the subject matter or content of *investment research* or the timing of its publication (though it may be appropriate for him to have an opportunity to check the accuracy of the facts relied on in the *investment research*);
 - (3) determining the remuneration of an *investment analyst*.

- 7.16.10 G (1) An *investment analyst's* remuneration should be structured so as not to create (or reasonably suggest the creation of) an incentive which is inconsistent with the provision of an impartial assessment of the subject matter of *investment research* by the *analyst*.
- (2) An *investment analyst's* remuneration should not be linked to a specific transaction, or to recommendations contained in *investment research*, but it may be linked to the general profits of the *firm*.

Policy content: involvement of analysts in other activities

- 7.16.11 G (1) An *investment analyst* should not be involved in activities in a way which suggests that he is representing the interests of the *firm* or a *client* if this is likely reasonably to appear to be inconsistent with providing an impartial assessment of the value or prospects of the *relevant investments*.
- (2) A *firm's* policy may allow it to use an *investment analyst's* knowledge and information to assist it to research *corporate finance business* opportunities, to provide ideas to sales or trading staff, or to provide information and advice to the *firm's* investment *clients*.
- (3) It is likely to be inappropriate for the policy to allow the *firm* to:
- (a) use an *investment analyst* in a marketing capacity (for example in pitches to solicit or obtain *corporate finance business* from the *issuer* of a *relevant investment*), if this would give a reasonable perception of lack of impartiality in his *investment research*; or

- (b) allow an *investment analyst* to act in a way which reasonably appears to be representing the *issuer* of a *relevant investment*, for example, in roadshows relating to issues or allocations of *relevant investments*.

Policy content: avoiding inappropriate influences

- 7.16.12 G *Firms* should put in place arrangements so that *investment research* sets out impartial views about the value or prospects of the *relevant investment* or the *relevant issuer* of the *investment analyst* or *analysts* responsible for its content. For example:
- (1) the *firm* should prohibit any of its *investment analysts* or other employees, from offering or accepting an inducement to provide favourable *investment research* (*COB 2.2.3R* requires the *firm* itself to take reasonable steps to ensure that such inducements are not offered, given, solicited or accepted);
 - (2) the *firm* should not give effective editorial control to someone whose role or commercial interests might reasonably be considered to conflict with the interests of the *clients* to whom the *investment research* is to be published or distributed; accordingly, a *firm* should:
 - (a) not allow anyone other than an *investment analyst* (such as a *relevant issuer*) to approve the content of *investment research* before *publication*; and
 - (b) only allow a *person* outside the *firm* (such as a *relevant issuer*), or any *employee* other than an *investment analyst*, to view it before its *publication* for verification of factual information in the *investment research*.

Policy content: means and timing of publication

- 7.16.13 G A *firm's* policy and procedures should provide for *investment research* to be published or distributed to its *clients* in an appropriate manner. For example it will be:
- (1) appropriate for a *firm* to take reasonable steps to ensure that its *investment research* is published or distributed only through its usual channels, as set out in the policy;
 - (2) inappropriate for an *employee* (whether or not an *investment analyst*) to communicate the substance of any *investment research*, except as set out in the policy.
- 7.16.14 G A *firm* should also consider whether or not other business activities of the *firm* could create the reasonable perception that its *investment research* may not be an impartial analysis of the market in or the value or prospects of a *relevant investment*. Consequently a *firm* should consider whether its policy should contain any restrictions on the timing of the publication of *investment research*. For example, a *firm* might consider whether it should restrict publication of relevant *investment research* around the time of an investment offering.

Policy content: disclosures

- 7.16.15 G A *firm* should consider what information by way of disclosures should accompany the *investment research* it publishes or distributes.

Schedule 1
Record keeping requirements

...

Table:

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
...				
COB 7.13.11R(1)(d)
COB <u>7.16.5R(2)(b)</u>	<u>Policy for managing conflicts of interest arising as a result of publication or distribution of investment research</u>	<u>Details of the policy</u>	<u>When adopted</u>	<u>Until three years after the policy ceases to have effect</u>

Annex B

Amendments to the Glossary

In this Annex all text is new and is not underlined.

Insert the following new definitions in the Glossary in the appropriate alphabetical position:

relevant investment (in relation to *investment research* or a public appearance) a *designated investment* that is the subject of that research or appearance.

relevant issuer

- (a) (in relation to a *designated investment* that is the subject of *investment research* or a *public appearance*) the *issuer* of that *designated investment*; or
- (b) (in relation to a *related designated investment* that is the subject of *investment research* or a *public appearance*) either the *issuer* of the *related designated investment* or the *issuer* of a *designated investment* that might reasonably be expected directly to affect the value of the *related designated investment*.