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Wall Street pact could spur change in Europe

Tue April 29, 2003 11:23 AM ET
By Alistair MacDonald and Sophy Tonder

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LONDON, April 29 (Reuters) - The Wall Street settlement over biased stock recommendations could force more job cuts and lower salaries on analysts at European investment banks, accelerating change in an industry pressured by the stock market downturn.

Industry watchers said the strict separation of equities research from investment banking, imposed under Monday's $1.4 billion Wall Street settlement, could alter the economics of stock analysis in Europe as well as the United States.

Banks have already cut equities research in the face of sliding revenues and may have to cut more, now research can no longer be paid for by corporate finance and has to be funded by less lucrative trading for fund management clients.

"The economics of research are going to be quite tricky," said a senior executive at a major European investment bank. "If research is going to be paid for solely by commissions from secondary trading, then there simply has to be less of it and analysts have to be paid less."

"The bigger houses will try to ensure they have a broad research platform, but second tier players will have to drastically pare down their research," the banker said.

European banks have already applied tough new disclosure requirements on equities research, prompted by New York Attorney General Eliot Spitzer's Wall Street probes that found analysts recommending stocks to win investment banking mandates.

Commerzbank, for instance, now spells out relationships with companies on research reports, following on from the U.S. regulatory changes, a spokesman said.

Rick Levitt, in research management at Dresdner Kleinwort Wasserstein ALVG.DE , said the pact between U.S. regulators and 10 investment banks only applied legally to those 10 firms.

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"Right now, what they are requiring these banks to do is not applicable...by law to anybody outside the group of 10." But he said the settlement would add to the pace of change in the business.

European players will come under pressure to follow the new U.S. model in terms of research.

"It is something that European banks have been discussing for some time," said one banker, who declined to be named. "They are likely to look at what the U.S. banks are doing and worry that if they don't follow suit they could lose some sort of competitive advantage."

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But some bankers said they did not see any need to follow U.S. banks to the letter.

"Internal procedures are a lot stricter than a year ago, but we are not going to slavishly follow what happens in the U.S.," said another European banker.

European regulators have already homed in on some of the issues raised by the U.S. enquiry.

The UK's Financial Services Authority (FSA), which regulates London, Europe's bigge financial centre, has said it found evidence of systematic bias in analyst recommendations and of bad management of conflicts of interest at investment banks

But regulators believe Europe has avoided the worst of the abusive practices seen on Wall Street, in which thousands of retail investors got burned.

And European banks are unlikely to face a tide of shareholder litigation that could hit their U.S. counterparts in the aftermath of the settlement.

"Litigation that has impacted sectors in the U.S., such as the tobacco industry and asbestos liabilities, hasn't always been as actively pursued in Europe, and has remained pretty much a U.S. phenomenon," said Piers Brown at Commerzbank Securities.

The Wall Street settlement could benefit independent research boutiques, hoping to capitalise on investor cynicism about the independence of investment bank research.

"There will be a broad benefit for independent research as a whole from this enquiry, which has focused the mind on independence," said Geoff Hawksworth, head of investment services at Standard & Poor's Investment Services, which researches 200 European stocks.

Hawksworth said fund managers would be encouraged to look at independent researc while investment banks were now likely to outsource more research.

S&P was just signed up by Scandinavian bank Nordea Securities NDA.ST for research on U.S. and European stocks.

Jamie Stewart, head of research at UK brokerage Eden Group, said that as research became more isolated from other parts of an investment bank, it would need to be priced separately.

"Funds will revalue research separately, rather than just accept it as part of an overall investment banking service, so there will be natural market attrition and only the best will survive," Stewart said. (Additional reporting by Jane Merriman and Tom Bergin)

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