Chapter 27

Identify and Resolve Ethical Challenges

Identifying the Ethical Dilemma Is the First Step

The first step in making the appropriate ethical decision relies on identifying the potential dilemma. This may seem obvious, but it can be difficult to see when an analyst is deeply entrenched in his or her research. Ethical dilemmas can come from many aspects of the analyst's role, but they almost always fall into one of two categories:

- Misconduct by the analyst for personal or professional gain.
- Conflicts of interest between two or more parties that rely on the analyst for an objective investment recommendation.

To help spot these potential ethical challenges, here are some of the most common types of misconduct by analysts seeking personal or professional gains:

- Going beyond building the mosaic by seeking out or requesting material information that the analyst knows or suspects is nonpublic

- Omitting risks or relevant facts from an investment recommendation that were:
    - Known, but downplayed in order to make the investment appear more attractive
    - Not properly assessed due to insignificant research conducted on the topic, even though the general risk was understood early in the process
- Relying solely on company management to provide an assessment of risk for an investment.
- Misrepresenting the thoroughness of research conducted, proactively or in response to a question
- Not clearly identifying an opinion, which could lead others to interpret it as fact
- Modifying a financial forecast or valuation multiple solely to justify a predetermined price target
- Covering up a mistake that could lead others to make an impaired investment conclusion
- Plagiarizing others' work
- Misrepresenting past performance or qualifications
- Sell-side only: Sharing material non-published information about a stock or recommendation with a client before it has been published or widely disseminated to all of the firm's clients

Unlike the misconduct mentioned above, even if an analyst has the best of intentions, *conflicts of interest* can't be entirely avoided. For equity research analysts, these conflicts most commonly hinder their ability to provide objective investment advice. To help spot these potential ethical challenges, I've identified some of the most common types of conflicts of interest. (Note that many are not unethical acts like those above, but rather conflicts.) Most of these are related to the sell-side, due to the nature of the sell-side analyst's role, which often involves serving more than one constituent:

- Being asked or influenced by a client or portfolio manager to make a recommendation change solely to help the person's position.

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