

Speech by Commissioner McCreevy at the  
Launch of the Association of European Independent Research Providers  
(EUROIRP)

London, 20 October, 2005

Thank you for that kind introduction. We are here today to mark an important occasion, the launch of a new European trade association. If I may use a metaphor from biology, the birth of a new trade association, like the emergence of a new species of plant or animal, marks the moment when a group of individuals – in this case, firms active in the independent research market – must be seen as separate and apart from the broader species that they emerge from – in this case, research firms and intermediaries more generally.

The existence of the trade association will help to define a market segment, even as its identity must evolve to reflect changes in that very market niche. In its early life, to continue the metaphor, the trade association of course is careful to draw up its mission and its membership criteria. Too exclusive, and it risks perpetual minnow status. With too broad a membership, it can risk diluting the messages in the search for consensus. Or give lurking competitors an unfair advantage.

From the point of view of the Commission, growth of European trade associations is all for the good. It provides us with a rich ecology of opinion on the complex financial topics which occupy us in Brussels. Crucially, the good ones provide focused views that are taken into account, along with those of other stakeholders such as consumers, the Member States, the European Parliament, and regulators.

In terms of the topics of most interest to you today, I think we in Europe have a good story to tell. The Financial Services Action Plan contains within it – particularly in the Market Abuse Directive and the Markets in Financial Instruments Directive or ‘MiFID’ – the overarching framework for uniformly high standards of market integrity and consumer protection across Europe.

In the area of research, the Market Abuse Directive contains a comprehensive regime for the disclosure of conflicts of interest by research providers. Any research provider has to disclose conflicts of interest that might impair the objectivity of the research. This applies whether or not the provider is an investment firm.

The MiFID complements the Market Abuse Directive by setting out organisational requirements for investment firms for handling conflicts of interest. After an extended period of consultation and discussion, involving Member States, regulators and stakeholders, we hope to bring forward our formal proposals for implementing measures to fill in the details of MiFID later this year.

The MiFID implementing measures are not yet set in stone. But assuming they remain in their current form, the measures will represent the European implementation of the global IOSCO standards for the management of conflicts of interest affecting investment research. The measures will say that if an investment firm wishes to present its material as investment research, it must adhere to some basic conflicts management standards. These are mainly about insulating the analysts from competing business interests such as those arising from corporate finance or from proprietary trading. The Directive will protect independence and objectivity through organisational requirements –

Chinese walls, separation of salaries, supervision and the like – but it will not mandate that firms completely hive off their research function. It will enable those firms that can't meet the standards to put out material containing general recommendations, as long as it is not presented as investment research.

What are the implications of these two Directives for the independent research market?

The Market Abuse Directive will lay bare the conflicts of interest of those integrated research providers that have direct commercial stakes in the securities they cover. This may push up demand for a more independent product by making commercial links much more apparent. On the other hand, depending on its precise business model, an independent house may itself need to disclose business links – for example relating to commission sharing arrangements – in order to fairly present its research. The overriding requirement in relation to research requires disclosure of “all relationships and circumstances that may reasonably be expected to impair the objectivity of the recommendation”.

The MiFID will affect the independent research market in a number of ways.

Firstly, independent houses that are also MiFID firms (for example, if they are introducing brokers or investment advisers) will need to comply with the research objectivity standards. And those standards will apply to independents who are not MiFID firms, but which provide research under outsourcing arrangements entered into with firms.

Secondly, the research standards mean that independents will also be subject to strong competition, as integrated houses that comply with the standards will be able to hold their material out as objective.

Thirdly, the standards may drive some investment firms to spin-off their research functions, in order to simplify conflicts management. Any such moves would clearly help grow the independent research sector.

Lastly, the MiFID contains strong provisions on inducements. Any independent research that is provided to fund managers through a commission sharing arrangement will need to improve services to clients.

In our view, the Market Abuse Directive and the MiFID together should go a long way towards addressing the problems of bias in research which we saw most glaringly during the stockmarket bubble at the beginning of this decade.

We will set out our formal thoughts on research in a formal Communication which we expect to publish in June next year. There has been a delay, and this is because we want to wait until the dust has settled on MiFID before publishing our definitive thoughts. That report will follow-up on the valuable work of the Forum Group, and will explain in more detail how the Market Abuse Directive and the MiFID work together to deliver higher standards of research conflicts management and disclosure.

I am aware that some of you think that we should go further in promoting the growth of the independent research sector, and even to convene a Forum Group 2. You no doubt look across the Atlantic at the pot of money set aside for independent research for five years under the

Spitzer settlement. Some of you chafe against being left out of access to data rooms for IPOs, and against the cross-subsidies of their research products enjoyed by the big investment banks.

We at the Commission are moving to a phase of consolidation of the Financial Services Action Plan or 'FSAP'. It will not be a do-nothing phase – there are certainly areas that we need to look at, such as asset management and retail financial services – but you will not see another FSAP II. I will generally only legislate where there is clear market failure, and where the benefits of doing so clearly outweigh the costs.

At this stage, on independent research, we are not yet convinced there is any significant market failure. Certainly we have no appetite for the kind of regulatory intervention that has happened in the States. An entire industry has been created by judicial fiat. What will happen at the end of five years, when the Global Settlement fund disappears, is anyone's guess. Will it be stability, volatility, chaos, or a mixture of all three?

Our approach is more incremental than that. We think we need to give the FSAP time to bed in. The cost of research to funds is becoming transparent through the work of regulators and the industry itself. This process cannot help but lead to a significant increase in activity in your sector. We will keep a keen eye on developments. We will be particularly concerned if serious market failures emerge. But at this stage we will not be wielding the regulatory sword – at least not just yet.

In closing, let me reiterate, that the Commission appreciates having focused and committed interlocutors in its policy-making endeavours. I wish you well in your endeavours, and look forward to considering your views and submissions in the future. More importantly, I look forward to

a period of vibrant competition between research sources, which cannot help but benefit all investors.

And as a new European organisation emerges – let us be enthusiastic about our work on integrating European capital markets. Right now:

- EU capital markets are strong
- firms are doing well in all sectors
- our IPO market is bigger than the US
- M&A activity is bigger than the US
- corporate bond issuance is bigger than the US

We are seeing the first swallows of the European capital market emerge. I very much welcome this – and your ambitions to be part of making it world class.

Thank you.