

EU Financial Market's Efficiency Requires Unaffiliated Financial Analysts

Globally, the major downturn in equity markets since their peak in 2000 has shaken the confidence of investors. This downturn has contributed significantly to the exposure of market abuses that have undermined faith in the integrity and proper functioning of financial markets as a whole. Among other market participants, sell-side analysts employed by banks and brokers have come under scrutiny.

As a result, the profession has been discredited. These scandals, however, only exaggerated the problems that were affecting financial analysts and their relation to investment banks globally. The spotlight has been turned to their embedded conflicts of interests.

LACK OF COVERAGE OF SMALL- AND MEDIUM-SIZED ENTERPRISES (SMEs)

Investors have retreated from capital markets for a long period of time. This has led to a significant reduction in research capacities with regard to costs by traditional investment firms and banks. They are now focusing their research on large caps. As a result, SMEs suffer from a lack of exposure and their ability to raise capital is impaired. Further consequences are redundancies among financial analysts and an exodus to businesses outside capital markets.

In order to secure the efficiency of the market, especially to avoid cluster risks for investors, EFFAS, the European Federation of Financial Analysts Societies, is taking measures to maintain the necessary research capacities. One important issue is the promotion of unaffiliated research as an essential requirement for sufficient coverage of SMEs and information for investors. Outsourcing research to unaffiliated analysts also introduces more flexibility for the investment industry by transforming fixed costs into lower variable costs.

The importance of unaffiliated research has to be taken into account in the future regulation of financial analysts in Europe.

EU INVESTMENT SERVICES DIRECTIVE (ISD) AND MARKET ABUSE DIRECTIVE (MAD)

Currently, the ISD and the MAD deal with financial analysis, research and investment banking.

The ISD still perceives financial analysis and research as an ancillary service to investment banking. Due to the fact that the directive does not regulate unaffiliated financial analysis and research, the market for financial analysis and research will not be fully integrated on a European-wide level.

This development is more likely because the MAD in Art. 6 (5) commits national regulation to fair presentation and disclosure of interest. Such regulation will also affect unaffiliated financial analysis and research. It may well lead to a fragmentation in the treatment of this sector resulting in higher costs for all market participants.

EUROPEAN PASSPORT FOR FINANCIAL ANALYSTS

The EU members will be obliged to incorporate the MAD into their national legislation. A European passport for financial analysts similar to the proposed passport for investment advisers under the ISD would guarantee that these national regulations do not create additional bureaucratic and economic hurdles to cross-border securities analysis.

Such a passport could help harmonise the regulations guiding the professional qualification of and ethical standards for EU analysts. By saving regulators and market participants the additional expenditure needed to fulfil the different national regulations, the EU analyst passport is an efficient cost-reduction measure.

INTRODUCTION OF PROFESSIONAL LIABILITY INSURANCE

Limiting liability risks by complying with professional minimum standards is an integral component of risk management. Individual securities experts already are potential targets of specialised capital market-oriented penal law as well as civil regulations. The MAD pushes the legal risks in capital market business to hitherto unknown dimensions. To protect against such risks, EFFAS is striving to establish professional liability insurance.

RECOGNITION OF PROFESSIONAL QUALIFICATION BY REGULATORY AUTHORITIES

The standard professional minimum qualification encompasses solid, qualifying training and continuing education. In its latest report on the regulation of sell-side analysts, IOSCO requires analysts to take periodic examinations.

EFFAS recently has integrated its European training programme CEFA (Certified EFFAS Financial Analyst) into the global CIIA® programme (Certified International Investment Analyst). The CIIA® is the only professional diploma with global, European and national content.

The CIIA® exam can be taken in differing mother tongues of the candidates. As a truly global qualification together with the inclusion of regional and local market knowledge within the examination structure, the CIIA® is clearly differentiated from existing designations in the market.

CONCLUSION

The majority of financial analysts are associated with professional organisations. In Europe, these independent national organisations have worked within EFFAS since 1960. Currently, the Federation comprises more than 14,000 investment professionals in 19 nations. On this level, a genuine European platform has been created to define a common set of principles and rules without neglecting or ignoring national or regional capital market structures, cultures and laws. EFFAS is the authoritative counterpart for politicians and EU representatives and a reliable partner in the achievement of a well-functioning integrated financial market.



Author: Fritz H Rau
Chairman of the European Federation of Financial Analysts Societies (EFFAS)



For questions and further information please contact:
EFFAS Operational Office

Einsteinstr. 5 • D-63303 Dreieich

Phone: +49 61 03 58 33-48 • **Fax:** +49 6103 58 33-35

Email: claudia.stinnes@effas.com • **Website:** www.effas.com