

2008 FINANCIAL MARKET INTEGRITY INDEX

UNITED KINGDOM

CFA Charterholders and Professional Integrity

With offices in Charlottesville, VA, New York, Hong Kong, and London, CFA Institute is the not-for-profit, professional association of 98,000 financial analysts, portfolio managers, and other investment professionals in 128 countries, of whom 84,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute Centre for Financial Market Integrity is the research, policy, and advocacy arm of CFA Institute.

The CFA designation 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, including ethics and professional standards, and must complete several years of qualifying financial work experience to earn the charter. To retain the designation, CFA charterholders also must annually renew their pledge to adhere to the CFA Institute Code of Ethics and Standards of Professional Conduct.

In 2002, when CFA Institute and the United Kingdom Society of Investment Professionals partnered, UKSIP members were adopted into CFA Institute and holders of the corresponding FSIP and ASIP designations were accepted into CFA Institute membership based on the comparable level of rigor needed to obtain these designations. Although all CFA Institute members adhere to an ethical standard, only CFA, FSIP, and ASIP designees also have displayed a level of mastery in investment principles. Therefore, this research does not include responses from all CFA Institute members but, rather, only from those who are active members with CFA, FSIP, or ASIP designations; all will be referred to collectively as “charterholders” throughout this report.

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Introduction

Value of the FMI Index

The Financial Market Integrity Index (the FMI Index) was developed by the CFA Institute Centre for Financial Market Integrity (the CFA Institute Centre) to gauge the perceptions investment professionals have about the state of ethics and integrity in six major financial services markets. Specifically, the index measures the level of integrity that investment practitioners experience in their respective markets—Canada, Hong Kong, Japan,

The FMI Index is distinguished from other market surveys and is proprietary in that it capitalizes on our exclusive access to seek the opinion and perspective of the CFA Institute membership (see inside cover for details). Charterholders are investment professionals who have earned the CFA, FSIP, or ASIP designation and are required to adhere to a stringent code of ethics. The informed opinion of this particular respondent group offers

The Financial Market Integrity Index was developed to gauge the perceptions investment professionals have about the state of ethics and integrity in financial services markets.

Switzerland, the United Kingdom, or the United States—and the practitioners' beliefs in the effectiveness of regulation and investor protections to promote such integrity. This pragmatic input from working investment professionals will help raise awareness of leading issues in the capital markets and will inform the work of the Centre in conducting regulatory outreach and developing enhanced professional standards.

valuable insight into the current state of ethical practices and standards in select global markets and will help to inform regulators and other financial industry thought leaders concerning potential areas for improving the investment profession.

The CFA Institute Centre provides this report on the findings of the survey (the Report) to advance the cause of ethics and integrity in financial markets

*The CFA Institute Centre
provides this report to advance
the cause of ethics and integrity
in financial markets.*

through the views and opinions of trained investment professionals so as to:

- Inform investors and regulators of the perceived ethics and integrity of practitioners and the effectiveness of regulatory systems in the market;
- Encourage investors to consider whether they are likely to be treated fairly and ethically if they invest in the market;
- Help assess whether a particular country or market has specific integrity issues that need to be addressed by regulators; and
- Inform practitioners in the market about how others perceive their actions and honesty, in general, and to stimulate remedial actions on their part where appropriate.

Each FMI Index Report measures the sentiments expressed by a cross section of survey respondents concerning ethical standards and investor protections of a particular market. The ratings discussed in this Report represent the opinions of a distinct group of professionals, charterholders, responding to a series of questions about their experiences with practitioners, regulations, and investor protections in the United Kingdom. This survey was specifically designed to gather the perceptions of only the U.K. market. Because respondent populations differ significantly between markets, we believe it will be more valid and informative to assess each country's report independently of the others, rather than trying to make cross-country comparisons.

About the FMI Index Methodology

The FMI Index is constructed to give equal weight to two dimensions of evaluation: (1) the ethics of market participants and (2) the effectiveness of market systems in ensuring market integrity.

The CFA Institute Centre, in consultation with Harris Interactive, developed the FMI Index to specifically reflect the perspectives and opinions of investment professionals identified as being committed to the highest level of professional ethics. CFA charterholders and holders of the ASIP and FSIP designations were asked to evaluate and rate a number of financial “market participants,” including sell-side analysts, hedge fund managers, board

members, and others, and “market systems,” such as market regulation and investor protections, including corporate governance, shareowner rights, and transparency. The questions relate to how market participants and market systems contribute to financial market integrity. Respondents were asked to answer a number of questions that rate on a five-point scale the ethical behaviour of these market participants and systems.¹

FMI Index Questions and Rating Scales

Please rate the overall ethical behaviour exhibited by the following groups in the United Kingdom.



For each of the following, please rate the overall effectiveness of market systems for ensuring market integrity in the United Kingdom.



Figure 1

The ethical behaviour of market participants and the effectiveness of market systems were the two dimensions of evaluation that produced the final FMI rating.

More than 2,000 professionals in six countries who hold the CFA, FSIP, or ASIP designations participated in the research by taking the survey either online or by scripted telephone interview between 2 April and 8 May 2008.

To provide the most statistically reliable opinions, this Report will use in-market ratings when referring to an index rating or score, unless otherwise noted.²

Out-of-market ratings will be used for discussion and comparisons only where noted because these results are statistically less significant as a result of smaller sample sizes.

The FMI Index is constructed to give equal weight to two dimensions of evaluation: (1) the ethics of market

participants and (2) the effectiveness of market systems in ensuring market integrity. Data gathered during phone interviews were transformed so that they could be integrated with online responses. This is an opinion-based survey, and CFA Institute makes no representations concerning accuracy or otherwise warrants use of the FMI Index for any purpose by readers.

For more comprehensive information regarding the overall FMI Index methodology, please refer to the full report available on the Centre's website at www.cfainstitute.org/centre.

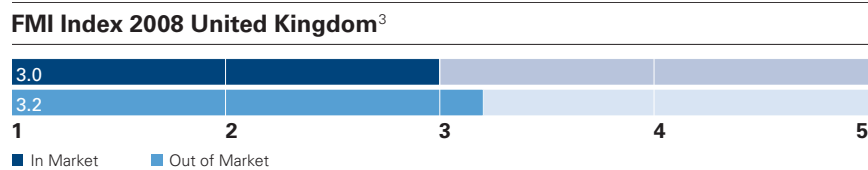
¹ One question dealing with severity of unethical behaviour or ethical lapses was an exception and listed a score of 1 as not severe at all and 5 as extremely severe. This question did not figure in the final calculations of the FMI rating.

² In this Report, in-market ratings are those from respondents inside the United Kingdom and out-of-market ratings are those given by respondents outside the United Kingdom.

Executive Summary

Figure 2

Respondents inside the United Kingdom gave the U.K. market a lower overall FMI rating (3.0) than did those outside the United Kingdom (3.2).



Given that the U.K. market is considered to have some of the highest regulatory and investor protection standards in the world, it is somewhat surprising to see the final FMI Index rating (see **Figure 2**) for the United Kingdom come in at exactly the mid-range score of 3.0 on a five-point scale.⁴

Based on respondent comments collected in the research, transparency and insider trading appear to be primary areas of concern. Those outside the United Kingdom had a slightly more favourable view of the effectiveness of regulatory and investor protections than did those inside the United Kingdom.

This rating suggests that respondents see room for improvement in the state of ethics and integrity in the U.K. market.

Conclusions

- The overall mid-range ranking of 3.0 that respondents assigned to market integrity signals that there is room for improvement both in the ethical behaviour of financial professionals and the effectiveness of market systems.
- Respondents generally rated the components of ethical behaviour of financial professionals in the United Kingdom higher than they rated the components of effectiveness of capital market systems.
- Based on ethics and integrity alone, nearly 72 percent of in-market respondents were either likely or very likely to recommend investing in U.K. markets, whereas those outside the United Kingdom were slightly less favourable, at 66 percent.
- Respondents provided open-ended comments in addition to their survey rankings that indicate insider trading and transparency are top areas of concern among investment professionals in the United Kingdom.
- Those outside the United Kingdom consistently rated the regulatory and investor protections slightly higher than did those inside this market; these differences are more pronounced in the areas of regulatory protections and financial transparency standards, whereas those outside the United Kingdom rated these market systems significantly higher than did those inside the market.

Based on ethics and integrity alone, nearly

72%

of in-market respondents are likely to recommend investing in U.K. markets.

³ A market's overall rating is composed of the 10 factors that make up the financial professionals rating and the 7 factors that make up the market systems rating. The final, overall rating for this market was created by taking the average rating or score from two sets of questions. The first question set contained 10 equally weighted components from a set of questions pertaining to investment professionals (i.e., market participants). The second question set contained 7 equally weighted components of questions pertaining to the effectiveness of capital market systems in ensuring market integrity. These two sets of questions were averaged as a set, and then each set carried equal weighting in the final determination of the FMI Index rating for this market.

⁴Final rating is based on in-market ratings.

Key Findings

Ethical Behaviour of Individuals

The first group of FMI Index questions asked the respondents their opinions concerning the ethical behaviour exhibited by various financial professionals—also referred to as “market participants”—in the market over the past year. The “all financial professionals” category received an above-average rating of 3.4. This rating is not simply an average of

the nine ratings linked to the ethical behaviour of specific professions but was asked separately as a control question. (The *average* rating of the nine professions is 3.1.)

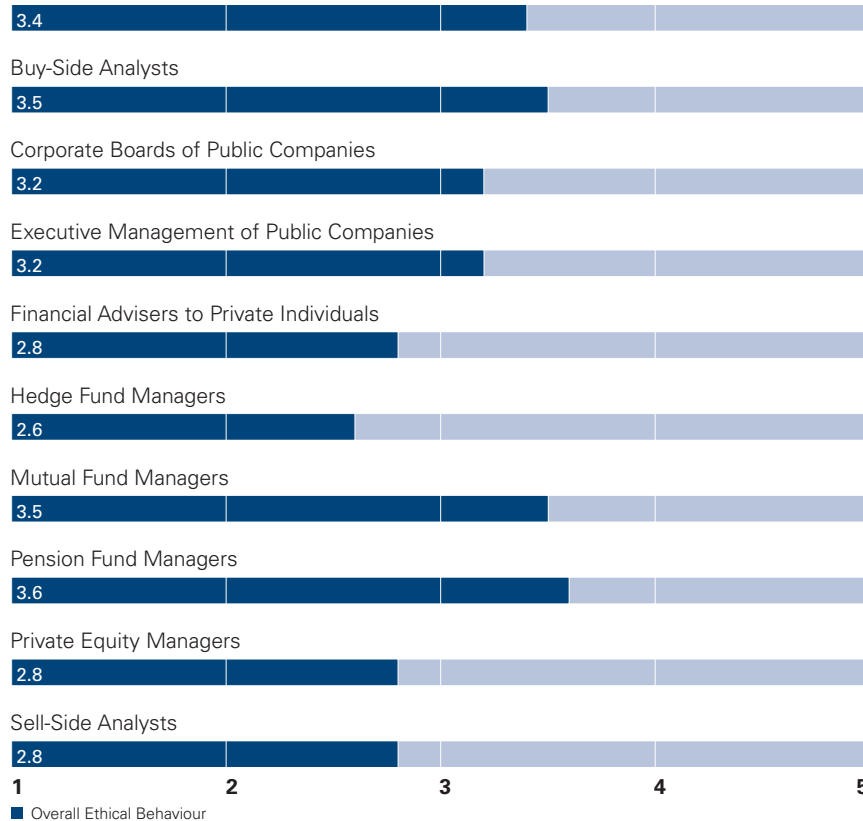
Of the nine professions listed in **Figure 3**, the ethical behaviour of hedge fund managers rated lowest at 2.6, although such a rating is not

Figure 3

Respondents were asked to rate the ethical behaviour of financial professionals as a whole, as well as the ethical behaviour of specific financial professionals.

Ethical Behaviour of Individual Market Participants

All Financial Professionals



unique to the U.K. market; hedge fund managers consistently rated below 3.0 in each of the six markets surveyed. Pension fund managers received the highest marks at 3.6.

Respondents rated the integrity of pension fund managers, mutual fund managers, and buy-side analysts more highly than the control question of “all financial professionals.” Financial advisers, private equity managers, sell-side analysts, and hedge fund managers all rated below a 3.0 or “somewhat ethical” overall.

In the United Kingdom, a high proportion of charterholders self-identify as being buy-side professionals; 55 percent of survey respondents in the United Kingdom consider themselves

buy-side professionals.⁵ It is, therefore, important to note that buy-side respondents rated the buy-side analysts a 3.5, a score no different from that given by the respondent population as a whole.

There is a small difference between how sell-side analysts rate themselves and how the rest of the respondents rate them. Sell-side analysts earned a rating of 2.8 from the entire survey population but a 3.1 from those who call themselves sell-side analysts. In the United Kingdom, 15 percent of those who answered this survey considered themselves sell-side professionals.

When given the opportunity to provide open-ended comments on issues or

⁵Please see demographic data at the end of this Report for more details about this survey.

Ethical Behaviour of Individuals

(continued)

“
Being treated fairly—insider dealing is something they should be concerned about because regulations are not being enforced. There are laws in place, but we rarely see convictions, but it goes on. Regulations are not enforced properly. This goes hand in hand with how market sensitive information is disseminated. There is an issue with how fairly investors have access to information that is made public.

— Survey Respondent

”

behaviours that they thought needed to be addressed, respondents most often noted insider trading and challenges related to conflicts of interest.

Of the more than 175 respondent comments received, greater than 1 in 10 commented on the issue of insider trading.

In the time since the administration of this survey (April and May 2008), there have been increased instances of the Financial Services Authority taking action against insider trading in the United Kingdom. Therefore, we will have to revisit this issue with the findings of the 2009 FMI Index to see if this issue is truly a systemic market weakness that remains a concern in 2009 or if respondents were particularly sensitised to the issue at the time of this survey.

Effectiveness of Regulatory and Investor Protections

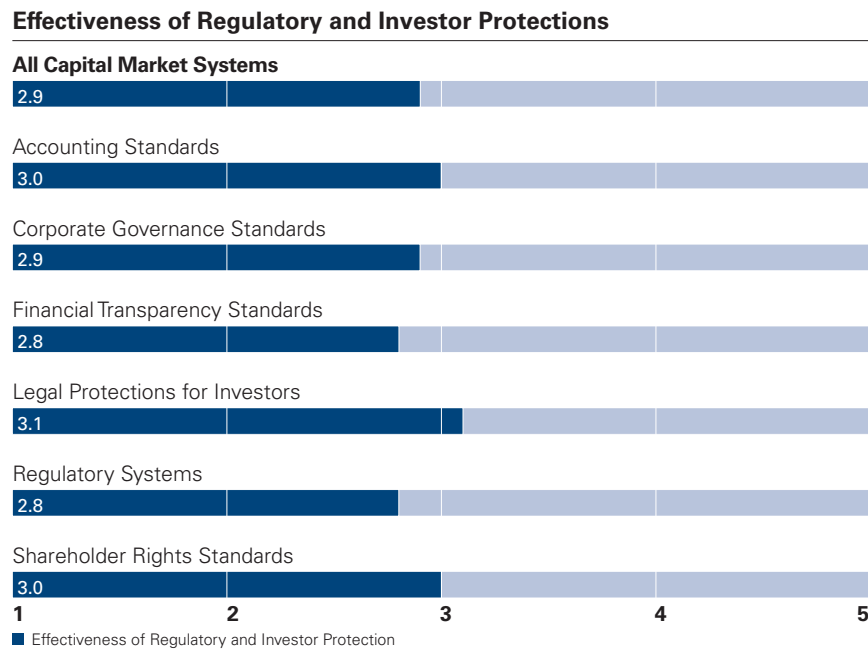
The second group of FMI Index questions asked the respondents their opinions concerning the effectiveness of regulatory and investor protections in the market over the past year. In the control question seeking ratings of “all capital market systems,” this group of investor protections received a less-than-adequate rating of 2.9. This control question rating was the same as the *average* aggregate rating of 2.9 earned by the group.

When given the opportunity to provide open-ended comments on issues or behaviours that they thought need to

be addressed, respondents most often noted challenges related to regulatory systems and transparency. A number of those who commented on the U.K. regulatory system stated that the current system could be made more effective through tighter enforcement measures.

In addition to issues related to regulation, respondents appeared most concerned with the current level of transparency in the United Kingdom. These concerns may reflect a lack of confidence in the current regulatory system and level of transparency in

Figure 4
 Respondents were asked to rate the overall effectiveness of capital market systems as a whole, as well as the effectiveness of specific systems and standards.



“
We have always lived in a world where the power of the market was deemed sufficient, but the latest debacle is one of a long line that highlights the triple whammy of governance failure, market failure, and regulatory failure. Light touch regulation is akin to no touch where monitoring and enforcement is totally inadequate.

— Survey Respondent

”

Effectiveness of Regulatory and Investor Protections

(continued)

the United Kingdom because some think that the banks and regulators were slow to acknowledge the damage caused by the subprime contagion begun in the United States. Comments about transparency ranged from requests for more transparency about fees to better transparency about the pricing of complicated financial interests. The most common thread that ran through comments about transparency concerned a desire

for more transparency from corporations about their financial prospects.

Respondents also were asked two subquestions about capital market systems that were distinct from the final financial market integrity rating of 3.0 for the United Kingdom. These questions were designed to further illuminate some of the reasoning behind the individual scores given to the various market system compo-

“
They could improve the quality and integrity of information provided.... Information often lacks depth and accuracy. Information tends to be skewed, ignoring the downside.

— Survey Respondent

”

nents. The first subquestion asked about the effectiveness of capital market regulation policies themselves. Specifically, we sought respondents' perceptions on whether the regulations and investor protections available in the market represent industry standard or best practice and if implemented correctly, whether those market systems offer a solid framework for investor rights. Respondents rated these regulations and policies as "good" by assigning an average rating of 3.0 out of 5.0.

The second subquestion focused on the effectiveness of implementation or enforcement of such regulations and policies. Respondents showed slightly less confidence in effective enforcement of existing regulations and policies than they did in the adequacy and level of regulation and policies. Respondents rated the enforcement process in the United Kingdom 2.8 out of 5.0.

“

Dissemination of information, corporate disclosures need to be more transparent, [there] needs to be greater corporate executive accountability.

— Survey Respondent

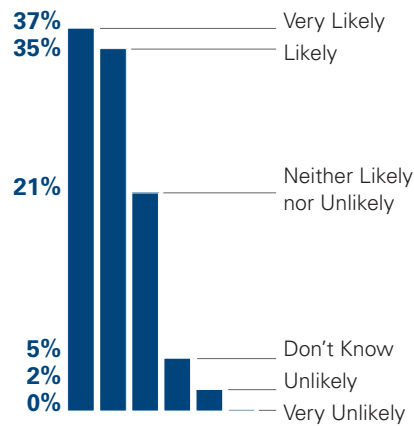
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Willingness to Invest in the United Kingdom

To test the connection between confidence in market participants and systems and the willingness to invest in the United Kingdom, we asked respondents about their willingness to recommend investing in the U.K. markets based solely on the ethical

behaviour of financial professionals and the effectiveness of capital market systems. The results demonstrated in **Figure 5** allow us to compare respondents' willingness to invest against the ratings they assigned to the integrity of the market participants and systems in the United Kingdom.

Figure 5
Likelihood of in-market respondents to recommend investing in the United Kingdom based solely on the ethical behaviour of market participants and the effectiveness of capital market systems.



Based Solely on Ethical Behaviour and Capital Market Systems, Would You Recommend Investing in the United Kingdom?

When asked whether they would recommend investing in the U.K. market based solely on the ethical behaviour of financial professions in the market and the regulatory and investor protections offered there, nearly 72 percent of charterholders in the United Kingdom said they were likely or very likely to make such a recommendation. Only about 2 percent said they were unlikely or very unlikely to invest based on the same criteria.

Respondents outside the United Kingdom were only slightly less enthusiastic, with 67 percent stating

that they were likely or very likely to invest based solely on their perception of ethical behaviour and investor protections.

As noted earlier, respondents assigned mid-level ratings to the overall integrity of market participants and systems, yet their willingness to invest rates considerably higher. Although U.K. respondents see a need for improvement in the ethical behaviour of market participants and the effectiveness of market systems, these issues are not so serious as to preclude investing in the United Kingdom. One possible explanation for the apparent difference is that, despite some specific concerns about such issues as conflicts of interest and insider trading, and the need for a more robust regulatory system, respondents in the United Kingdom remain confident that putting their capital into this market is preferable to other options.

A number of scores throughout this Report seem lower than expected given that the United Kingdom arguably offers investors some of the world's strongest regulatory, enforcement, governance, and legal protections. Considering current market circumstances, investors may have lost confidence in the policies and enforcement procedures that are meant to ensure fair dealing in the capital markets. This raises the interesting question of whether bear markets or financial crises call into question the quality of, or expose weaknesses in, existing regulation that might otherwise go unnoticed in stable or bull markets. Are respondents' concerns about ethical lapses or regulatory weaknesses simply caused by the negative attention on troubled markets, or are those weaknesses real? Our FMI Index data will help assess these questions over time.

Other Key Survey Considerations

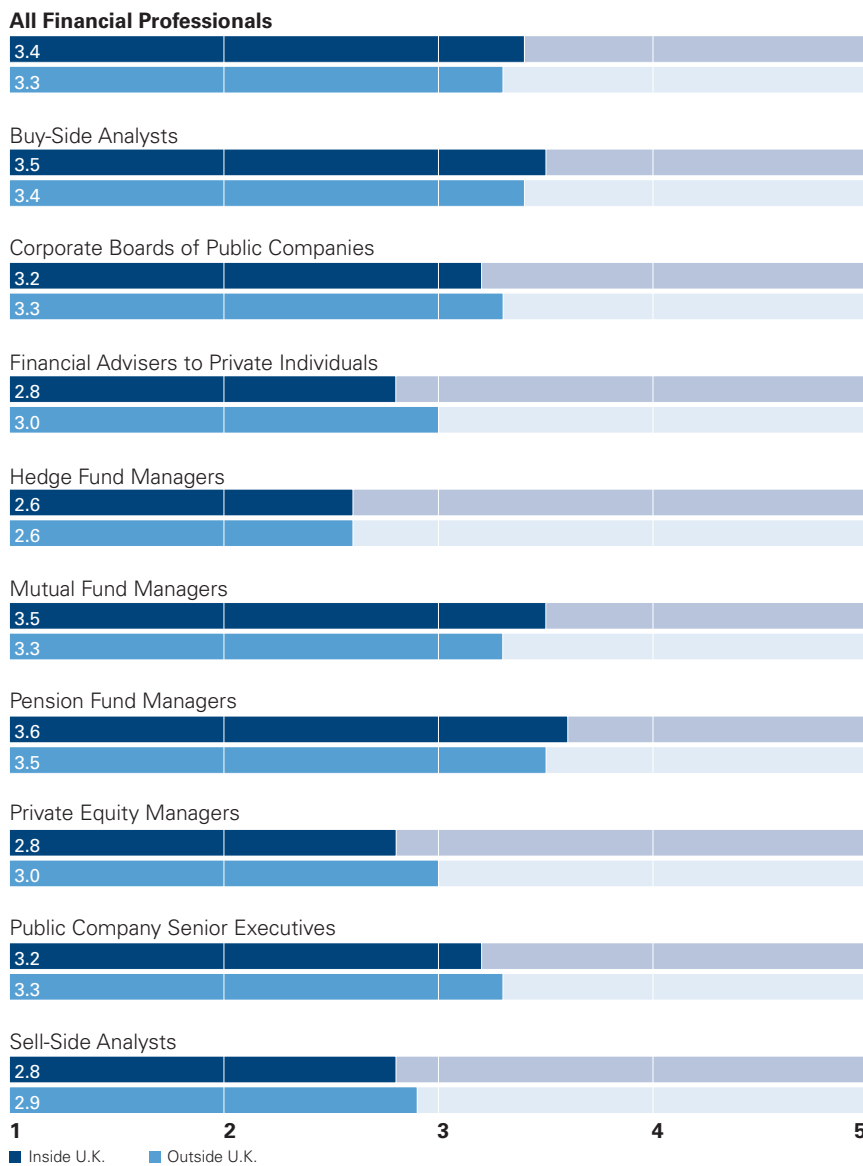
In-Market vs. Out-of-Market Perceptions

Charterholders from the five other markets we surveyed (Canada, Hong Kong, Japan, Switzerland, and the United States) were given the opportunity to rate and comment on the U.K. market. (Survey respondents were given the option to skip questions pertaining to any market about which they did not think they were knowledgeable.)

Respondents outside the United Kingdom rated the behaviour of financial professionals about the same as did those inside the United Kingdom (see **Figure 6**). In fact, ratings from inside and outside the United Kingdom were within 0.1 points of each other on all but three occasions (private equity managers, mutual fund managers, and financial advisers).

Ethical Behaviour of Individual Market Participants

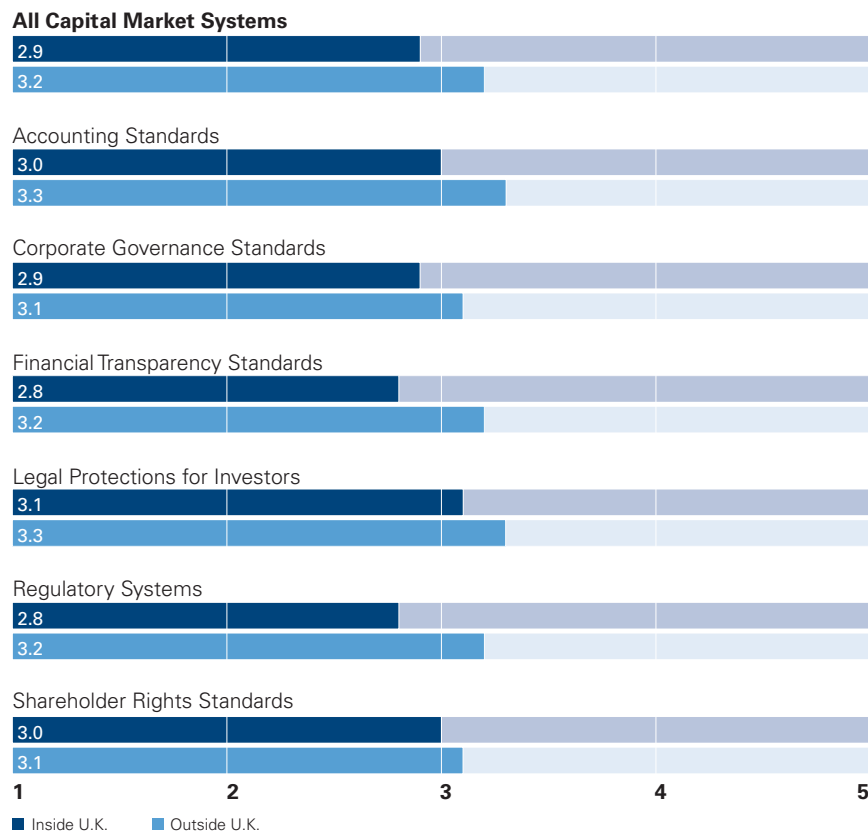
Figure 6



In-Market vs. Out-of-Market Perceptions

(continued)

Figure 7 Effectiveness of Regulatory and Investor Protections



The uniformity of opinion between those inside and outside the United Kingdom drops with the ratings concerning the effectiveness of regulatory and investor protections. As shown in **Figure 7**, respondents outside the United Kingdom rated the control question on effectiveness of “all capital market systems” higher than did those within the United Kingdom.

This difference in opinion likely reflects the fact that many outside the United Kingdom still hold the U.K. system of regulatory and investor protections in relatively high esteem. It is also understandable that in the wake of market

turmoil brought on by the credit crunch in the United States—symbolized in the United Kingdom by the Northern Rock crisis and allegations of market abuse during rights issues for some of the leading banks—that some within the U.K. market may have lost faith in their system of regulatory controls and investor protections.

It is also interesting to note that the two categories that differ the most between out-of-market and in-market opinion are regulatory systems and transparency, the two market systems that garnered the most comments from respondents.

Comments of Survey Respondents

Respondents were given opportunities in connection with several of the survey questions to provide written comments about their thoughts and concerns. In particular, additional comments were solicited in the survey section concerning individual market participants and again after questions concerning market systems. At the completion of the survey, respondents also were asked what additional or specific issues investors should be

concerned about and for any other comments.

Respondents provided more than 175 substantive comments; those stating something to the effect of “no answer” or “nothing to add” were excluded.

The various responses were examined and then categorized based on the main concern of each comment (e.g.,

Figure 8

Survey respondents commented most about conflicts of interest, regulations/regulatory system, transparency, and insider trading.

Issues Raised Most Frequently

Conflicts of Interest	18 comments
Insider Trading	20 comments
Regulatory Systems	21 comments
Transparency	20 comments

“*Regulatory systems (Bank of England, FSA, Treasury) were not very transparent with the handling of the Northern Rock crisis.*”

— Survey Respondent

”

corporate governance, transparency, fraud). The key areas of comment and the topics raised most often are highlighted in **Figure 8**. In instances where an individual raised more than one concern, we identified the primary concern for this Report and noted any secondary or tertiary concerns, although these do not appear in Figure 8.

Regulation

We received the most comments on the current regulatory system in the United Kingdom. Although the comments received were diverse in nature, and some respondents simply wrote “regulation” or “regulatory system” as a cause for concern, it is interesting to note that a number of respondents noted the Northern Rock crisis as a symptom of a regulatory system in need of some improvement.

Transparency

Comments on the topic of transparency covered a number of issues. Respondents commented on the lack of transparency of hedge funds, the need for greater transparency in asset pricing, the need for a higher level of transparency in financial products sold to the public, and the need for greater transparency to combat insider trading.

That transparency continues to be an issue of such great concern to respondents in one of the most sophisticated markets in the world demonstrates that there are a number of areas with room for improvement.

“
*In the wake of Northern Rock
it is difficult to have much
confidence about the workings of
the regulatory environment.*

— Survey Respondent

”

Comments of Survey Respondents

(continued)

Insider Trading

The United Kingdom was the only market (of the six markets surveyed) in which insider trading was cited by respondents as a primary area of concern.

Many respondents who cited this as an area of concern simply wrote “insider trading” in the box reserved for their comments. Respondents who did elaborate tended to connect the issue with that of transparency, or more precisely, a lack of transparency.

“
*There should be greater
transparency and a reduction
in market abuse and insider
trading.*

— Survey Respondent

”

“
Sell-side analysis very much tends to be skewed by corporate considerations, and I still don't think conflict of interest is adequately addressed.

— Survey Respondent

”

Conflicts of Interest

Conflicts of interest was an issue not unique to the United Kingdom; similar concerns were cited in more than half of the markets surveyed in 2008.

Like the issues of regulation and transparency, the conflicts of interest cited by respondents cover a broad swath

of territory, from conflicts between financial advisers and their clients to perceived conflicts in the sell-side analyst community. A unifying theme through many of these comments was the belief that in too many cases, the clients' interests are not being put first.

“
Conflicts of interest between financial advisers and investors.

— Survey Respondent

”

Demographics

The following figures indicate some of the key demographic information about the respondent base (please see complete methodology report at www.cfainstitute.org/centre for further details). It is interesting to note that

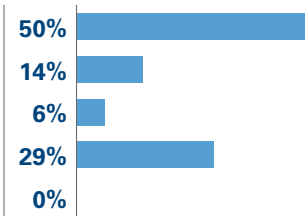
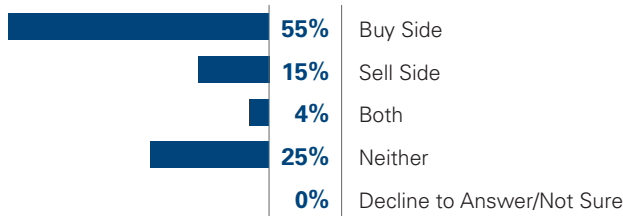
of the overall group of respondents, a large number indicated that they were working or employed in some capacity other than one of the practitioner categories identified in the survey.

Respondent Profiles for U.K. Market

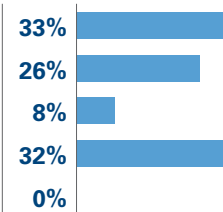
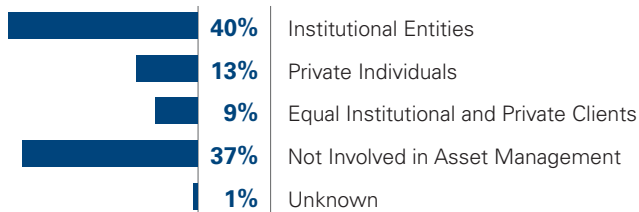
In Market (254 respondents)

Out of Market (111 respondents)

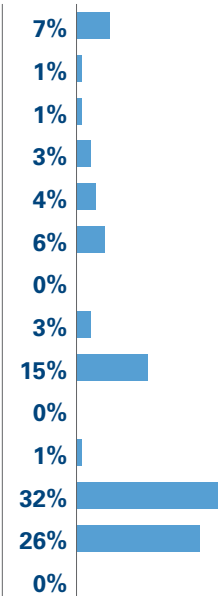
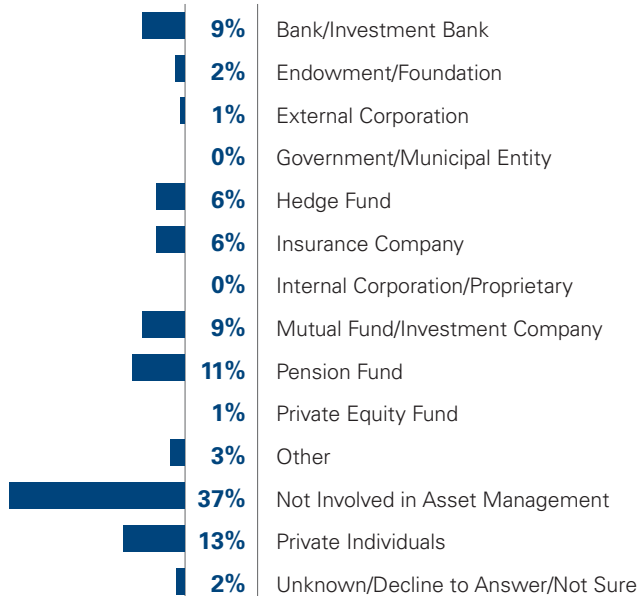
Buy/Sell Side



Client Asset Base



Institutional Asset Client Type

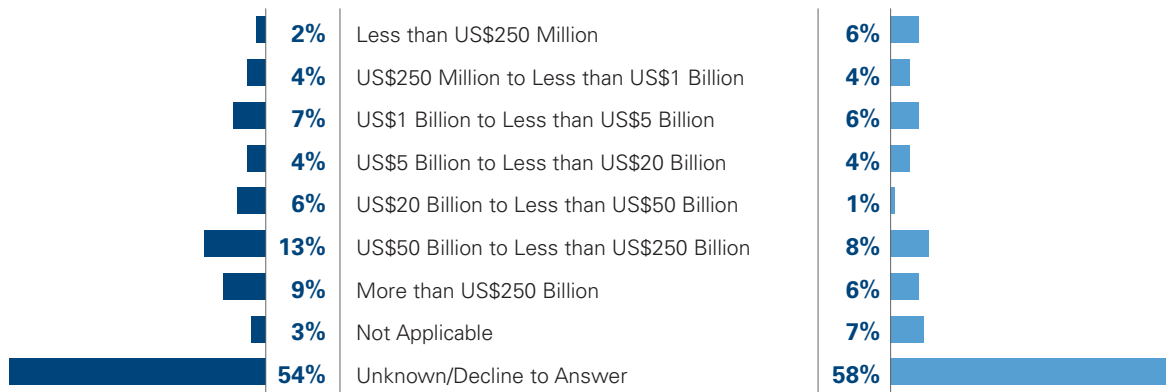


Respondent Profiles for U.K. Market (continued)

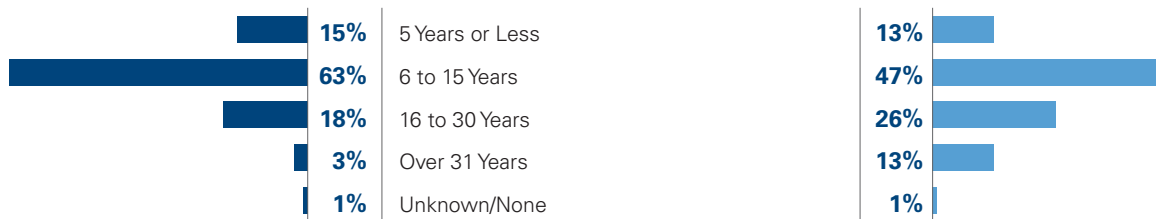
In Market (254 respondents)

Out of Market (111 respondents)

Assets Under Management



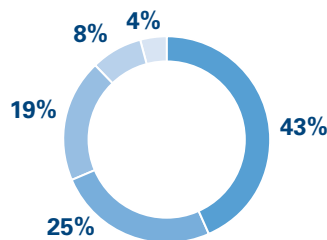
Years in the Investment Industry



Overview of Out-of-Market Respondents

Market

- 43% Canada
- 25% United States
- 19% Switzerland
- 8% Hong Kong
- 4% Japan



*May not add to 100% because of rounding.

CFA Institute Centre for Financial Market Integrity

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