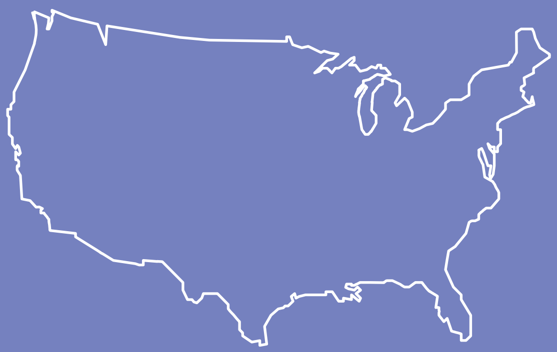
Financial Market Integrity Index

United States



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Centre for Financial Market Integrity

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MAJOR FINDINGS

- More confidence shown in market foundations of the U.S. market than in financial professionals.
- Confidence lowest in ethical behavior of hedge fund and private equity professionals.
- Ethical behavior of corporate boards and executives seen as less than adequate.
- Those outside the United States consistently have more confidence in ethical behavior of U.S. professionals and integrity of U.S. markets than do those inside the United States.

INTRODUCTION

Financial Market Integrity Index

The Financial Market Integrity Index (the Index), developed by the CFA Institute Centre for Financial Market Integrity, reflects the views and opinions of CFA Institute members around the world.

The Index measures the sentiment of a global cross-section of the CFA Institute membership concerning ethical standards in a number of markets. This report focuses on the U.S. market. For a more in-depth look at the methodology of the Index, please see the methodology section at the back of this report.

The CFA Institute Centre for Financial Market Integrity is the advocacy arm of CFA Institute. With headquarters in Charlottesville, Virginia, and regional offices in New York, Hong Kong, and London, CFA Institute (formerly the Association for Investment Management and Research®) is a not-for-profit professional association of more than 89,000 financial analysts, portfolio managers, and other investment professionals in 130 countries of which over 76,000 are holders of the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 134 member societies and chapters in 55 countries and territories.

The CFA charter is widely recognized as the designation of professional excellence within the global investment community. CFA charterholders must pass three rigorous examinations that test their understanding of a number of financial disciplines and ethics, and must complete at least four years of qualifying financial work experience to earn the CFA charter. All members must obey the rules of a principles-based ethical code in order to remain CFA Institute members. The CFA Institute Centre for Financial Market Integrity believes that the informed opinion of this survey group offers valuable insight into the current state of financial market integrity.

The CFA Institute members participating in this survey (survey participants) were asked to evaluate and rate a number of financial market participants (sell-side analysts, money managers, etc.) and market foundations (regulation, transparency, etc.) concerning how these individuals and market foundations contribute to financial market integrity. This survey asked survey participants to answer a number of questions by rating the ethical behavior of these market participants and market foundations on a scale of 1 (poor) to 5 (excellent).

The CFA Institute Centre provides the findings of this report to advance the cause of ethics and integrity in financial markets as reflected in the views of our professional members. This is an opinion-based survey, and CFA Institute makes no representations concerning accuracy or otherwise warrants use of the Index for any purposes by readers. The comments offered in the "Overall Perception" section of this report are those of CFA Institute individual members and do not necessarily represent the opinions of CFA Institute or the CFA Institute Centre. These opinions are identified in quotation marks and are followed by that individual's job title.

Analysis of in-market vs. out-of-market opinion
Each market was rated by CFA Institute members who work and live inside that market as well as members who work and live outside that market. The survey explores the differences in perceptions in each group, using commentary from members to support such analysis where appropriate.

Analysis of changes in the survey's rating
The frequency of future surveys will be at least annual, and these future reports will analyze the changes in a market's overall Index rating and the reasons for that change in rating.

EXECUTIVE SUMMARY

Financial Market Integrity Index: United States

The survey finds some intriguing information in this inaugural report concerning the financial market integrity of the U.S. market. Survey participants affirmed that, in general, the state of financial market integrity in this market is adequate. The highest confidence ratings relate to the ethical behavior of money managers (3.39 of 5) and the legal protections offered to investors (3.45). Survey participants showed the least confidence in the ethical behavior of private equity and hedge fund managers (2.46), due primarily to reduced transparency of these market participants. Survey participants also saw a need for improvement in the ethical behavior of corporate boards (2.78) and corporate executives (2.75).

Control Question Tracking

The first question of the survey served as a control question. This question asked respondents to “rate the overall quality of ethical behavior by all of those who interact with and contribute to the financial integrity of this market.” Survey participants gave the U.S. market a rating midway between adequate and very good for this question. This control result was then compared against the average rating for survey questions 2–6 relating to investment professionals.

Disconnect in Overall Confidence in Individuals

Survey questions 2–6 dealt with the ethical behavior of different investment professionals in the U.S. financial markets and averaged only 2.89, or below adequate, compared with the control rating of 3.52. The significant difference in these ratings indicates that survey participants have some degree of confidence in the ethical standards of U.S. financial markets in general but that they show less confidence when asked about the specific investment professionals discussed in this survey. Only the rating of money managers (3.39) even approached the level of confidence survey participants showed in the ethical standards of all financial market participants (3.52).

More Confidence in Market Foundations

Survey participants showed more confidence in market foundations represented by questions 7 through 10 (average rating of 3.29) than they did in the individuals covered by questions 2 through 6 (average rating of 2.89). This result suggests that survey participants find it easier to have confidence in the regulatory, legal, governance, and financial transparency structures of the U.S. market than in the ethical behavior of those individuals actually providing those financial services to market participants.

SUMMARY OF SURVEY PERCEPTIONS

	Average Scores (Range 1–5)		
	Total Rating	In-Market Rating	Out-of-Market Rating
1. Overall Ethical Behavior of Financial Services Professionals	3.52	3.50	3.57
Confidence in the Ethical Behavior of:			
2. Sell-Side Analysts	3.09	3.04	3.20
3. Money Managers	3.39	3.37	3.43
4. Private Equity/Hedge Fund Managers	2.46	2.41	2.59
5. Corporate Boards	2.78	2.69	2.98
6. Corporate Executives	2.75	2.66	2.95
Confidence in Adequate Market Foundations:			
7. Regulatory Protections	3.30	3.20	3.52
8. Legal Protections	3.45	3.44	3.49
9. Corporate Governance Standards	3.04	2.94	3.23
10. Financial Transparency	3.37	3.32	3.48
Confidence in People (2–6)	2.89	2.83	3.03
Confidence in Market Foundations (7–10)	3.29	3.23	3.43
Index Rating (average of questions 1–10)	**3.12**	**3.06**	**3.25**

Note: Survey participants were given the option of answering "not applicable/don't know" for a question if they felt they could not answer the question or did not have adequate knowledge to answer the question. Therefore, the actual number of responses for each question may be lower than the total number of survey respondents.

Note on ratings: The full versions of the questions asked can be found at the end of this report. The numbers in the columns above reflect the average answers of that group of survey participants for that question. Scores break down in the following manner:

1 = poor
2 = less than adequate
3 = adequate
4 = very good
5 = excellent

Total Rating: This rating reflects the answers of all survey participants.

In-Market Rating: This rating reflects the answers of all survey participants who live or work in the United States.

Out-of-Market Rating: This rating reflects the answers of all survey participants who live and work outside the United States and have indicated that they have experience dealing with the U.S. financial markets and the investment professionals who work in these markets.

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OVERALL PERCEPTION OF U.S. MARKET

The following analysis reviews the survey results for each of the 10 survey questions answered by 805 survey participants.

1. Overall Ethical Behavior of Financial Professionals

Please rate the overall quality of ethical behavior by all of those who interact with and contribute to the financial integrity within this market.

	Total	In U.S.	Outside U.S.
Poor	2%	2%	3%
Less than Adequate	10%	11%	6%
Adequate	33%	33%	33%
Very Good	45%	43%	47%
Excellent	10%	11%	11%
Rating	**3.52**	**3.50**	**3.57**
Total Respondents	**745**	**502**	**243**

Note: Percentages may not add up to 100 because of rounding.

Question 1 asked survey participants their overall impressions of the ethical behavior of financial professionals in general. This question garnered the highest rating from the survey group. Roughly 54 percent of those in the United States thought the ethical behavior of financial professionals was very good or excellent.

Survey participants outside the United States gave an even higher rating to U.S. financial professionals (3.57) than did those based in the United States (3.50).

Only 12 percent of all survey participants gave a rating of poor or less than adequate. Approximately 55 percent of all survey participants thought the overall ethical behavior of financial professionals in the United States was very good or excellent.

Survey Participant Comments

Positive Comments

> "I believe most market participants have high ethical qualities, but some aspects of, and participants in, the industry do not always work in their clients' best interest."
>
> —Financial Advisor/Wealth Manager

> "'Adequate' may not be attainable in my mind, but we must continue to work toward that as a goal."
>
> —Plan Sponsor

> "While I believe many players have high ethical standards, the impact of those who do not is disproportionate to the number."
>
> —Buy-Side Analyst

Negative Comments

> "Improvements have been made in the past few years, but we still have a lot to do to really have excellent ethical quality."
>
> —Investment Consultant

> "It seems like that in most firms, ethics are not a focus. This is especially true when ethics are at odds with firm profits."
>
> —Investment Consultant

"Individual investors have little to no access to conflict-free investment counsel."

—Investment Consultant

"Profit incentives need to be changed to reward ethical behavior more than unethical behavior."

—Buy-Side Analyst

"Unfortunately for many in the business development areas of our business and profession, there is still an attitude of 'how much can we get by' rather than always focusing on the most clear correct business practices."

—Fund/Portfolio Manager

Survey Responses Focused on Specific Issues Not Addressed in the Question

"The 401(k) marketplace has come under much scrutiny due to revenue sharing arrangements and lack of disclosure to plan sponsors and participants."

—Investment Consultant

"The people who had ill-gotten gains from illegally timed stock options should be required to return all the money to shareholders and employees."

—Sell-Side Analyst

2. Overall Ethical Behavior of Sell-Side Analysts

Please rate the overall quality of ethical behavior exhibited by analysts (sell side) and the analyst community (sell side).

	Total	In U.S.	Outside U.S.
Poor	4%	4%	2%
Less than Adequate	22%	24%	18%
Adequate	41%	40%	43%
Very Good	29%	27%	34%
Excellent	4%	5%	4%
Rating	**3.09**	**3.04**	**3.20**
Total Respondents	**713**	**485**	**228**

Note: Percentages may not add up to 100 because of rounding.

Question 2 asked survey participants their overall impressions of the ethical behavior of sell-side analysts. About 28 percent of those inside the United States rated the ethical behavior of sell-side analysts as poor or less than adequate. About 32 percent of those inside the United States rated the behavior of U.S. sell-side analysts as very good or excellent.

Those outside the United States had a more favorable opinion of sell-side analysts in the United States, with 38 percent of this group citing the ethical behavior of U.S. analysts as very good or excellent.

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Perceptions of Sell-Side Analysts vs. Non-Sell-Side Analysts

	Sell-Side Analysts	Non-Sell-Side Analysts
Poor	0%	4%
Less than Adequate	13%	23%
Adequate	47%	41%
Very Good	34%	29%
Excellent	6%	4%
Rating	**3.34**	**3.07**
Total Respondents	**47**	**666**

Note: Percentages may not add up to 100 because of rounding.

Because a number of survey participants were sell-side analysts, it is informative to look at results for those who were and were not currently employed as sell-side analysts. Sell-side analysts gave themselves an average rating of 3.34, and non-sell-side analysts gave sell-side analysts an average rating of only 3.07.

It is not surprising that sell-side analysts themselves thought more of their ethical behavior than did survey respondents who were not sell-side analysts. No sell-side analyst rated his or her profession's overall ethical behavior as poor, and only 13 percent gave a rating of less than adequate. Approximately 27 percent of non-sell-side analysts thought that sell-side analysts' behavior was poor or less than adequate.

Survey Participant Comments

Positive Comments

> "The tech blowup caused a lot of the borderline ethical analysts to be brought out into the light. I also think that separating paying for research from other parts of the business has allowed the analyst community to just produce better research rather than spending time pushing deals."
>
> —Buy-Side Analyst

> "Overall, I believe that the sell side tends to be ethical, except when the market is 'at extremes' (like the dot.com bubble). There are, and always will be, isolated pockets of pump and dump manipulators trying to fleece investors. However, for the vast majority of *professional* analysts, there is a need to be ethical in order to preserve credibility."
>
> —Fund/Portfolio Manager

> "A little better than Canada, although the analysts still are biased. The only difference between the Canadian and U.S. markets is the hold period on a secondary or IPO."
>
> —Sell-Side Analyst

Negative Comments

> "Countless 'independent' research firms have sprung up over [the] last few years. I've worked for several of these fee-based firms. Companies pay for 'independent' research but in fact typically think they are paying for a favorable buy rating. Analysts are frequently pressured into biased reports because otherwise, the independent firm does not receive payment from the hiring company. I think it is a more confusing landscape for investors than ever before. It's a minefield out there, and if I'm not sure who to trust, who to associate with, how would the average investor know?"
>
> —Investment Consultant

> "Investment banking businesses need to be spun-off from equity research firms before sell-side analysts will ever be taken seriously again."
>
> —Buy-Side Analyst

> "Chinese walls that separate research analysts and the sell side are ineffective in overcoming the conflicts of interest. Just like a law firm cannot be on both sides of the 'v.' in a case, investment banks should not purport to provide independent research."
>
> —Investment Consultant

> "Some sell-side research is actually quite good; however, some is clearly developed to 'deliver the sale.' Generally, this research is designed more to promote the I-Bank's trading operations (more than an investment banking function) and diminishes the credibility of the analyst in my view."
>
> —Fund/Portfolio Manager

3. Overall Ethical Behavior of Money Managers

Please rate the overall quality of ethical behavior exhibited by money managers (buy side) and mutual fund companies, collective fund schemes, or unit trusts.

	Total	**In U.S.**	**Outside U.S.**
Poor	2%	2%	2%
Less than Adequate	12%	13%	11%
Adequate	38%	38%	37%
Very Good	41%	39%	45%
Excellent	7%	8%	6%
Rating	**3.39**	**3.37**	**3.43**
Total Respondents	**712**	**497**	**215**

Note: Percentages may not add up to 100 because of rounding.

This question asked survey participants their overall impressions of the ethical behavior of money managers in the United States. The money manager community fared the best among survey participants in questions concerning the ethical standards of a specific group. The answers of the total survey population differed little from those of U.S.-based survey participants.

Those outside the United States thought more of the ethical behavior of money managers (average rating of 3.43) than did those based in the United States (average rating of 3.37).

Perceptions of Money Managers vs. Non-Money Managers

	Money Managers	**Non-Money Managers**
Poor	3%	2%
Less than Adequate	14%	11%
Adequate	37%	38%
Very Good	38%	42%
Excellent	8%	7%
Rating	**3.35**	**3.41**
Total Respondents	**269**	**443**

Note: Percentages may not add up to 100 because of rounding.

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Because a number of survey participants were money managers, it is informative to look at results for those who were and were not employed as money managers. The survey found little difference in the overall answers given by those who listed themselves as money managers and those who did not, although it may be mildly surprising that the average overall rating money managers gave themselves was slightly lower than the average rating given by non-money managers.

Survey Participant Comments

Positive Comments

> "Buy-side managers are also driven to high ethical standards in order to maintain their credibility and reputations. While the headlines are often filled with the mistakes of a few, the majority of managers will maintain high ethical standards in order to outperform over the long term. Laws will always need to be changed in order to adapt to the changing marketplace and ways people find to circumvent current laws."
>
> —Fund/Portfolio Manager

> "Now that the bad apples were exposed and more attention has been brought to how money managers conduct business, there has been more transparency through disclosure for registered investment companies."
>
> —Investment Consultant

> "Knowing that the SEC is watching has cleaned up behavior."
>
> —Investment Consultant

Negative Comments

> "Relatively ethical, but too much effort of PMs is exerted on selling as opposed to investing. Perhaps the jobs should be more specialized."
>
> —Buy-Side Analyst

> "I still think much is needed to improve ethics in this area. Lack of resources/oversight allows some on the buy side of the business to benefit from info that not everybody else gets access to."
>
> —Buy-Side Analyst

> "'Soft dollars' are still the major reason for this (my low) rating. . . . There is an inherent conflict in using soft dollars, yet almost every money manager uses it."
>
> —Investment Consultant

> "Best execution is too nebulous of a concept in the regulatory world to have any practical implications. This needs to be clarified and enforced."
>
> —Investment Consultant

> "Possible conflicts of interest should have a brighter spotlight placed on it [we presume prospectus disclosure], instead of burying it in a list of 100 risks to the investment."
>
> —Fund/Portfolio Manager

4. Ethical Behavior of Private Equity and Hedge Fund Professionals

Please rate the overall quality of ethical behavior exhibited by private equity and hedge fund professionals.

	Total	In U.S.	Outside U.S.
Poor	16%	17%	15%
Less than Adequate	37%	40%	31%
Adequate	33%	31%	36%
Very Good	12%	10%	16%
Excellent	2%	2%	2%
Rating	**2.42**	**2.41**	**2.59**
Total Respondents	**633**	**449**	**184**

Note: Percentages may not add up to 100 because of rounding.

Survey participants appeared most concerned about the ethical behavior of private equity and hedge fund professionals. Some of this unease undoubtedly stems from the less-than-transparent nature of private equity and hedge funds. This question also elicited the most "not applicable/don't know" answers from survey participants; 21 percent of all respondents and 12 percent of those based in the U.S. market declined to answer the question because they felt they did not possess adequate knowledge about hedge funds or private equity.

The hedge fund and private equity communities may have some confidence building to do, as about 57 percent of those inside the U.S. and 46 percent of those outside the U.S. market rated the ethical behavior of these individuals as poor or less than adequate.

Less than 15 percent of the total survey group thought that private equity and hedge fund professionals generally exhibit very good or excellent ethical behavior.

Survey Participant Comments

Positive Comments

> "Ethical behavior is better in the case of private equity professionals than in the case of hedge fund professionals."
>
> —Fund/Portfolio Manager

> "People are naturally more skeptical of this arena. The professionals know it, so they have to behave in a more ethical way than those who hide behind the guise of being 'registered.'"
>
> —Investment Consultant

> "I would say most are very ethical. The problem arises when too much risk is taken and the bet goes bad. . . . This can cause some hedge fund managers to double down due to the mindset that they may as well bet the house because they will have to liquidate anyway."
>
> —Fund/Portfolio Manager

> "My personal experience with these funds is that they have so much freedom to pursue their strategies, there is little need to break financial rules. Moreover, their compensation is very directly aligned with that of their clients, so there is no incentive to take advantage of clients. What is best for their clients financially is best for them as well."
>
> —Investment Consultant

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Negative Comments

> "This is an area of current concern to me. I believe that the majority of investment professionals are guided by an invisible hand to maintain high ethical standards in order to achieve long-term success; the hedge fund market is undergoing a change similar to the excesses found during the dotcom bubble. Hedge funds are now being marketed to 'less than professional investors' and thus need more regulations to be protected. In the current environment, it is too easy for miscreants to take advantage of unsophisticated investors."
>
> —Fund/Portfolio Manager

> "While progress is being made, this is likely the segment demanding the most immediate attention."
>
> —Plan Sponsor

> "I do think there are some very reputable professionals running money at hedge funds, but most are just hungry individuals looking to cash in quickly."
>
> —Buy-Side Analyst

> "Personally I do not believe the unregulated hedge funds provide an equal playing field for everybody else. Wall Street is driven by the almighty buck and is willing in my opinion to give proprietary info [to hedge funds] just to win the trading volumes from hedge funds."
>
> —Buy-Side Analyst

> "The level of unethical behavior among hedge funds is deplorable. Questionable trading schemes, the use of insider information, market manipulation, etc. are all prevalent among many hedge managers."
>
> —Fund/Portfolio Manager

5. Ethical Behavior of Corporate Boards

Please rate the overall quality of ethical behavior exhibited by corporate boards of public companies.

	Total	In U.S.	Outside U.S.
Poor	9%	11%	5%
Less than Adequate	28%	30%	24%
Adequate	40%	38%	44%
Very Good	18%	17%	21%
Excellent	4%	3%	6%
Rating	**2.78**	**2.69**	**2.98**
Total Respondents	**722**	**493**	**229**

Note: Percentages may not add up to 100 because of rounding.

Approximately 41 percent of U.S. survey participants rated the ethical behavior of directors of U.S. companies as poor or less than adequate, while only about 29 percent of those outside the United States thought directors at these companies deserve such a rating.

Those that operated outside the United States had a more favorable opinion of the ethical behavior of boards (2.98) than did those inside the United States (2.69).

Nearly 40 percent of all those surveyed thought that U.S. corporate boards exhibited adequate ethical behavior, although nearly as many (roughly 37 percent) thought that the ethical behavior of U.S. corporate boards was poor or less than adequate.

Survey Participant Comments

Positive Comments

"Definitely improved, but I am not sure if it's due to tighter oversight or on account that they are actually more ethical now."

—Buy-Side Analyst

"Many positive changes have taken place due to Sarbanes–Oxley."

—Buy-Side Analyst

"I believe significant improvement has been made here over the last five years. Prior to 2001, I might have rated them a '2' or less."

—Rating Agency Credit Analyst

"It seems that there is more ability to monitor board activities because private enterprises now exist to monitor board activities and provide information to shareholders."

—Fund/Portfolio Manager

Negative Comments

"I had direct exposure to the board of a Fortune 500 company for 2½ years. Board members were generally passive and demonstrated a lack of knowledge about the company's business. They were paid a lot of money to be on the board and yet would sit through meetings without engaging in discussion, no/limited questions to the CEO. Serious accounting irregularities were later revealed, but the board never had a hint of it, not even the Audit Committee. Many board members make a lucrative living sitting on several boards, and that's their motivation. It is hard to act with integrity when you are risking $100K a year. I feel very strongly that board reform is critical in our country and could be the single best thing we could do for investors."

—Investment Consultant

"I believe the level of corporate governance is very poor indeed, at least what I can see from the perspective of board oversight on salaries, operations, etc."

—Fund/Portfolio Manager

"Concerns should be expanded beyond conflicts of interest. I define board integrity as free of conflicts of interest, shepherd of company assets, and difficult taskmaster when evaluating executive performance. The boards should also be elected by majority vote."

—Fund/Portfolio Manager

"I think that the interests of corporate management continue to dominate the agendas of most corporate boards, rather than the interests of the remaining stakeholders."

—Fund/Portfolio Manager

"Lack of diversity (women and minorities) in developing boards is a problem. I vote against the entire board of my company each year for my personal holdings because of diversity issues on the board and in senior management—they are the rule, not the exception."

—Buy-Side Analyst

Some Survey Participants Focused on Executive Compensation

"Executive compensation is out of hand."

—Financial Advisor/Wealth Manager

"Executives are overcompensated. Compensation is not geared to performance for shareholders, and boards perpetuate this."

—Investment Product Developer

"Overcompensated and should have to listen to shareholders' interests more. They are 'in bed' with others just like themselves, and the compensation packages for officers of those companies are outrageous when compared to the average worker."

—Sell-Side Analyst

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6. Ethical Behavior of Executive Management

Please rate the overall quality of ethical behavior exhibited by the executive management of public companies.

	Total	In U.S.	Outside U.S.
Poor	10%	13%	5%
Less than Adequate	27%	28%	24%
Adequate	42%	42%	43%
Very Good	18%	15%	25%
Excellent	2%	2%	3%
Rating	**2.75**	**2.66**	**2.95**
Total Respondents	**726**	**498**	**228**

Note: Percentages may not add up to 100 because of rounding.

The answers to this question are highly correlated (0.7263) with the previous question concerning the ethical behavior of corporate boards. On average, survey participants rated the ethical behavior of corporate executives slightly lower than they did that of corporate boards.

More than 40 percent of U.S. survey participants thought that the ethical conduct of corporate executives was poor or less than adequate. Those outside the United States, however, had a significantly higher opinion of executives at U.S. companies; about 28 percent of these individuals believed the ethical behavior of management was very good or excellent.

Roughly 20 percent of survey participants worldwide believe the ethical behavior of U.S. corporate executives was very good or excellent.

Survey Participant Comments

Positive Comments

> "The overall environment is very good; but the few bad apples can cause great and widespread pain due to the halo (pitch fork) effect that one unethical instance has on investors' views of company management teams across the market."
>
> —Fund/Portfolio Manager

> "Although the headlines are always present, there are plenty of honest people running firms. You just don't hear about them as much."
>
> —Buy-Side Analyst

> "Of course there are exceptions, which have been well publicized (WorldCom, Enron), but in my experience, the majority of executives care about their legacy and about securing the long-term future of a company. Senior management is rewarded with stock options, which does help align their interests with that of other shareholders. I think stronger boards would help ferret out those executives who are corrupt, so we need board reform. Also, Wall Street analysts could do a better job of rewarding management decisions that are right for the long run; executives feel so pressured to make/exceed quarterly estimates that they feel justified to manipulate the numbers to satisfy the Street's short-run focus."
>
> —Investment Consultant

Negative Comments

"The risk of misconduct increases with the opportunity to make more money. The difference between the risk of an analyst being unethical and a CEO being unethical is that the CEO stands to make more money and has the means to manipulate the system. A CEO's reputation (and compensation) tends to stand on corporate performance, which can be manipulated via accounting. An analyst/money manager's reputation/compensation is a function of their performance (stock picking) and trust shown in them (as measured by assets under management). The actions of an unethical CEO may not be discovered for several quarters, whereas a bad call by an analyst is known relatively quickly."

—Fund/Portfolio Manager

"Backdating of stock options is a perfect example of why ethical behavior among corp. executives is still low."

—Investment Consultant

"All compensation for executives is too high—it should not be so high compared to the average worker—it makes them removed from reality of what it is like to work for their company. They should not take compensation in excess of a certain number of times the compensation of the average worker."

—Sell-Side Analyst

"Too short-term focused."

—Fund/Portfolio Manager

"Generally more interested in developing the 'spin' for quarterly earnings results. I would really like to see more time on conference calls focused on future investment and marketing plans than on explanations of 'operating earnings.' This may fall out of the realm of 'traditional ethics concerns,' but it is of concern to myself and other colleagues."

—Fund/Portfolio Manager

"Management of most U.S. companies still seem too concerned about short-term profitability. I hate to generalize, but compensation of upper management in the U.S. seems out of whack with the rest of the world. Are they really worth that much?"

—Sell-Side Analyst

"Too much empire building and self-seeking behavior thanks to indifferent boards who tolerate satisficing behavior."

—Investment Consultant

7. Effective Regulation

Please rate the extent to which this market has effective regulators in place.

	Total	In U.S.	Outside U.S.
Poor	5%	5%	3%
Less than Adequate	16%	18%	11%
Adequate	36%	37%	33%
Very Good	32%	30%	35%
Excellent	12%	9%	17%
Rating	**3.30**	**3.20**	**3.52**
Total Respondents	**749**	**506**	**243**

Note: Percentages may not add up to 100 because of rounding.

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Nearly 40 percent of survey participants in the United States rated regulatory effectiveness in this market as very good or excellent. Those who operated inside the United States were also more likely to cite U.S. regulation as poor (5 percent) or inadequate (18 percent) than those looking at the U.S. market from outside the country.

Those outside the United States rated the effectiveness of regulators higher than those inside the United States. A number of respondents cited Sarbanes–Oxley as an example of regulation that had gone too far in the United States; a similar number of survey participants stated that the SEC needs more resources to effectively fulfill its mandate. Although a healthy majority of survey participants rated the regulation in the U.S. market as adequate or better, a number of survey participants cited overburdened regulators as a concern in their comments.

Survey Participant Comments

Negative Comments

> "The first line examiners need better training and more experience. I am certain that many critical things get by them. And they fixate on small errors that are not material. In my experience, there is a need for much improvement. Compensation needs to improve so that when they finally get experienced, they stay, rather than move to a firm at many multiples of their former salaries."
>
> —Buy-Side Analyst

> "Regulators appear to be understaffed and likely underpaid; they only go after high-profile cases (i.e., biggest bang for the buck)."
>
> —Buy-Side Analyst

> "Regulators are filled with lawyers who have no experience as market professionals. Therefore, these regulators do not really understand the markets they monitor."
>
> —Sell-Side Analyst

> "Nothing is being done proactively. It takes scandal after scandal after scandal to make only marginal reforms."
>
> —Buy-Side Analyst

> "Regulators are always reactive, not proactive, but I don't know how you can 'improve' the system. The cry for regulation always occurs because something bad happened as the result of somebody finding a way to circumvent/avoid existing regulations. I don't know how we can expect, nor probably do we want, government to be proactive. While I believe that a certain degree of regulation is necessary, the law of unintended consequences mandates that whatever regulators do, it will cause other problems."
>
> —Fund/Portfolio Manager

> "Actions taken by regulators tend to be more reactive than proactive. . . wait till a scandal hits and then address it. . . . Regulators may need to think more like unethical managers so they can be on the lookout for situations to clamp down on before they become a disaster."
>
> —Fund/Portfolio Manager

> "Despite my citations of less than adequate ethics in certain sectors, I still think that some regulations have gone too far while others need work/clarification. Regulation AC is just silly. A dishonest analyst has no problem in signing his name fraudulently to the veracity of this statement if he is creating flimsy research to begin with. If the research is fraudulent or misleading, the regulations already exist to punish the analyst. Let's use some stepped up enforcement to prosecute those [who violate] regulations. The regulations explicitly decouple investment banking and research activities; however, many fixed-income research analysts experience more pressure from their trading desks than their I-Banking department."
>
> —Fund/Portfolio Manager

“Sarbanes–Oxley may have been too restrictive.”

—Sell-Side Analyst

“I view current regulators and the scope of legislation as too cumbersome for the market to operate at its full potential.”

—Valuation Consultant

“We need stronger enforcement not really more regulations.”

—Fund/Portfolio Manager

“Better oversight needed, not more laws.”

—Fund/Portfolio Manager

“I do not believe more regulators are needed. I believe in ‘voting with your feet.’”

—Rating Agency Credit Analyst

“Judging from audits of colleagues’ firms, regulators are not scratching the surface of everyday practice. They look for key items only and ignore many other important issues.”

—Fund/Portfolio Manager

8. Effective Legal Protections

Please rate the extent to which this market offers effective legal protections to investors.

	Total	In U.S.	Outside U.S.
Poor	4%	4%	3%
Less than Adequate	12%	13%	10%
Adequate	35%	33%	38%
Very Good	35%	35%	35%
Excellent	15%	15%	15%
Rating	**3.45**	**3.44**	**3.49**
Total Respondents	**735**	**499**	**236**

Note: Percentages may not add up to 100 because of rounding.

Although a number of survey participants emphasized the “overly litigious” nature of the U.S. markets, this question earned the highest marks of the four questions concerning the “market foundations” of the U.S. markets. The answers given by survey participants hardly vary between those operating inside and outside the U.S. market.

The majority (about 70 percent) of all survey respondents thought the legal environment for investors in the United States provides adequate or very good legal protections to investors, while just over 15 percent of all respondents believe that the legal protections in the United States are poor or less than adequate.

Survey Participant Comments

Positive Comments

“Considering the fact that in the end the investor is responsible for his decisions and having done the proper due diligence or hired someone to do the diligence, there are very good legal protections that do exist.”

—Investment Consultant

“Strong jurisdiction, but high legal costs can be onerous.”

—Investment Banker

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Negative Comments

"Frivolous lawsuits abound in the U.S.; the U.S. lawyers are out of control."

—Chief Financial Officer

"Too much predatory legal action."

—Investment Product Developer

"Very little of the fines/restitution gets back to the actual investors/clients that we deal with daily."

—Fund/Portfolio Manager

"At least on paper. The arbitration clauses make it hard for small investors to press their cases."

—Buy-Side Analyst

"Arbitration needs to be more even between parties."

—Educational

Two Respondents Gave the Exact Same Answer

"It depends on the size of the investor."

—Investment Consultant

"It depends on the size of the investor."

—Chief Financial Officer

9. Effective Corporate Governance

Please rate the strength of corporate governance standards in this market.

	Total	In U.S.	Outside U.S.
Poor	7%	8%	4%
Less than Adequate	22%	24%	18%
Adequate	38%	38%	37%
Very Good	27%	24%	34%
Excellent	6%	5%	7%
Rating	**3.04**	**2.94**	**3.23**
Total Respondents	**742**	**498**	**244**

Note: Percentages may not add up to 100 because of rounding.

The survey participant group as a whole rated governance standards in the United States just above adequate, while those in the United States rated governance standards in the United States slightly lower.

Roughly 32 percent of survey participants in the United States thought that the current level of corporate governance in the United States is poor or less than adequate.

Those outside the United States rated the overall governance at 3.23, safely in the adequate range.

Nearly 30 percent of all survey respondents saw governance standards in the United States as poor or inadequate.

Survey Participant Comments

Positive Comments

"Shareholder activism and improvements in corporate governance guidelines have improved ethical behavior in recent years."

—Investment Consultant

"Separation of CEO/Chair is needed—but much better than it used to be."

—Educational

"Improvements have been made, but there is still work to be done."

—Plan Sponsor

Negative Comments

"Very few corporations exhibit the governance that their shareholders deserve (usually those with activist large shareholders). Shareholder activism is difficult and expensive for most institutional investors and virtually impossible for retail investors."

—Sell-Side Analyst

"'Corporate governance' has become an oxymoron, much like 'military intelligence.' Boards have become so inbred that they are more concerned about keeping the status quo [so] that the companies and shareholders are suffering. I believe what we are reading in the headlines is the tip of the iceberg. There needs to be more accountability to shareholders, and the increased activity of 'activist' institutional shareholders is, perhaps, the first sign of things to come."

—Fund/Portfolio Manager

"It is a great mystery why the very owners of the company cannot elect the directors that run the company by a majority vote. Why does the greatest capitalist country in the world still have totalitarian elections for directors?"

—Buy-Side Analyst

"Corporate governance is deeply flawed in the U.S. The current system's main role is to protect the interests of executive management."

—Sell-Side Analyst

"Excessive CEO compensation and perks do not align with adding shareholder value, and boards perpetuate it."

—Corporate Treasurer

"The SEC needs to press harder for independence of mutual fund boards. Have you ever seen a fund board get rid of an advisor?"

—Buy-Side Analyst

"SOX does some good things; but section 404 provisions are overwhelming and need to be restructured."

—Fund/Portfolio Manager

"Recent rise of shareholder activist funds and their pursuit of the board of director positions is concerning."

—Buy-Side Analyst

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10. Financial Transparency

Please rate the overall level of financial transparency in this market.

	Total	In U.S.	Outside U.S.
Poor	2%	3%	1%
Less than Adequate	17%	19%	11%
Adequate	33%	32%	37%
Very Good	37%	35%	40%
Excellent	11%	11%	10%
Rating	**3.37**	**3.32**	**3.48**
Total Respondents	**757**	**505**	**252**

Note: Percentages may not add up to 100 because of rounding.

About 46 percent of those in the United States rated financial transparency in the United States very good or excellent.

Those outside the United States saw this aspect of U.S. financial market integrity in a more favorable light than did those inside the United States.

Few survey participants cited financial transparency in the United States as poor, although nearly 20 percent of all respondents thought the current state of financial transparency in the United States was poor or less than adequate.

Survey Participant Comments

Negative Comments

> "Financial transparency is good but always needs improving. Much like regulation, required disclosures are reactive not proactive. This is because companies do not want to discuss the bad things, but this is exactly the information that investors need to hear. Sometimes the need to improve disclosure is the result of companies trying to hide things. Other times, changing markets mandate that new information be disclosed."
>
> —Fund/Portfolio Manager

> "Financial transparency should include transparency with respect to other stakeholders, such as the environment. Externalities should be more systematically incorporated in stakeholder reports."
>
> —Fund/Portfolio Manager

> "The average investor is at a disadvantage with little to no transparency. Hedge funds don't offer transparency, the short interest is not available to common investors except monthly, the DTCC does not offer transparency in Fail to Delivers, over-voting, etc."
>
> —Fund/Portfolio Manager

> "Absurd complexity of U.S. GAAP leads to significant 'gaming of the GAAP system.' Fasten your seatbelt for the coming bursting of the 'private-equity bubble.'"
>
> —Private Equity Analyst

> "Although the level of material contained in the notes of most documents is good, the increasing complexity of certain regulations (FAS 133, FAS 149, etc.) is making the interpretation of some financial information a bit more difficult. Granted these standards are being designed to handle the ever growing complexity of the financial markets, it would just be nice to see some notes written more in plain English that an average investor could understand."
>
> —Fund/Portfolio Manager

> "The information may be there, but burying things you 'have' to disclose is not transparent."
>
> —Fund/Portfolio Manager

CORRELATIONS

U.S. Answer Correlations

	Overall Behavior	Sell-Side Analysts	Money Managers	Hedge Funds & Private Equity	Corporate Boards	Corporate Executives	Regulatory Protections	Legal Protections	Corporate Governance	Financial Transparency
Overall Behavior	1.0000	0.5900	0.6013	0.4459	0.5010	0.5199	0.5686	0.4930	0.5020	0.5050
Sell-Side Analysts	0.5900	1.0000	0.5392	0.5004	0.4829	0.5300	0.4867	0.3774	0.4640	0.3988
Money Managers	0.6013	0.5392	1.0000	0.5127	0.5224	0.5256	0.5148	0.4372	0.4777	0.4772
Hedge Funds & Private Equity	0.4459	0.5004	0.5127	1.0000	0.4762	0.4845	0.4189	0.3782	0.4239	0.3653
Corporate Boards	0.5010	0.4829	0.5224	0.4762	1.0000	0.7263	0.5553	0.4584	0.6322	0.4784
Corporate Executives	0.5199	0.5300	0.5256	0.4845	0.7263	1.0000	0.5229	0.4286	0.6092	0.4923
Regulatory Protections	0.5686	0.4867	0.5148	0.4189	0.5553	0.5229	1.0000	0.6216	0.6168	0.5798
Legal Protections	0.4930	0.3774	0.4372	0.3782	0.4584	0.4286	0.6216	1.0000	0.5595	0.5696
Corporate Governance	0.5020	0.4640	0.4777	0.4239	0.6322	0.6092	0.6168	0.5595	1.0000	0.5800
Financial Transparency	0.5050	0.3988	0.4772	0.3653	0.4784	0.4923	0.5798	0.5696	0.5800	1.0000

The correlation between answers for the questions concerning the ethical behavior of boards and the ethical behavior of executives is higher than that of any other two questions in the survey for the U.S. market, at 0.7263. Most correlations fall between 0.4500 and 0.5500.

In general, answers to questions about the ethical behavior of individuals tended to be more highly correlated with each other than they were with answers concerning market foundations.

It comes as little surprise that corporate governance protection answers show relatively high correlations with answers for corporate boards (0.6322) and corporate executives (0.6092) because boards and executives often set some of the corporate governance standards at companies in this market. The regulatory protections answers are also relatively highly correlated with those for corporate governance (0.6168).

Legal protections also tend to be relatively highly correlated with regulatory protections (0.6216).

A perfect positive correlation of 1 would demonstrate that all survey participants gave the same answers for those two questions. A perfect negative correlation of –1 would signal that all survey participants provided diametrically opposed answers to these questions.

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METHODOLOGY AND PARTICIPANT STATISTICS

Methodology

The Financial Market Integrity Index is based on answers provided by our survey respondents to a questionnaire that yields an overall "market integrity" score for each of the markets surveyed. Participants answered 10 questions on a five-point scale (1 = Poor to 5 = Excellent) that were aggregated to arrive at an overall country score. Comments were also collected from survey participants to better communicate the insight of CFA Institute members. Because not all survey participants possess the expertise to answer every question, in addition to the five-point scale, survey participants were given the option to answer "don't know/not applicable" if they thought they did not possess the requisite knowledge or expertise to answer a particular question.

The CFA Institute membership will participate in this survey on an ongoing basis. The population of each survey will change, however, as new members join CFA Institute and some survey participants fail to answer the survey or drop out of the survey pool.

Survey participants stated that, on average, the survey took approximately 15–20 minutes to complete. To encourage better comparability between answers among survey participants for each individual question, a short definition of what was being discussed in each question was given to survey participants before they answered each question. This more detailed example of these questions is what survey participants saw when they took the survey. For example, the question asking about effective legal protections in a market was followed by a brief definition of what is meant by "effective legal protections." The full questions and question definitions as seen by survey participants are listed below.

1. **Please rate the overall quality of ethical behavior by all of those who interact with and contribute to the financial integrity within this market.**

A market characterized by ethical behavior has sufficient controls in place to guard against unethical behavior. In such a market, conflicts of interests are not tolerated if they could harm the interests of shareowners. Firms operating in a highly ethical marketplace expect ethical behavior from their employees and supply employees with the ethical training necessary to ensure a principled market.

2. **Please rate the overall level of ethical behavior exhibited by analysts (sell side) and the analyst community (sell side).**

Analysts with a high level of ethical integrity are independent, not letting potential conflicts of interest and outside influences other than their diligent research color their opinions. Such analysts put the interests of their clients above those of their firms and issue research reports unbiased by investment banking or any company relationships.

3. **Please rate the overall level of ethical behavior exhibited by money managers (the buy side) and mutual fund companies, collective fund schemes, or unit trusts.**

Buy-side money managers that exhibit a high level of ethical integrity act in the best interests of investors first and foremost and do not place other interests or incentives (compensation, internal firm conflicts) above those of producing returns for their shareholders. Mutual fund companies, collective fund schemes, or unit trusts that exhibit high ethical standards are structured so that money managers are chosen using "arms-length" transactions that are intended to best benefit shareowners first and foremost. A highly ethical money management industry provides shareholders and potential shareholders with enough information to make informed investment decisions.

4. **Please rate the overall level of ethical behavior exhibited by private equity and hedge fund professionals.**

Private equity and hedge fund professionals operate in environments that are generally less heavily regulated than those of their buy-side and sell-side compatriots. Private equity and hedge fund professionals that act in an ethical and professional manner do not use a lower level of regulatory oversight as a license to take advantage of their clients. Highly ethical private equity and hedge fund professionals do not break financial market rules or cross ethical lines in their attempts to earn higher returns.

5. **Please rate the overall level of ethical behavior exhibited by corporate boards of public companies.**

Boards that exhibit integrity are independent of management and do not engage in relationships with management that could compromise the independence of a board member. If such related-party relationships do exist, board members with high levels of integrity remove themselves from decisions in which a conflict of interest exists. Markets in which boards have the ability to act with high levels of integrity allow boards to act in the interests of shareowners and put controls in place to avoid the dominance of board members by management.

6. **Please rate the overall level of ethical behavior exhibited by the executive management of public companies.**

Executives with a high level of integrity work to build long-term value for shareowners and do not routinely engage in empire building or other self-serving endeavors that put their own interests above those of their shareowners. Such managers look to align their interests with those of the company's shareowners and do not look to manipulate a company's financial position to their own benefit if such action would be to the detriment of company shareowners.

7. **Please rate the extent to which this market has effective regulators in place.**

Regulators that champion integrity and look to foster ethical behavior protect the interests of shareholders by ensuring timely and transparent corporate disclosures. Such regulators do not tolerate market inefficiencies and conflicts of interest that may be harmful to shareowners. A strong regulatory body also vigorously enforces its regulatory standards in order to ensure compliance, and it does not allow those it regulates to work around regulation or flout the rules with little or no penalty.

8. **Please rate the extent to which this market offers effective legal protections to investors.**

A developed legal system gives investors the ability to protect their ownership rights; this may include the ability to bring a suit against the board or management or the corporation itself. A market with effective legal protections provides for the initiation and adjudication of claims and does not place onerous legal hurdles in the way of investors in order for them to have their ownership rights protected.

9. **Please rate the strength of corporate governance standards in this market.**

A market with strong corporate governance standards ensures that the interests of directors and management are sufficiently aligned with shareowners. This market does not allow the interests of management or another interested party to dominate those of shareowners. A market in which companies exhibit an appropriate level of governance controls also allows corporations to develop sustainable businesses that can reward shareowners over the long term while not allowing management or other parties to compromise the prospect of long-term shareowner wealth creation. Corporate governance best practices include independent boards and committees with adequate oversight over company management, adequate accounting and internal control oversight, and sufficient links between executive compensation and company performance.

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10. Please rate the overall level of financial transparency in this market.

Financial disclosures should be complete, accurate, and relevant, providing shareowners with the sufficient and detailed information they need to make an informed investment decision. An adequately financially transparent market does not allow corporate enterprises to routinely obfuscate their true financial position, thus leaving shareowners or potential shareowners with a less than optimal understanding of a company's true financial position.

Survey Participant Statistics

The survey population for these reports totaled 805 individuals. The demographic breakdown of this population is as follows:

Profession	
Fund manager or portfolio manager	36%
Buy-side analyst	16%
Investment consultant	10%
Sell-side analyst	7%
Investment banker	4%
Risk officer or risk analyst	2%
CEO, CFO, or CIO	2%
Financial analyst	2%
Educational	1%
Credit manager or credit analyst	1%
Investment advisor	1%
Plan sponsor	1%
Other	17%
Types of Assets Analyzed or Purchased in Profession	
Equity securities	30%
Both equity and fixed-income securities	29%
Fixed-income securities	16%
Alternative assets (derivatives, options, swaps)	5%
Hedge funds and/or fund of funds	4%
None of the above	4%
All of the above	2%
Other	10%
CFA Charterholders	
CFA charterholder	85%
CFA Institute member—not charterholder	15%
Average Assets under Management of Those Survey Participants Who Manage Money	
USD 50 Billion or more	8%
USD 20 Billion – USD 50 Billion	5%
USD 5 Billion – USD 20 Billion	13%
USD 1 Billion – USD 5 Billion	23%
USD 250 Million – USD 1 Billion	22%
Less than USD 250 Million	29%

Other Survey Participant Data

Inside the United States: 508

Outside the United States: 297

Average age: 41.06

Average years as charterholder: 7.6