



**SECURITIES AND
FUTURES COMMISSION**

證券及期貨事務監察委員會

Investor Survey on Investment Research Activities

投資者對於投資研究活動
的意見調查報告

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Executive summary

There has been concern in recent years that conflicts of interest faced by securities research analysts or their firms may compromise their abilities to offer independent and unbiased opinions. To better assess the state of the research industry and obtain a more comprehensive view from investors, the Securities and Futures Commission (SFC) worked with the Consumer Council to survey retail and institutional investors' views on this area in mid-2003. This exercise followed an earlier survey on the securities firms' investment research practices and their views on the issues concerned.

The survey questionnaires were distributed to investors through various channels. 403 questionnaires were completed and returned, of which 361 were from retail investors.

The major findings of the survey are:

- The use of research reports in making investment decisions is fairly common among retail and institutional investors.
- A clear difference exists between institutional and retail investors in their channels for accessing research reports. The print media, broadcast media and financial websites are the main channels for the retail investors, whereas institutional investors mostly obtain research reports directly from the brokerage firms.
- Both retail and institutional investors are more interested in factual details and analyses on specific stocks or industry sectors than specific recommendations and target prices.
- Institutional investors indicate a higher level of satisfaction with the quality of the research reports. Many retail investors think that analysts' recommendations are not substantiated with sufficient analyses and the basis and methods used by analysts are unclear and inconsistent.
- Both retail and institutional investors tend to disregard the risk warnings or disclaimers contained in research reports. The main reason cited being that the warnings or disclaimers do not disclose anything useful.
- Retail investors generally do not think that analysts and their firms have made sufficient disclosure of the conflicts of interest in research reports or at public appearances. Both retail and institutional investors would like to see further disclosures on the analysts' and the firms' interests in the subject companies, as well as the firms' relevant investment banking relationships. The majority of retail and institutional investors also agree that analysts should disclose their real names and licence status in research reports or at public appearances.
- Other than putting in place internal control measures to address analysts' conflicts, many investors also support enforcement actions and investor education in this regard.

Introduction

1. Investors often make references to the information or opinions provided by securities analysts or brokerage firms during the investment process. In recent years, there has been concern that conflicts of interest faced by securities research analysts or their firms may compromise their abilities to offer independent and unbiased opinions. Conflicts may arise as a result of pressures being brought to bear upon them, such as their firms having an investment banking relationship with the subject company or their having financial interests in the companies concerned. Such conflicts of interest may undermine the confidence of investors in financial markets.
2. The SFC has been actively monitoring the developments in this area. To better assess the state of the research industry and obtain a more comprehensive view from investors, the SFC worked with the Consumer Council to survey retail and institutional investors' views on this area in mid-2003. This exercise followed an earlier survey on the securities firms' investment research practices and their views on the issues concerned.

Methodology and responses

3. The survey questionnaire covered various aspects, including investors' use of and observations on research reports, and their views on issues relating to disclosure and conflicts of interest. In the questionnaire, we broadly defined the meaning of a "research report" to include any investment recommendation on listed stocks in Hong Kong –
 - published by an analyst or brokerage firm in any form (such as print medium or website); or
 - disseminated by an analyst at a public appearance (including television or radio broadcast); or
 - disseminated through a brokerage firm's account executive via telephone.

4. The questionnaire was distributed through various channels, including the Consumer Council's April 2003 issue of its monthly 'CHOICE' magazine. Investors were also invited to complete the questionnaire online through the SFC's website. 403 completed questionnaires were returned, among which 361 were from retail investors and 15 from institutional investors. 27 respondents did not indicate their investing capacity.

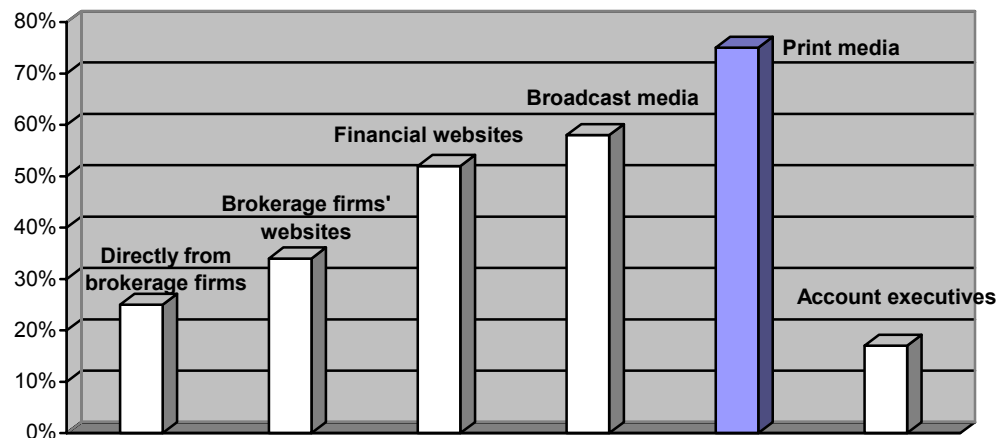
Responses of retail investors

Use of research reports

5. The use of research reports by retail investors is fairly common. 76% often or occasionally use research reports, whether directly or indirectly, in making investment decisions. The following characteristics are noted:

- The print media, broadcast media and financial websites are their most common channels for obtaining research reports. The print media is used by more than 70% of retail investors. Please see Chart 1.

Chart 1: Retail investors' channels for obtaining research reports



- Retail investors are more interested in factual details and analysis on specific stocks or industry sectors than specific recommendations (such as “buy”, “hold” or “sell”) and target prices in research reports (Table 1). 44% often track the performance of stocks recommended by analysts. This would imply that retail investors do not always take analysts’ recommendations at face value but make their decisions based on facts and analyses.

Table 1: Information in research reports that interests retail investors

Type of information	Proportion of respondents indicating interest in the information
Specific recommendation	55%
Target price	49%
Analysis on specific stocks	80%
Analysis on specific industry sectors	63%
Factual details about specific stocks	66%
Factual details about specific industry sector	48%
Track records regarding analysts' recommendations on specific stocks or	38%
Names of the analysts	26%

- On investment horizons, 32% of them hold stocks for one year or more, 26% for six to 12 months, 34% for one to six months and 9% for less than one month. This indicates that many retail investors are short-term investors.

Understanding research reports

6. Retail investors are generally not too satisfied with the quality of research reports, hence affecting their reliance on them.
 - Only 29% state that the recommendations contained in research reports are often substantiated with sufficient basis and analysis, and 55% state that the basis and analysis are occasionally insufficient.
 - Only 28% state that analysts often use clear and consistent methods in their analyses, and 49% state that the methods used are occasionally unclear and inconsistent.
 - Only 15% state that analysts often follow up on their previous recommendations in the research reports.

Risk warnings or disclaimers

7. Many retail investors disregard the risk warnings or disclaimers contained in research reports. Only 28% often read them. Please see Chart 2. The main reason cited for ignoring the warnings or disclaimers being that they do not disclose anything useful (Chart 3).

Chart 2 : Percentages of retail investors who read risk warnings or disclaimers

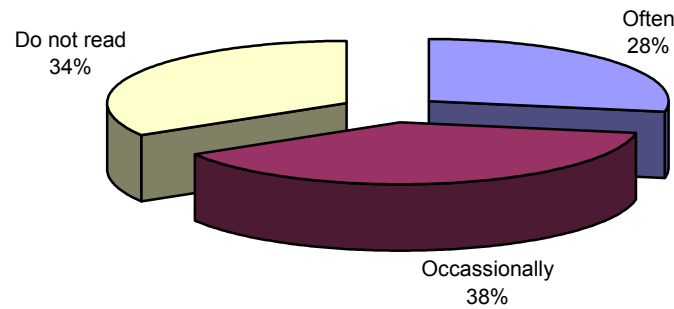
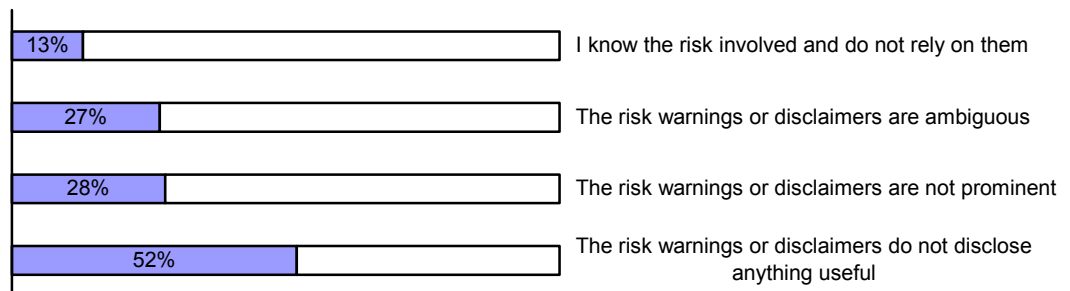


Chart 3: Reasons for not reading risk warnings or disclaimers

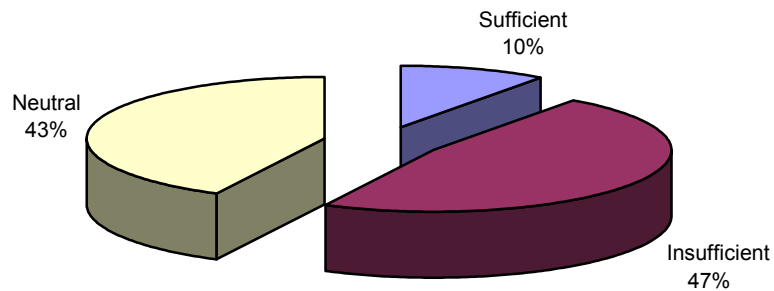


■ Proportion of respondents who stated so

Disclosure of analysts' interest

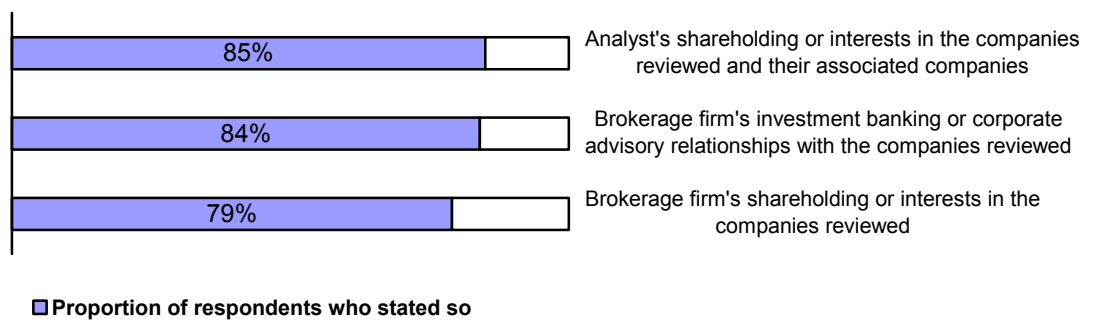
8. Many retail investors think that analysts and their firms do not make sufficient disclosure on their conflicts of interest in research reports or at public appearances. As Chart 4 indicates, 47% of them state that disclosure is insufficient and only 10% state otherwise.

Chart 4: Retail investors' view on sufficiency of conflicts disclosure by analysts or firms



9. Areas that respondents would like to see further disclosure are analysts' and their firms' interests in their subject companies, and the firms' relevant investment banking relationships. Please see Chart 5.

Chart 5: Areas of further disclosure favoured by retail investors



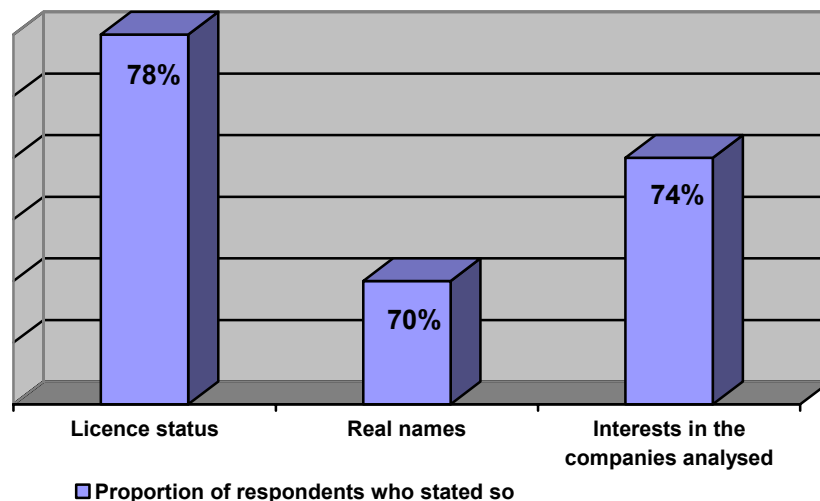
Disclosure of analysts' professional credentials

10. Most retail investors agree that analysts should disclose their real names, licence status, and interests in their subject companies in research reports or at public appearances:

- 78% agree that all analysts or commentators who are licensed persons should disclose their licence status in research reports, including reports published in the print and broadcast media.
- 70% agree that all analysts or commentators should disclose their real names in research reports, including reports published in the print media.
- 74% agree that all analysts or commentators should disclose their interests in their subject companies.

Furthermore, 60% agree that only persons who have specific qualifications or experience are allowed to act as research analysts.

Chart 6: Credential disclosures favoured by retail investors

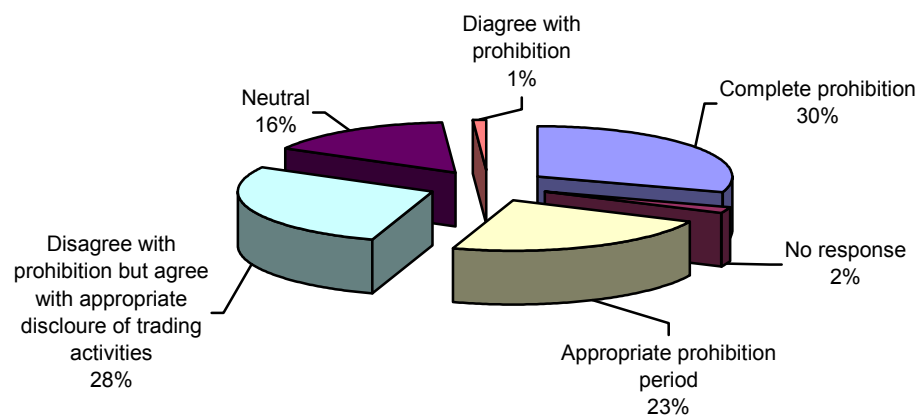


Internal controls and procedures

11. Retail investors agree that investment firms should put in place internal control measures to address analysts' conflicts of interest:

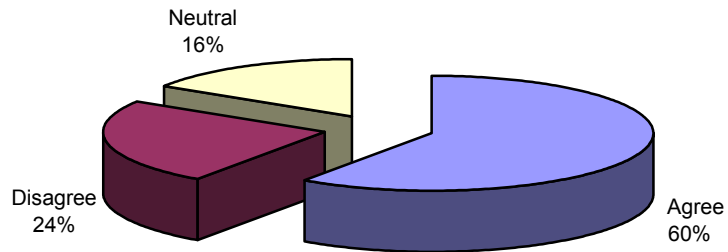
- 30% think that an analyst should be prohibited from trading a stock on which the analyst is reviewing. 23% agree that there should be an appropriate prohibition period, whereas 28% think that there should be appropriate disclosure of the trading activities. Please see Chart 7.

Chart 7: Retail investors' views on trading prohibition against analysts on their subject stock



- More than half of the retail investors think that an investment firm should not publish research reports covering a company that the firm (or its group) is advising on the initial public offering (IPO). While 24% think otherwise, they agree that if the firm has made sufficient disclosure and has appropriate rules governing the release of such reports, they could do so. Please see Chart 8.

Chart 8: Retail investors' views on prohibiting relevant firms publishing pre-IPO research reports



- On internal control measures that an investment firm could establish to address analysts' conflicts of interest, 38% cite "independent reporting lines for analysts", 32% "Chinese Wall", 44% "independent remuneration determination mechanism" and 43% "separate and independent entity for investment research".

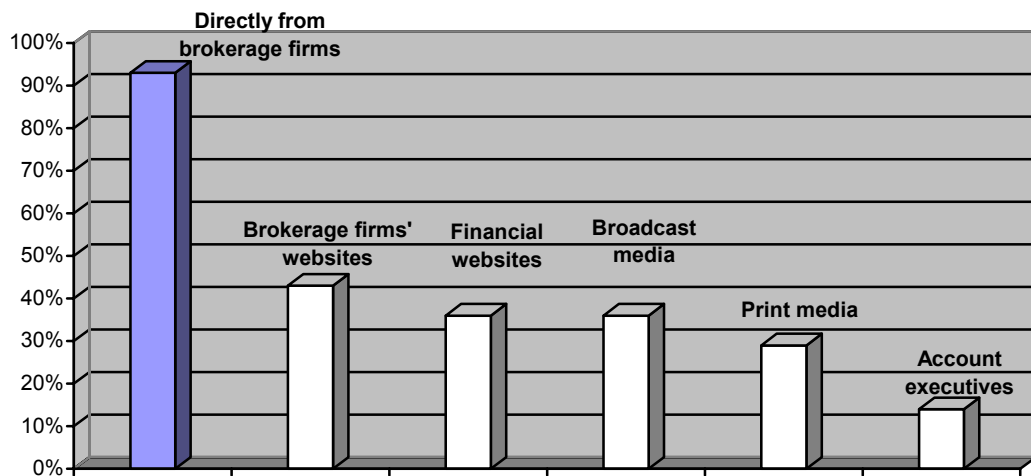
Responses of institutional investors

Use of research reports

12. Institutional investors also commonly use research reports. 93% of them often or occasionally use research reports, whether directly or indirectly, in making investment decisions. The following characteristics are noted:

- Most institutions investors obtain research reports directly from brokerage firms. Please see Chart 9.

Chart 9: Institutional investors' channels for obtaining research reports



- Institutional investors are most interested in factual details and analyses on specific stocks or industry sectors. They pay less attention to specific recommendations (such as “buy”, “hold” or “sell”) and target prices in research reports, as indicated in Table 2. This would imply that institutional investors tend to make their decisions based on facts and analysis rather than relying on analysts’ recommendations.

Table 2: Information in research reports that interests institutional investors

Type of information	Proportion of respondents indicating interest in the information
Specific recommendation	36%
Target price	36%
Analysis on specific stocks	86%
Analysis on specific industry sectors	79%
Factual details about specific stocks	79%
Factual details about specific industry sector	71%
Track records regarding analysts' recommendations on specific stocks or sectors	50%
Names of the analysts	36%

- On investment horizons, 50% have an average stock holding period of one year or more, 43% have an average ranging from one to 12 months, and none for less than one month. This shows that institutional investors have a longer investment horizon than retail investors.

Understanding research reports

13. Generally, institutional investors are more satisfied than retail investors with the quality of research reports:
 - 36% state that the recommendations are often substantiated with sufficient basis and analysis, whereas 50% state otherwise.
 - 50% think that analysts often use clear and consistent methods in their analyses, whereas 43% state that the methods used are occasionally unclear and inconsistent.
 - 21% state that analysts often, and 71% state that analysts occasionally, follow up on their previous recommendations in the research reports.

Risk warnings or disclaimers

14. The majority of institutional investors do not often read the risk warnings or disclaimers contained in research reports. Please see Chart 10. The main reason cited for disregarding them is that they do not disclose anything useful, as indicated in Chart 11.

Chart 10: Percentages of institutional investors who read risk warnings or disclaimers

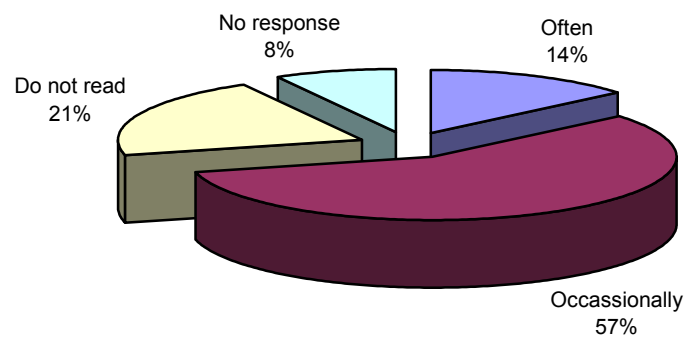
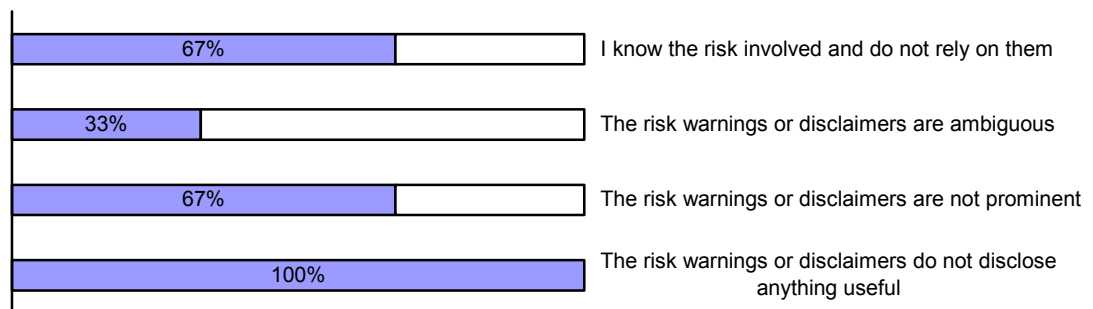


Chart 11: Reasons for not reading risk warnings or disclaimers

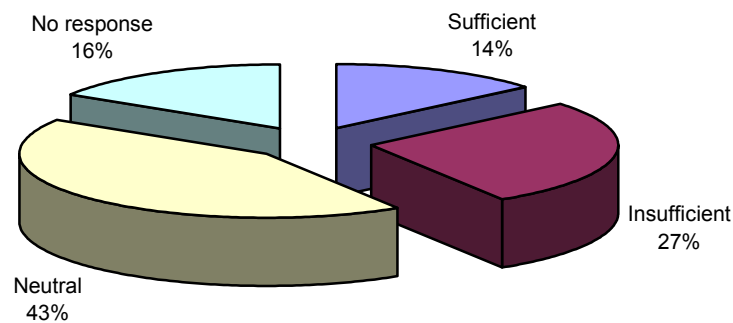


■ Proportion of respondents who stated so

Disclosure of analysts' interest

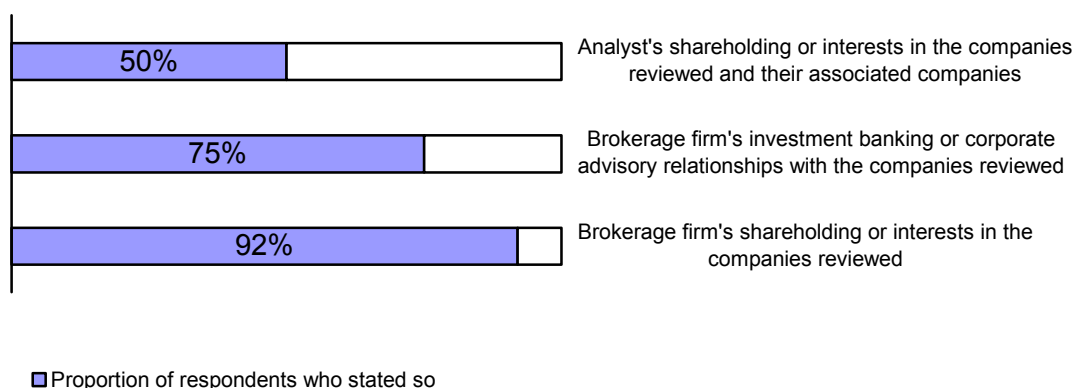
15. Many institutional investors are not concerned whether analysts and their firms have made sufficient disclosure of conflicts in their research reports or at public appearances. Please see Chart 12. This contrasts with the views of retail investors where 47% of the respondents feel that there is insufficient disclosure.

Chart 12: Institutional investors' view on sufficiency of conflicts disclosure by analysts or firms



16. Areas that respondents would like to see further disclosure are brokerage firm's interests in the subject companies (92%), the firm's relevant investment banking relationships (75%), and the analyst's relevant interests (50%). Please see Chart 13.

Chart 13: Areas of further disclosure favoured by institutional investors

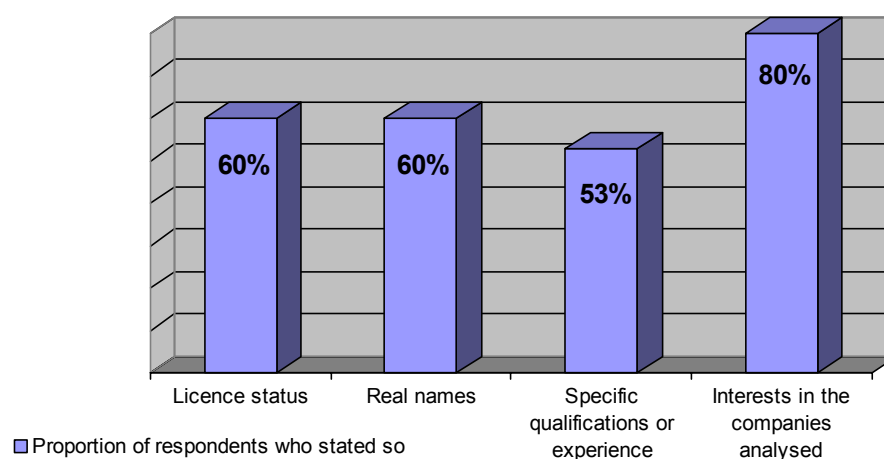


Disclosure of analysts' professional credentials

17. The majority of institutional investors agree that analysts should disclose their real names, licence status, specific qualifications, and interests in their subject companies:

- 60% agree that all analysts or commentators who are licensed persons should disclose their licence status in research reports, including reports published in the print and broadcast media.
- 60% agree that all analysts or commentators should disclose their real names in research reports, including reports published in the print media.
- 53% agree that only persons who have specific qualifications or experience are allowed to act as research analysts.
- 80% agree that all analysts or commentators should disclose their interests in their subject companies.

Chart 14: Credential disclosures favoured by institutional investors

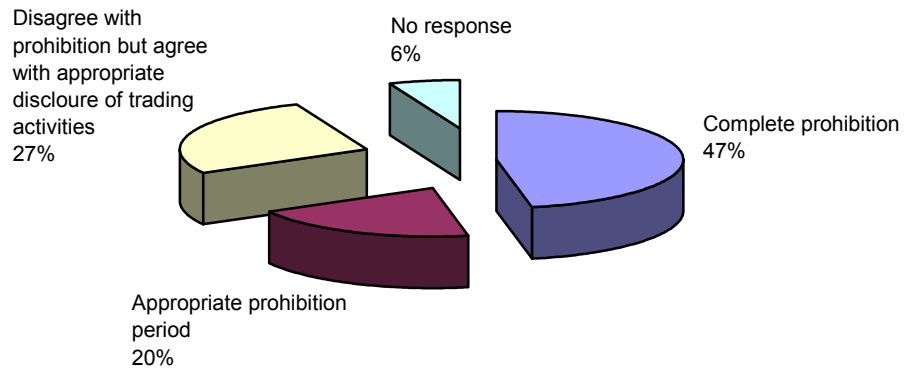


Internal controls and procedures

18. Institutional investors agree that investment firms should put in place internal control measures to address analysts' conflicts of interest:

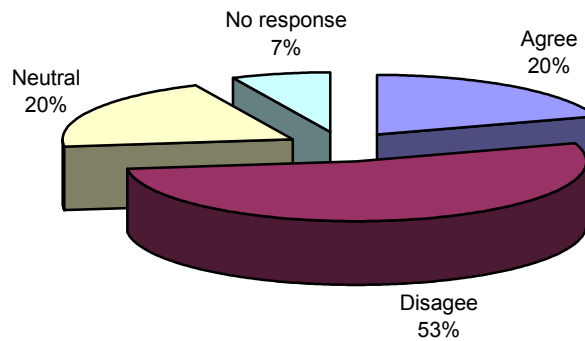
- 47% think that an analyst should be prohibited from trading a stock on which the analyst is reviewing. 20% agree that there should be an appropriate prohibition period, whereas 27% think that there should be appropriate disclosure of the trading activities. Please see Chart 15.

Chart 15: Institutional investors' views on trading prohibition against analysts on their subject stock



- 20% of the institutional investors think that an investment firm should not publish research reports covering a company that the firm (or its group) is advising on the IPO. While 53% think otherwise, all respondents agree that the firm should make sufficient disclosure and should have appropriate rules governing the release of such reports. Please see Chart 16.

Chart 16: Institutional investors' views on prohibiting relevant firms publishing pre-IPO research reports



- On internal control measures that an investment firm could establish to address analysts' conflicts of interest, 71% cite "independent reporting lines for analysts" and "Chinese Wall", 57% "independent remuneration determination mechanism", and 43% "separate and independent entity for investment research".

Respondents' general comments

19. Respondents have also made the following comments:
- Analysts should state an effective time horizon for their target prices and recommendations, and provide a comparison of the forecast target price with the actual price over a period of time.
 - Investors should be made more aware of the analysts' conflicts of interest.
 - The SFC should publicly reprimand and disclose the full names of those analysts and their firms that are guilty of misconduct.
 - No one, other than licensed persons, should be allowed to publish research reports, or otherwise comment on securities through other media.