



**SECURITIES AND
FUTURES COMMISSION**
證券及期貨事務監察委員會

Consultation Conclusions on the Regulatory Framework for Addressing Analyst Conflicts of Interest

**關於處理分析員利益衝突的
監管架構的諮詢總結**

**Hong Kong
November 2004**

**香港
2004年11月**

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EXECUTIVE SUMMARY

1. On 31 March 2004, the SFC published a Consultation Paper on the Regulatory Framework for Addressing Analyst Conflicts of Interest (“Consultation Paper”). A total of 30 submissions were received from industry participants, legal professionals, investors and other interested parties. Overall, the respondents were supportive of the SFC’s initiative to enhance its regulatory framework to address analyst conflicts of interest.

Regulatory approach

2. We have finalised Paragraph 16 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (“the guidelines”), which is designed to remove, reduce or manage analysts’ conflict of interest. The guidelines are based on the International Organization of Securities Commissions’ (“IOSCO”) principles, and took into account best market practices in other overseas jurisdictions, Hong Kong’s unique market characteristics and responses from the market to ensure that there is a balanced approach between protecting investors’ interests and facilitating the flow of legitimate market information.
3. The majority of the changes to the proposals in the Consultation Paper were made with a view to clarify issues concerning the practical application of the guidelines.

Key changes to the Consultation Proposals

4. From the feedback received, we have fine-tuned the guidelines with the following key changes:
 - *Scope of application:* the guidelines will only cover securities that are shares, stock warrants or options listed in Hong Kong, which carve out research on fixed income securities, collective investment schemes and foreign exchange.
 - *Limitations on dealing by analysts:* the post research issuance trading blackout period on analysts has now been extended from 1 to 3 business days.
 - *Analyst disclosure of relevant financial interests:* a narrower definition for “associate” has been adopted.
 - *Disclosure by firms of relevant financial interests:* the triggering threshold is now 1% of the market capitalisation of the listed corporation of the relevant securities and the additional criterion of \$5 million monetary threshold has been dropped.
 - *Quiet periods and trading blackout periods:* safe harbours have been provided for regular coverage or occurrence of unscheduled news events.
 - *Analyst reporting lines:* limit the prohibition of analyst reporting lines to the investment banking function only.

- *Analyst media appearances*: an analyst will be required to disclose (i) his name, (ii) licence status, and (iii) the fact of having a financial interest in the covered securities when making media appearances.

Way forward

5. The guidelines are scheduled to come into effect on 1 April 2005.
6. The market had diverse views on pre-deal research. We recognise that this is a complex issue that warrants separate examination. The SFC's Corporate Finance Division is currently reviewing the regulatory framework regarding public offerings of securities and prospectuses, and will be consulting the market in due course.
7. While the Securities and Futures Ordinance ("SFO") has made it clear that those who publish research or commentaries in the media do not fall within the SFC's licensing regime, we understand that many media organizations already have internal guidelines and policies regarding financial journalists and their commentaries. These media organizations are encouraged to enforce such policies and further develop a common code of best practice to ensure high standards across the industry. The SFC is happy to provide assistance to the media organizations towards developing such internal codes of best practice to address analyst conflicts.
8. Together with the release of the guidelines, the SFC intends to organize investor education campaigns to enhance investor awareness and understanding of the issue concerning the overall regulatory framework for analyst conduct. We believe that once these guidelines, which seek to establish clear industry benchmarks, are in place, the market will gather momentum for better information flow and enhanced transparency in the area of analyst conduct.

Introduction

9. On 31 March 2004, the SFC published a Consultation Paper on the Regulatory Framework for Addressing Analyst Conflicts of Interest. The consultation period was scheduled to end on 30 April 2004. However, due to positive feedback from respondents, many of whom had requested an extension in order to thoroughly examine the consultation proposals, the SFC continued to accept and consider responses received up until July 2004. At the end of the consultation period, the SFC also continue to engage in dialogue with practitioners, members of the media and other interested parties, particularly on the issue of analyst disclosure during media appearances.
10. The Consultation Paper proposed clearer and more specific guidelines to address potential and actual analyst conflicts that may exist in the Hong Kong market. These guidelines are intended for incorporation as a separate paragraph (Paragraph 16) in the Code of Conduct to govern the conduct of persons licensed by or registered with the SFC, including relevant individuals of registered institutions.
11. The guidelines were drafted in light of international developments, taking into account Hong Kong's unique market characteristics. As a member of the IOSCO, the SFC's guidelines also reflected IOSCO's Statement of Principles for Addressing Sell-side Securities Analyst Conflicts of Interest.
12. The purpose of this document is to provide interested persons with an analysis of the key issues raised during the consultation exercise and the rationale for the SFC's conclusions. *This document should therefore be read in conjunction with the Consultation Paper.*
13. A total of 30 submissions were received from industry practitioners, legal professionals, investors and other interested parties. All the submissions, save those where consent for publication had been withheld, and the Consultation Paper are published on the SFC's website at <http://www.hksfc.org.hk>.
14. Annex 1 contains the revised guidelines.

Recent Developments

15. Being an international financial center, Hong Kong is not immune to the analyst conflicts issue. The recent SFC disciplinary action against an analyst for front running his investment research has added urgency to addressing the matter.

16. We are convinced that clear and specific guidelines are required to address the analyst conflicts issue, and the issuance of guidelines focusing on the following three areas is the right approach:
- Identification, elimination, avoidance, management or disclosure of conflicts of interest faced by analysts.
 - Integrity of analysts and their investment research.
 - Education of investors concerning the actual and potential conflicts of interest faced by analysts.
17. We are mindful of the need to strike a balance between protecting investors' interests and facilitating the flow of legitimate market information, while at the same time ensuring that our approach is practical and takes into consideration the characteristics of the Hong Kong market. We recognize that the guidelines should not unnecessarily fetter the free flow of information. Together with enhanced investor education, we believe that once the guidelines, which seeks to establish clear industry benchmarks, is in place, market forces will move towards better information flow and transparency in the market place, as well as higher professional standards in the industry.

Summary of consultation comments and SFC's responses to the issues raised in the Consultation Paper

18. In general, respondents welcomed SFC's initiative to enhance the regulatory framework to address analyst conflicts of interest. Comments received varied considerably in range and depth, with some focusing on the broader principles and others on details. Some respondents also requested clarifications on the interpretation of the guidelines.
19. The following is a summary of the main comments received during the consultation exercise and our responses to these comments.

Scope of application and proposed definitions for specific terms in the guidelines

20. Respondents suggested that foreign exchange contracts and fixed income securities, as well as research on such products, should be excluded from the definitions of "financial product" and "investment research". They advocated that due to the differences in the nature and characteristics of the foreign exchange and fixed income securities markets, it would be inappropriate to apply the rules created for equity research to these instruments. Moreover, respondents contended that price movements in foreign exchange and fixed income securities are influenced by many macro-economic and other factors, and as such, are less vulnerable to any adverse influence by analysts. In the case of collective investment schemes, respondents argued that investment research on any such scheme is less likely to affect the value of units in the scheme.

21. Several respondents sought clarifications on the scope of the guidelines. In particular, they queried whether research reports produced elsewhere but circulated internally by firms in Hong Kong, or analysts who are employed by licensed firms but based offshore, are subject to the guidelines.
22. Regarding the definition of “analyst”, although the majority was in agreement with our proposed definition, a few respondents were concerned that the term may be too widely defined and may affect the flow of market information. Some also suggested that independent and buy-side analysts should be excluded from the definition.
23. We agree with the respondents’ view that due to their different characteristics, foreign exchange contracts, fixed income securities and collective investment schemes are less likely to be affected by the analyst’s recommendations. Given the differences in their pricing structures, we have limited the scope of the guidelines to cover only securities that are either shares, stock warrants or stock options listed in Hong Kong. Research on fixed income securities, foreign exchange and collective investment schemes have been excluded. For the avoidance of doubt, we also state that the guidelines are intended to cover investment research on securities that are traded in Hong Kong or investment research that has an influence on such securities.
24. We believe that independent and buy-side analysts should also be subject to the guidelines where, for instance, their research reports containing recommendations on specific securities are published. Like sell-side analysts, independent and buy-side analysts would also be subject to the guidelines that prevent potential conflicts arising from their financial interests in or relevant relationships with the listed corporation. It should, however, be noted that investment research conducted solely for the firm’s and its group companies’ internal consumption, or on macro-economic or strategic issues, and giving personal (one-to-one) investment advice, are excluded from the scope of the guidelines.

Specific designation for licensed analysts

25. In the Consultation Paper, we suggested that it might be useful to have a designation mechanism for analysts, such as by way of a licensing condition. Most respondents commented that such a designation is not necessary, as they believed that the regulatory regime should remain simple. Furthermore, any designation mechanism would add to the firms’ compliance costs. Several other respondents were in favour of a designation mechanism, but they had different views as to the type of designation that should be established.
26. Given that the majority of comments suggest that a designation system is not necessary and the diverse views from supporters regarding such a mechanism, we believe that it may not be appropriate to mandate such a designation at this stage.

Analyst trading blackout period

27. In the Consultation Paper, we suggested imposing on analysts a trading blackout period on the covered securities for 30 days prior to and 1 business day after the issuance of investment research, on analysts in regard to the covered securities. By the same token, an analyst would not be allowed to publish research on relevant securities for 30 days after trading such securities.
28. While many respondents supported the proposal, some commented that research is often driven by unscheduled news events. The blackout period would also disadvantage analysts who had just purchased relevant stocks as they would not be allowed to publish relevant research should any major event occur.
29. Also, several respondents believed that the post issuance 1 business day period is too short, as it does not give sufficient time for investors to digest the information.
30. Taking into account these comments, we have added another exemption to the blackout period, providing a safe harbour to allow firms or analysts to issue research during the blackout periods upon the occurrence of a major, publicly known event that would affect the prices of relevant securities. This is in addition to the proposed exemption allowing an analyst to trade under special circumstances outlined in the firm's policy and pre-approved by its compliance function.
31. We believe the communication network in Hong Kong is highly efficient and enables firms to communicate with their clients within a relatively short period of time. That said, we share the market's view that investors may not have sufficient time to react to or act on research reports within the same day. We have therefore extended the post issuance blackout period from 1 to 3 business days.

Analyst's financial interests and relevant relationships

32. The majority of the respondents were supportive of our proposed requirements for analysts to disclose the fact of their having financial interests in the covered listed corporation, and whether they or their associates have relevant relationships with the listed corporation in research reports. Some respondents sought clarification of the terms "associate" and "officer". There were also comments suggesting that the definition of "associates" under the SFO may be too wide for the purposes of the guidelines and should be limited to members of the analyst's household.
33. As stated in the Explanatory Notes of the Code of Conduct, unless otherwise specified or if the context otherwise requires, words and phrases in the Code of Conduct shall be construed by reference to any definition of such word or phrase in Part 1 of Schedule 1 to the SFO. Therefore, the term "officer" in the guidelines is construed accordingly.

34. We appreciate the concern that the definition of “associates” under the SFO may be too wide. We have therefore restricted its definition to include only the following:

- The spouse, or any minor child (natural or adopted) or minor stepchild, of the analyst.
- The trustee of a trust of which the analyst, his spouse, minor child or minor stepchild, is a beneficiary or a discretionary object.
- Another person accustomed or obliged to act in accordance with the directions or instructions of the analyst.

Firm’s financial interests and relevant relationships

35. Respondents agreed with the principle that firms and their group companies should disclose financial interests in, and investment banking relationships with, the covered listed corporation when publishing research reports. Some felt that the definition for “firm” may be too wide thus creating a compliance burden as it may be difficult to keep track of the interests held by other group companies on a daily basis, especially if the group has many companies. A few respondents believed that group companies, such as asset management companies, which are separated by Chinese Walls from the research analyst function, should not be required to disclose their financial interests since they have no control over the analyst or his research.

36. Several respondents suggested that instead of disclosing “any investment banking relationship”, which can be broad and difficult to determine, the disclosure should be premised on whether fees were received by the firm for its investment banking services.

37. We have clarified in the guidelines so that the definition for “firm” is now limited to any group company that carries on a business in Hong Kong in investment banking, proprietary trading or market making, or agency broking, in relation to securities. We believe this approach should address respondents’ concerns over the complexity of the disclosure requirement.

38. We appreciate the suggestion that the use of fees received as a basis for disclosure of an investment banking relationship would be a simple measurement. However, we note that firms may not receive any upfront fees upon their being granted a mandate for providing investment banking services. We should also point out that under our proposal, the firms are only required to disclose the fact that they have an investment banking relationship with the listed corporation, not the details of such relationship. It is also not our intention that firms should be required to make such disclosure if the disclosure involves price sensitive information.

Threshold for disclosing “material financial interests” by firms

39. Respondents were mostly in agreement with the proposed 1% threshold which would trigger disclosure of a firm’s financial interests with a listed corporation. A small number of respondents suggested that a 5% threshold would be more appropriate, so as to be consistent with the current threshold for disclosure of interests under Part XV of the SFO. Some respondents argued that they do not see the need for such additional disclosure given the SFO disclosure requirements. A few respondents advocated that a simple 1% market capitalization threshold was sufficient, and that a two-pronged criteria consisting both the percentage and HK\$5 million levels might be too burdensome. There were also some respondents who were against having a floor limit, reasoning that a 1% stake in the shares of a listed corporation is quite significant, as the 1% holding would in effect amount to roughly 4% of the listed corporation’s free float (on the basis that the Listing Rules generally require 25% of a listed corporation’s issued capital to be held in the hands of the public). Several other respondents also requested clarifications on the scope of “financial interest” and the timeframe to which financial interests are to be determined.
40. While there are existing provisions for disclosure of interests under the SFO, the regulatory intent behind these provisions addresses a different set of objectives. These provisions, however, do not address the needs of addressing the specific issue of analyst conflicts of interest. In respect of the threshold, we agree that a simple 1% level without the additional monetary level would be more appropriate. We have revised the guidelines accordingly.
41. We have also clarified in the guidelines that “financial interest” refers to any commonly known financial interests, such as investment in the securities in respect of a listed corporation, or a financial accommodation arrangement between the listed corporation and the firm or analyst. We also made clear that the term does not include commercial lending conducted at arm’s length (whether provided by the listed corporation to the firm or analyst or vice-versa), or investments in any collective investment scheme notwithstanding the fact that the scheme has investments in a listed corporation (securities in respect of a listed corporation). Consequently, securities held as collateral in an arm’s length commercial lending are excluded.
42. Regarding the timeframe for the disclosure of a firm’s financial interests, we take the view that the disclosure should be based on up-to-date information.

Prohibition of solicitation of investment banking business by analysts

43. Most respondents were in favour of our proposal to prohibit research analysts from participating in business activities designed to solicit investment banking business, such as sales pitches and deal road shows. As a result, no change is necessary in this respect.

Company visits in the course of investment research

44. Some respondents suggested that analysts should also refrain from conducting company visits.
45. We believe that company visits form part of an analyst's function and should be permitted. However, in this respect, firms and analysts should ensure that there are proper and adequate measures in place to shield the analysts from improper influences that may affect the objectivity of their work. Furthermore, both the firm and the analyst must abide at all times with the prohibitions against market misconduct, in particular insider dealing.

Quiet periods

46. We proposed in the Consultation Paper that firms who act as a manager or sponsor of a public offering should not issue any investment research on the listed corporation for a period of 40 days after an initial public offering and 10 days after a secondary offering (with the exception of firms which have been publishing research on the listed corporation on a regular basis). The proposal is in line with the approach taken by major international markets.
47. While the majority of the respondents were in support of our proposal, some commented that research is often driven by unscheduled news events and, as such, an exception should be made for such events. The blackout period would disadvantage analysts as they would not be allowed to publish research or change their ratings on the stock should any major event occur. A respondent suggested that the quiet period should run from the day of pricing.
48. We accept both suggestions and the relevant changes have been made to the guidelines. On this matter, analysts of the firm should observe the firm's internal procedures to ensure that they comply with the restrictions under the quiet periods.

Pre-deal research

49. In the Consultation Paper, the market was asked to give its views on whether "pre-deal research" (i.e. investment research issued before the public offering of the securities that are covered in the research) should be allowed.
50. There were diverse views on this issue. Some respondents advocated a complete ban while others took an opposite view. The international market practice on pre-deal research also varies among different jurisdictions. This subject matter will be examined in a separate consultation to be conducted by SFC's Corporate Finance Division in the context of the regulatory framework for public offers of securities. The comments received on pre-deal research so far will be considered

in that consultation exercise. Pending such consultation and its outcome, we neither express any views nor draw any conclusions at this stage.

Analyst reporting lines and participation in other functions

51. The majority of respondents supported our proposal to prohibit analysts from reporting to the investment banking function, although some suggested it was not appropriate to extend this prohibition to the dealing function. Respondents were also generally in support of banning analysts from issuing research while participating in the investment banking activities. However, a few respondents commented that given the high office rental in Hong Kong, it would be costly for small firms to implement physical segregation.
52. We appreciate that firms may ultimately have their research function placed under their dealing function, with internal controls in place to ensure analyst independence. While we have limited the scope of the prohibition concerning analysts reporting to the investment banking function, firms are expected to put in place appropriate control procedures governing information flow between the research and other functions to avoid any potential conflicts of interest.
53. As a general principle outlined under Paragraph 16.7, we would also like to remind firms that they should establish, maintain and enforce a set of written policies and control procedures to eliminate, avoid or manage any actual and potential analyst conflicts of interest, including conflicts arising from analyst's participation in firm's other functions. These policies and procedures should be commensurate with each firm's scale of operations. While no laws or regulations can effectively prevent anyone from intentionally committing misconduct, the guidelines are necessary to minimize the conflicts that may arise during the course of an analyst's work. Analysts should ensure that they do not use any non-public information obtained while assisting in the firm's other functions in connection with their subsequent investment research.

Disclosure of third party benefits by analyst

54. The respondents overwhelmingly supported the requirement to disclose any third party benefits received by an analyst in connection with his research reports. Some respondents also suggested the imposition of thresholds for such a disclosure, and for prohibiting analysts from receiving benefits altogether.
55. We agree that the receipt of any third party benefit should be disclosed. As for the prohibition threshold, we understand that many firms have appropriate internal policies regarding the receipt of gifts and other third party benefits. We would therefore leave it to the firms to formulate their own appropriate thresholds. We expect firms to put in place such thresholds in accordance with best practice.

Analyst appearances in the mass media

56. In our consultation proposal, we recommended that analysts who are SFC licensees should disclose their real names, license status, and the fact of their having financial interests in the listed corporation when publishing commentaries in or through the mass media.
57. Comments on this proposal were received from respondents of varying backgrounds, including members of the media, who expressed concerns over the practicality of the proposed measures. In particular, they raised the following issues:
- **Space/time limitations of the newspaper/broadcast media.** Full disclosure of the analyst's and his firm's interests would be overly space/time consuming, in particular where numerous stocks are discussed. Moreover, during live broadcasts, the analyst may not have sufficient time to prepare the necessary disclosures.
 - **Analysts not privy to firms' interests.** Due to compliance requirements and information barriers within the firms, analysts may not be in a position to disclose their firms' interests.
 - **Blackout period prohibiting an analyst from trading prior to and after issuing a recommendation is burdensome.** During live broadcasts, it would be awkward for analysts to refrain from answering queries on stocks in which they had traded recently.
58. We recognize that the mass media is a popular medium through which Hong Kong investors obtain financial information. With a view to addressing the concerns and the need to protect investors while not hindering the flow of legitimate financial information, we will adopt the following approach for governing analyst conduct during mass media appearances.

Analyst personal appearances

59. The guidelines will impose on an analyst who makes an appearance in the mass media and gives or discusses investment research simplified disclosure requirements. Such analyst will only need to disclose:
- (i) his name during the appearance,
 - (ii) the fact (but not the details) that he is licensed, and
 - (iii) the fact (but not the details) that he and/or his associate (but not his firm) has a financial interest in the listed corporation.

For the purposes of paragraphs 59 to 66, making an appearance shall include appearing in broadcasting programmes and writing articles, reports or comments in the print media.

60. The analyst should make the above disclosures at the time the analyses or comments are provided. This manner of disclosure would only be applicable where the analyst appears in his personal capacity, which is the case in most appearances.
61. Apart from the disclosure requirements (which are simplified), all other provisions of the guidelines will apply. This will include, for instance, the trading blackout periods. However, where unsolicited questions regarding specific securities are raised with an analyst by the audience during such appearances, the analyst may respond and comment or give recommendations, notwithstanding that his and/or his associate(s) may have traded in those securities during the preceding 30 days. He should, however, make the relevant disclosures (i.e. the fact, but not the details, of his and/or his associate(s) having any financial interests in the listed corporation) before providing the recommendation or comment. Furthermore, an analyst should take the initiative to make the disclosure even where he has not been reminded by the programme controller to do so.
62. Similarly, if an analyst is approached by financial journalists for comments (e.g. opinions on a certain stock after the occurrence of a news event), the analyst may provide his comments, notwithstanding that his and/or his associate(s) may have traded in the relevant securities during the preceding 30 days, but the analyst should disclose to the journalist his name, licence status, and the fact of his and/or his associate(s) having a financial interest in the listed corporation prior to giving any comments.

Use of pseudo names by analysts

63. The proposal requiring analysts to use their real names during media appearances attracted a wide range of responses. Some respondents, including media representatives, were in full support of a strict prohibition against analysts using pseudo names. These respondents questioned the motives behind writing such anonymous articles, pointing out that the articles could serve as a platform for providing false or misleading information, and manipulating share prices by “talking up the stocks”. On the other hand, several respondents (who also included media representatives) explained that licensed persons might write for the print media under pseudo names so as to protect themselves from possible retaliation by their firms or the covered listed corporations. If the analysts were required to disclose their real names, many would stop making commentaries on stocks, which could adversely affect the flow of market information.
64. While we note that some newspaper columns or financial articles are currently written under pseudo names, many financial commentaries bear the names of the authors. Although financial commentary columns under pseudo names appear to be popular among retail investors, there is concern in the market that some of these articles could be misused, resulting in market misconduct. We believe that

the conduct issues relating to pseudo names therefore involve not only analyst conflicts, but also wider issues of market integrity and misconduct.

65. Given its wide context, the SFC has further consulted with a broad range of market participants including media organizations on the issue of pseudo names. Many of the respondents viewed that being licensed by the SFC and working as an analyst in a firm, an analyst is, in fact, placed in a special position with access to corporate information and to market players such as listed corporations. As such, the investing public has a legitimate expectation that analysts conduct themselves in a proper, transparent and accountable manner. The use of pseudo names by analysts in articles published in the media reduces, or may appear to reduce, the degree of the transparency and accountability of these licensed persons.
66. On balance, we believe that analysts should disclose their names when publishing their analyses or commentaries in the mass media. We recognize that the concerns raised by some respondents that if pseudo names were not allowed to be used, some might choose not to write, thus affecting the amount of information in the market. Yet, on the other hand, it is very important that the market and the investing public are comfortable with the level of accountability and transparency behind such information. We believe that in the longer term, both the Hong Kong market and its investors will benefit from a regime that delivers better transparency and accountability when analysts publish their comments or recommendations.

Firms communicating their investment research through the mass media

67. If a firm communicates its investment research through the mass media, such as disseminating its research reports in whole or in part in a sponsored programme, it should observe the requirements of the guidelines and in particular, make full disclosures as prescribed under Paragraphs 16.4, 16.5 and 16.8.

Financial journalism

68. Several respondents suggested that all commentators who provide analyses or recommendations on securities over the media should also be regulated.
69. We wish to reiterate that the SFO has made it clear that those persons who publish research or recommendations in the media do not fall within SFC's licensing regime if they do not conduct regulated activities.¹ These commentators, however, should be aware that while they are not licensed and therefore not governed by the Code of Conduct, they are still subject to other provisions of the

¹ The definition for "advising on securities" in Schedule 5 to the SFO does not include a person giving advice or issuing analyses or reports through a newspaper, magazine, book or other publication which is made generally available to the public; or television broadcast or radio broadcast for reception by the public, whether on subscription or otherwise.

SFO relating to market misconduct. Dealings in insider information or market manipulation attract both criminal and civil liabilities under the SFO.²

70. We note that a few industry practitioners have expressed concern that if only licensed persons are subject to the guidelines, there is potential for conflicts of interest by unregulated media commentators who comment/write on securities. On the other hand, we also recognize the important role that the media plays in the dissemination of information, and the reliance the public places on this.
71. The Commission is mindful that the principal aim of these guidelines is to regulate the conduct of licensed analysts, thereby promoting a set of standards that are conducive to maintaining market integrity and protecting Hong Kong's reputation as an international financial centre. We will continue to closely monitor market activities that may be detrimental to investors' interests, such as wrongful dissemination of information or advice. Despite the absence of any licensing requirement, media commentators would be expected to adhere to high ethical standards when they make commentaries to the wider public. We understand that many media organizations have internal policies regarding financial commentaries in place, covering issues such as managing and disclosing columnists' conflicts and preventing misleading commentaries being published. We believe that, with the implementation of the guidelines on analysts, and the investor education programs that will dovetail these guidelines, would encourage all media organizations to put in place their own internal policies. In fact, we would encourage mass media organizations to develop among them a generally accepted code of best practice to ensure high standards of financial commentary and analysis across the industry. The SFC would be happy to assist in this undertaking.

Disclosure requirements vis-à-vis the mass media

72. A licensed firm may not have control over the publication of extracts or summaries, in part or in whole, of its research reports. Licensed firms should therefore ensure that proper disclosures required by the Code of Conduct are made in their research reports. If the mass media publishes an extract or summary of a research report, in part or in whole, notwithstanding that the mass media is not subject to the provisions of the guidelines, the media is encouraged to disclose the source (i.e. name of the firm and date of issuance of the original research report) in its publication. Such disclosure would help readers make an informed investment decision based on these extracts and any subsequent news about the listed corporation which would affect its stock price.

² Sections 298 and 300 of the SFO respectively provide for the criminal offences of disclosure of false or misleading information to induce transactions, and employment of fraudulent or deceptive devices in securities or futures contract transactions. In terms of civil provisions, section 277 provides for civil liability in respect of disclosure of false or misleading information to induce transactions, while section 279 requires every officer of a corporation to take all reasonable measures to ensure that proper safeguards exist to prevent the corporation from perpetrating market misconduct.

73. Where analysts and/or firms had made relevant disclosures when they provide analyses or comments in the mass media, they will not be held responsible if their investment research is subsequently published or otherwise reproduced in whole or in part by the mass media without the relevant disclosures.

Investor Education

74. The SFC's proposal to continue with its investor education initiatives was well received. We will continue our investor education work to increase the investing public's awareness of analyst conflicts and the measures individual analysts and firms will have to undertake pursuant to the guidelines to reduce or manage such conflicts. We believe investor education will better equip investors to differentiate between commentaries from licensed persons, other commentators, as well as writers who publish under pseudo names; and to decide for themselves the extent to which they may wish to place their reliance on the commentaries from these various types of persons.

Final Note

75. As the guidelines are principles based, firms should adopt these guidelines in a manner that is commensurate with the firm's structure and business model. In order to facilitate firms' compliance with the guidelines, a Questions & Answers section has been posted on the SFC website to address the most frequently asked questions and clarify practical issues that firms commonly encounter in the interpretation and application of the guidelines.
76. The SFC would like to thank the industry participants and other interested parties who have made valuable suggestions and comments in response to the Consultation Paper. The SFC will continuously monitor the developments in the area of analyst conflicts, and will review the guidelines should the need arise.
77. Upon implementation of the guidelines, we hope to see a convergence of standards in the investment research sector, including analyses published in the media, brought about by market forces.
78. The guidelines will be issued under section 399 of the SFO, and scheduled to come into effect on 1 April 2005.

Paragraph 16 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission

Analysts

16.1 Application

- (a) This paragraph applies to:
 - (i) an analyst;
 - (ii) a firm that employs any analyst; and
 - (iii) a firm that issues any investment research.
- (b) This paragraph covers investment research on securities that are traded in Hong Kong and investment research that has an influence on such securities.

16.2 Interpretation

- (a) “Analyst” for the purposes of this paragraph means any individual within a firm who prepares and/or publishes investment research or the substance of investment research. The term does not include an individual:
 - (i) giving investment advice or comments wholly incidental to his dealing or broking function;
 - (ii) conducting research solely for the firm’s internal consumption and not for distribution to clients; or
 - (iii) giving personal (one-to-one) investment advice.

In respect of paragraph 16.2(a)(ii), the firm’s internal consumption includes consumption by all companies in the group and not just those specified in paragraph 16.2(d).

- (b) “Associate” for the purposes of this paragraph means:
 - (i) the spouse, or any minor child (natural or adopted) or minor step-child, of the analyst;

- (ii) the trustee of a trust of which the analyst, his spouse, minor child (natural or adopted) or minor step-child, is a beneficiary or a discretionary object; or
 - (iii) another person accustomed or obliged to act in accordance with the directions or instructions of the analyst.
- (c) “Financial interest” for the purposes of this paragraph means any commonly known financial interest, such as investment in the securities in respect of a listed corporation, or financial accommodation arrangement between the listed corporation and the firm or analyst.

This term does not include commercial lending conducted at arm’s length, or investments in any collective investment scheme notwithstanding the fact that the scheme has investments in securities in respect of a listed corporation.

- (d) “Firm” for the purposes of this paragraph means any intermediary and its group of companies. A company will only be regarded as a group company if it carries on a business in Hong Kong in:
- (i) investment banking;
 - (ii) proprietary trading or market making; or
 - (iii) agency broking,
- in relation to securities.
- (e) “Individual employed by or associated with...the firm” for the purposes of paragraph 16.5(c) means any individual:
- (i) employed by the firm in accordance with whose directions or instructions the analyst is accustomed or obliged to act;
 - (ii) employed by the firm who has influence on the subject matter or content, or the timing of distribution, of investment research; or
 - (iii) who is responsible for determining the remuneration of the analyst.
- (f) “Investment research” for the purposes of this paragraph includes documentation containing any one of the following:
- (i) result of investment analysis of securities;
 - (ii) investment analysis of factors likely to influence the future performance of securities, not including any analysis on macro economic or strategic issue; or

- (iii) advice or recommendation based on any of the foregoing result or investment analysis.

and an investment/research report shall be construed accordingly.

- (g) “Listed corporation” for the purposes of this paragraph means a corporation the securities of which are listed on The Stock Exchange of Hong Kong Limited.
- (h) “Securities” for the purposes of this paragraph means shares issued by a listed corporation and any warrants or options on these shares which are listed or traded on The Stock Exchange of Hong Kong Limited.

16.3 Principles

The Commission believes the following principles³ are of fundamental importance to the business undertaken by all analysts and firms to which this Paragraph applies.

(a) Analyst trading and financial interests

Mechanisms should exist so that analysts' trading activities or financial interests do not prejudice their investment research and recommendations.

(b) Firm financial interests and business relationships

Mechanisms should exist so that analysts' investment research and recommendations are not prejudiced by the trading activities, financial interests or business relationships of the firms that employ them.

(c) Analyst reporting lines and compensation

Reporting lines for analysts and their compensation arrangements should be structured to eliminate or severely limit actual and potential conflicts of interest.

(d) Firm compliance systems

Firms that employ analysts should establish written internal procedures or controls to identify and eliminate, avoid, manage or disclose actual and potential analyst conflicts of interest.

³ These principles generally replicate those published by the International Organisation of Securities Commissions (“IOSCO”) on 25 September 2003 in the Statement of Principles for Addressing Sell-side Securities Analyst Conflicts of Interest (“Statement of Principles”). Aside from these principles, analysts and firms are encouraged to adopt the measures specified in the Statement of Principles as best practices. The Statement of Principles is available at the IOSCO website at www.iosco.org.

(e) Outside influence

The undue influence of securities issuers, institutional investors and other outside parties upon analysts should be eliminated or managed.

(f) Clarity, specificity and prominence of disclosure

Disclosures of actual and potential conflicts of interest should be complete, timely, clear, concise, specific and prominent.

(g) Integrity and ethical behavior

Analysts should be held to high integrity standards.

16.4 Analyst trading and financial interests

(a) Firms to establish dealing policies for analysts

A firm that employs any analyst should establish and maintain written policies and control procedures governing the dealings and tradings by any such analyst with a view to eliminating, avoiding, managing or disclosing actual or potential conflicts of interest arising from such dealings or tradings.

(b) Limitations on dealing by analysts

An analyst or his associate should not deal in or trade any securities in respect of a listed corporation that the analyst reviews:

- (i) in a manner contrary to his outstanding recommendation; or
- (ii) within 30 days prior to and 3 business days after the issue of investment research on the listed corporation,

except in special circumstances outlined in the firm's policy and pre-approved by the relevant legal or compliance function.

In respect of paragraph 16.4(b)(ii), an analyst should not issue any investment research on a listed corporation if he or his associate had dealt in or traded the securities in respect of the listed corporation within the previous 30 days, except on occurrences of major events that would affect the price of the securities and the events are known to the public.

(c) Disclosure of relevant relationships

If an analyst or his associate serves as an officer of the listed corporation that the analyst reviews, the analyst should disclose that fact in the research report.

(d) Disclosure of relevant financial interests

If an analyst or his associate has any financial interests in relation to a listed corporation that the analyst reviews, he should disclose that fact in the research report.

16.5 Firm financial interests and business relationships

(a) Disclosure by firms of relevant financial interests

Where a firm has any financial interests in relation to a listed corporation the securities in respect of which are reviewed in a research report, and such interests aggregate to an amount equal to or more than 1% of the listed corporation's market capitalization, the firm should disclose that fact in the research report.

(b) Disclosure by firms of relevant market making activities

A firm that makes a market in the securities in respect of the listed corporation should disclose that fact in the research report.

(c) Disclosure by firms of relevant relationships

A firm having an individual employed by or associated with the firm serving as an officer of the listed corporation should disclose that fact in the research report.

(d) Disclosure by firms of relevant business relationships

A firm that has an investment banking relationship with the listed corporation should disclose that fact in the research report. Any compensation or mandate for investment banking services received within the preceding 12 months would constitute an investment banking relationship.

(e) Improper dealing by firms ahead of issue of investment research

A firm should not improperly deal or trade ahead in the securities in respect of the listed corporation which its investment research covers.

(f) Firms not to provide certain assurances to listed corporations

A firm should not, with a view to commencing or influencing a business relationship with a listed corporation, provide any promise or assurance of favourable review or change of coverage or rating in its investment research.

(g) Quiet periods

A firm that acts as a manager, sponsor or underwriter of a public offering should not issue any investment research covering the listed corporation at any time falling within a period of:

- (i) 40 days immediately following the day on which the securities are priced if the offering is an initial public offering; or
- (ii) 10 days immediately following the day on which the securities are priced if the offering is a secondary public offering,

unless the firm has been issuing investment research on the listed corporation with reasonable regularity in its normal course of business, or on occurrences of major events that would affect the price of the securities and the events are known to the public.

The day on which the securities are priced refers to the day when the specific price of the offering is determined.

16.6 Analyst reporting lines, compensation and participation in other functions

(a) Analyst reporting lines and compensation

A firm that has an investment banking function should not:

- (i) arrange for its analysts to report to such function; or
- (ii) directly link its analysts' compensation to any specific investment banking transaction.

(b) Pre-approval of investment research by investment banking function

A firm that has an investment banking function should not allow such function to pre-approve analyst reports or recommendations, except in circumstances subject to oversight by compliance or legal function where investment banking function reviews a research report for factual accuracy prior to publication.

(c) Analysts not to solicit investment banking business

An analyst should not participate in business activities designed to solicit investment banking business, such as sales pitches and deal road shows.

16.7 Firm compliance systems

A firm should establish, maintain and enforce a set of written policies and control procedures to eliminate, avoid or manage actual and potential analyst conflicts of interest. These policies and procedures should be appropriately formulated having regard to the firm's particular structure and business model and the experience and investment profile of its clients.

16.8 Outside influence

An analyst or his firm should disclose in the research report the fact where the listed corporation or other third party has provided or agreed to provide any compensation or other benefits in connection with the investment research.

16.9 Making commentaries or recommendations through the mass media

When an analyst makes commentaries or recommendations through the mass media, all provisions in paragraph 16, as modified (where applicable) under paragraph 16.9(a) and (b) below, should apply.

(a) Analysts appearing in personal capacity in the mass media

When an analyst provides analyses or comments on securities in respect of a listed corporation in the mass media in his personal capacity, including appearing in person, he should disclose the following at the time the analyses or comments are provided:

- (i) his name;
- (ii) his licence status; and
- (iii) where he and/or his associate has a financial interest in the listed corporation, the fact of having such an interest.

(b) Analysts responding in personal capacity to queries from audiences and journalists

When an analyst is asked by members of an audience, or otherwise by a journalist, for analyses or comments on specific securities, he may offer such analyses or comments, provided that he makes the disclosures set out in paragraph 16.9(a)(i) to (iii) notwithstanding the fact that he and/or his associates have traded in the relevant securities during the 30 days prior to giving such analyses or comments.

(c) Firms communicating their investment research through the mass media

For avoidance of doubt, when a firm communicates its investment research through the mass media, such as disseminating its research reports in whole or in part in a sponsored programme, all relevant provisions in paragraph 16 should apply.

16.10 Clarity, specificity and prominence of disclosure

(a) Quality of disclosure

Where any matter is required to be disclosed under this Paragraph, the disclosure should be:

- (i) clear;
- (ii) concise;
- (iii) specific;
- (iv) given adequate prominence; and
- (v) released in a timely and fair manner.

(b) Methods of disclosure

Any disclosure required under this Paragraph should be made in a method that is commensurate with the medium through which the investment research, or analyst's advice or comments, is being delivered. The required disclosures are limited to the fact of the matter. Details such as the amount or its nature are not required.

(c) Disclosure responsibility

Where relevant disclosures have been made by analysts and/or firms, they will not be held responsible if their investment research, or recommendation is published or otherwise reproduced in whole or in part by the mass media without the relevant disclosures.

16.11 Integrity and ethical behavior

- (a) An analyst should have a reasonable basis for his analyses and recommendations.
- (b) An analyst should define the terms used in making recommendations, and utilize such definitions consistently.