

# Ethical and Professional Standards

## CFA Level III Workshop

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# Agenda

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- Exam Overview
- Philosophy & Tips
- CFA Institute Professional Conduct Program
- Code & (vs) Standards
- Standards in Detail
- Standards in Practice
- Asset Manager Code of Professional Conduct
- Q&A

# Exam Overview

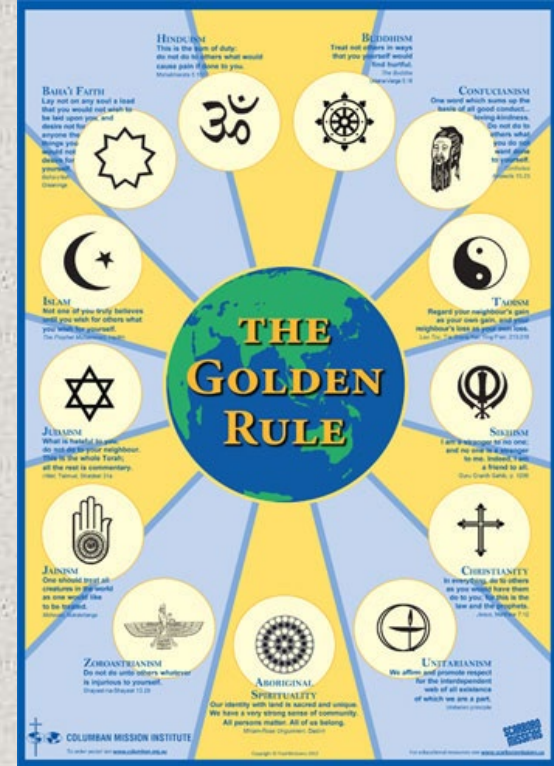
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- 10 – 15% of exam on Ethics
  - Bubble boost
- 2 – 3 item/essay sets on Ethics
- Questions more or less follow the vignette progression. Can skim questions first if you like.
- Most questions test retention and application. Some test “higher cognitive mental processes.”

# Ethical Rules of Thumb

## The Golden Rule:

Treat others as you  
would like to be treated



# General Guidelines

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- Correct course of action is always based on the “facts and circumstances” of each case.
- Questions will likely not require recitation of the Code and Standards, or specific numbering of a Standard. It will all be reciting of concepts, or application.
  - Likely answers could be:
    - A) The person/event is not in violation of the Standards.
    - B) The person/event violated Standard I.A. Knowledge of the Law.
    - C) The person/event violated Standard II.B. Fair Dealing.
    - Selecting appropriate course of action, given a situation.
- Questions may ask the “best” answer, rather than the “ideal” answer. Various shades of grey.

# Ethical Rules of Thumb

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- Be a professional
- Do unto others....
- The least rigid and most rigid course of action is often not the best.
  - Disclose situation
  - Discuss with offending party
  - Report to supervisor
    - Consult legal counsel
    - Refuse opportunity or compensation
    - Dissociate from activity
    - Quit job
    - Report to regulators

# Ethics Study Tips

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- Code of Ethics: Guiding principles
- Standards of Professional Conduct: Rules-based, actionable items.
- Read the entire document, especially the examples
- Remember: Just because something is legal, doesn't mean it's ethical.
- Read all the examples; do lots of practice problems

# Professional Conduct Program

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- CFA Institute Board of Governors enforces member and candidate adherence to the Code and Standards through the Professional Conduct Program (PCP), delegated to the Disciplinary Review Committee (DRC).
- Investigations can be initiated from:
  - Self-disclosure
  - Written complaints
  - Public sources
  - Exam proctors
- After the investigation, the matter will be:
  - Dismiss
  - Issue a cautionary letter
  - Continue proceedings to discipline
- The Member or candidate has the opportunity to reject or accept any charges and proposed sanctions. If the candidate rejects the conclusions and sanctions, the matter will be referred to a DRC panel.

# Code of Ethics

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- Act with integrity, competence, diligence, respect, and in an ethical manner with the public, clients, prospective clients, employers, employees, colleagues in the investment profession, and other participants in the global capital markets.
- Place the integrity of the investment profession and the interests of clients above their own personal interests.
- Use reasonable care and exercise independent professional judgment when conducting investment analysis, making investment recommendations, taking investment actions, and engaging in other professional activities.

# Code of Ethics (continued)

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- Practice and encourage others to practice in a professional and ethical manner that will reflect credit on themselves and the profession.
- Promote the integrity of and uphold the rules governing capital markets.
- Maintain and improve their professional competence and strive to maintain and improve the competence of other investment professionals.

# Standards of Professional Conduct

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- I. Professionalism
  - A. Knowledge of the Law
  - B. Independence and Objectivity
  - C. Misrepresentation
  - D. Misconduct
  - E. Competence (new 2023)
- II. Integrity of Capital Markets
  - A. Material Non-Public Information
  - B. Market Manipulation
- III. Duties to Clients
  - A. Loyalty, Prudence and Care
  - B. Fair Dealing
  - C. Suitability
  - D. Performance Presentation
  - E. Preservation of Confidentiality
- IV. Duties to Employers
  - A. Loyalty
  - B. Additional Compensation Arrangements
  - C. Responsibility of Supervisors
- V. Investment Analysis, Recommendations and Actions
  - A. Diligence and Reasonable Basis
  - B. Communication with Clients and Prospective Clients (rev. 2023)
  - C. Record Retention
- VI. Conflicts of Interest
  - A. Avoid or Disclose Conflicts (rev. 2023)
  - B. Priority of Transactions
  - C. Referral Fees
- VII. Responsibilities as a CFA Member or CFA candidate
  - A. Conduct as Participants in CFA Institute Programs
  - B. Reference to CFA Institute, CFA Designation, and CFA Program

# Standards of Professional Conduct

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## I. Professionalism

A. Knowledge of the Law

B. Independence and Objectivity

C. Misrepresentation

D. Misconduct

E. Competence

# SoPC: Professionalism

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## 1(A) Knowledge of the Law:

- Understand and comply with all applicable laws, rules and regulations (including CFA Institute Code of Ethics and Standards of Professional Conduct).
- When there are conflicts, comply with the more strict law, rule or regulation.
  - Highest applicable law generally applies, unless indicated otherwise
  - Code and Standards generally set minimum obligations, unless enhanced by additional applicable obligations
- Do not knowingly participate in, must dissociate yourself from violations.

# SoPC: Professionalism

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## 1(B) Independence and Objectivity:

Determine whether compensation jeopardizes independence.

- Must use reasonable care and judgment and maintain independence and objectivity
- Must not offer, solicit, or accept any gift or benefit that reasonably could be expected to impair independence and objectivity

Common general guidelines:

- Gifts not automatically prohibited. Limits can be subjective. Ensure gifts are disclosed to firm/supervisor.
- Travel expenses should be modest and necessary.
- Consider compensation and investment situations that may impair independence and objectivity

# SoPC: Professionalism

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## 1(C) Misrepresentation:

- Don't overstate your ability, the CFA charter, or investment performance.

### Specific issues:

- Guarantees of performance or profit
- Selective performance presentations
- Competency of CFA charterholders
- Omissions
- Plagiarism

❖ Keep things factual!

# SoPC: Professionalism

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## 1(D) Misconduct:

Do not engage in dishonesty, fraud, or deceit. Do not commit any act that reflects poorly on your professional reputation, integrity, or competency.

- Most things that reflect poorly on your character could also get you trouble with the CFA Institute, even if it is legal.

Examples:

- Getting arrested for civil disobedience... OK!
- Tiger Woods... (probably) NOT OK!

- ❖ Does it make you question the person's integrity?

# SoPC: Professionalism

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## 1(D) Competence:

Act with and maintain the competence necessary to fulfill their professional responsibilities.

➤ Mirrors what is already in the Code of Ethics

Specifically:

1. Knowledge of relevant info to perform a function
2. Skills needed to complete tasks and achieve goals
3. Abilities and attitudes that result in observable outcomes

❖ Basic recommendation: Do your homework!

# Standards of Professional Conduct

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## II. Integrity of Capital Markets

### A. Material Non-Public Information

### B. Market Manipulation

# SoPC: Integrity of Capital Markets

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## 2(A) Material Non-Public Information:

Do not act, or cause others to act, on material non-public information.

1. Material: Reasonably expected to have an impact on a security's market price.
2. Non-Public: Has not been disseminated to the public or market.

### ❖ Exception: The Mosaic Theory

➤ Material Public info + Immaterial Non-Public info = \$\$\$

# SoPC: Integrity of Capital Markets

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## 2(B) Market Manipulation:

Do not engage in practices that distort prices or artificially inflate trading volume, with the intent to mislead the market.

# Standards of Professional Conduct

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## III. Duties to Clients

- A. Loyalty, Prudence and Care
- B. Fair Dealing
- C. Suitability
- D. Performance Presentation
- E. Preservation of Confidentiality

# SoPC: Duty to Clients

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## 3(A) Loyalty, Prudence, and Care:

- Exercise reasonable care and prudent judgment.
- Place the interests of your clients and employer before your own

## Topics:

- Fiduciary duty: not imposed
- Soft-Dollar commissions
- Proxy voting

# SoPC: Duty to Clients

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## 3(B) Fair Dealing:

- Must deal fairly and objectively with all clients

## Common issues:

- Trade priority
- Recommendations must be distributed fairly
  - “Fairly” does not mean “equally”
- Different levels of service can be offered, but cannot disadvantage other clients. IPO subscriptions a common issue.

# SoPC: Duty to Clients

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## 3(C) Suitability:

- Make a reasonable inquiry into a client or prospect's investment experience and situation
- Determine if an investment is suitable, based on situation and client's written objectives and mandates
- Judge suitability of investments in the context of the client's total portfolio
- Only take actions specific with the client's stated mandate or strategy

## Industry themes:

- ERISA rules: Prudent Man Rule → Prudent Investor Rule
- Real World application: Investment Advisers of individual investors often obtain full "discretion," with little direction as to strategy, and minimal inquiry into financial situation and goals.

## Common issues:

- Manager has a time-sensitive investment opportunity, and can't adequately get approval for trade, or lacks time to investigate suitability.... Don't trade!

# SoPC: Duty to Clients

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## 3(D) Performance Presentation:

- Ensure information is fair, accurate, and complete.

## Potential Confusion:

- GIPS is encouraged, but not required
- GIPS addresses marketing scenarios, but not necessarily client reporting

## Issues to Consider:

- Is information shown in proper context? (is an appropriate benchmark shown?)
- Consider the Golden Rule... if you were receiving this, what additional or revised information would help you make a more informed investment decision? If you were an auditor or regulator, what skeptical questions would you ask?

# SoPC: Duty to Clients

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## 3(E) Preservation of Confidentiality:

- Do it! Exceptions to this rule include...
  - Information concerns illegal activity
  - Disclosure required by law
  - Client or prospect approves disclosure

### Further clarification:

- You are not a lawyer! There is no “attorney-client privilege” when concerning illegal activity or court-ordered subpoenas.
- CFA Institute exempted themselves in this requirement, when concerning their Professional Conduct Program.

### Common dilemmas:

- Family members: confidentiality still applies, unless client instructed otherwise.
- Recently deceased: confidentiality still applies, until trust executor instructs otherwise.

# Standards of Professional Conduct

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## IV. Duties to Employers

A. Loyalty

B. Additional Compensation Arrangements

C. Responsibility of Supervisors

# SoPC: Duty to Employers

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## 4(A) Loyalty:

- Act in the benefit of your employer, and do not deprive your employer of the value they're paying you for.

## Common issues:

- You are encouraged, not required, to provide your employer with a copy of the Code and Standards
- Moonlighting: Get it approved
- Departure:
  - Don't: Take work product, client lists, or colleagues
  - Do: All those things above, after you've left. 😊 (Except violate non-compete agreements)
- Whistleblowing: Do it as a last resort, to adhere to your other obligations of acting with integrity, and upholding the capital markets
- Employees vs. Independent Contractors

# SoPC: Duty to Employers

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## 4(B) Additional Compensation Arrangements:

- Do not accept gifts, benefits, compensation or consideration that competes or might reasonably be expected to create a conflict of interest with their employer's interest, unless they obtain written consent from all parties involved.

## Common questions:

- Client offers bonus for good performance: Get approval from supervisor/employer. May affect your focus on other clients.
- Moonlighting: Doesn't really matter whether you are in direct competition or not. Your time is valuable too. Non-profit board participation may be a distraction or conflict.

# SoPC: Duty to Employers

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## 4(C) Responsibility of Supervisors:

- *Members and candidates* must make a reasonable effort to ensure anyone under their supervision complies with applicable laws, regulations, and the Code and Standards.

## Key Issues:

- It doesn't matter if your subordinates are obligated to comply with the Code and Standards. Your responsibility becomes their responsibility.
- Just informing your subordinates of the responsibility is not enough. Monitoring and detecting needed.

# Standards of Professional Conduct

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## V. Investment Analysis, Recommendations and Actions

A. Diligence and Reasonable Basis

B. Communication with Clients and Prospective Clients

C. Record Retention

# SoPC: Investment Analysis

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## 5(A) Due Diligence & Reasonable Basis:

- Exercise diligence, independence, and thoroughness in analyzing investments, making recommendations, and taking investment actions.
- Have a reasonable and adequate basis, supported by appropriate research and investigation, for any investment analysis, recommendation, or action.

## Common Issues:

- 3<sup>rd</sup> Party Research: Don't plagiarize in publications. Also, you can't automatically rely on the research of other professionals, without doing your own research.
- Group research: What do you do if a group recommends with something you disagree with?
  - Make your objection known to the group.
  - Dissociate yourself with the recommendation/report if you feel strongly.
  - If you feel the recommendation violates standards or regulations (not just you disagreeing with it), then tell a supervisor, CCO, or consult legal counsel [don't want to inappropriately violate Duty to Employer].

# SoPC: Investment Analysis

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## 5(B) Communications with Clients and Prospective Clients:

- Disclose the basic format and general principles of the investment process used to analyze investments, select securities, and construct portfolios.
- Disclose the significant limitations and risks associate with the investment process.
- Use reasonable judgment in identifying which factors are important to the investment analysis, recommendations, or actions, and include those factors in communications with clients and prospects.
- Distinguish between fact and opinion in the presentation of investment analysis and recommendations.
- NEW in 2023: Disclosures about nature and costs of services provided.
  - Removes subjectivity on when to disclose. When in doubt: Disclose!

## Common Issues:

- Investment Strategy details: What would you want to know?
- Fact vs. Opinion

# SoPC: Investment Analysis

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## 5(C) Record Retention:

- Must develop and maintain appropriate records to support their investment analyses, recommendations, actions, and other investment-related communications with clients and prospects.

## Recommendations:

- Think about what you would need to support your other obligations, such as Due Diligence and Reasonable Basis.

# Standards of Professional Conduct

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## VI. Conflicts of Interest

A. Disclosures of Conflicts

B. Priority of Transactions

C. Referral Fees

# SoPC: Conflicts of Interest

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## 6(A) Disclosure of Conflicts:

- Avoid or make full and fair disclosure of all matters that could reasonably be expected to impair independence and objectivity, or interfere with duties to clients, prospective clients, and employer. Must ensure disclosures are prominent, are delivered in plain language, and communicate the relevant information effectively.

## Recommendations:

- Avoidance is the first option. When in doubt, disclose. Document to protect yourself.

# SoPC: Conflicts of Interest

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## 6(B) Priority of Transactions:

- Investment transaction for clients and employers must have priority over transactions in which the member or candidate is the beneficial owner.

## Common issues:

- Relationships: spouses, kids, *immediate* family, and trusts or retirement accounts in which the member has a direct or indirect pecuniary interest.
- Prevention: Consider recommended procedures

# SoPC: Conflicts of Interest

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## 6(C) Referral Fees:

- Must disclose to their employer, clients, and prospective clients, any compensation, consideration, or benefit received from or paid to others for the recommendation of products or services.

### Key Point:

- They aren't saying you can't accept outside compensation, you just have to tell everyone.

“Sunlight is the best disinfectant”

# Standards of Professional Conduct

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## VII. Responsibilities as a CFA Institute Member or CFA candidate

A. Conduct as Participants in CFA Programs

B. Reference to CFA Institute, CFA Designation, and CFA Program

# SoPC: Responsibilities of Members

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## 7(A) Conduct as Participants in CFA Institute Programs:

- Must not engage in any conduct that compromises the reputation or integrity of CFA Institute or the CFA designation, or the integrity, validity, or security of CFA Institute programs.

### Key Points:

- Don't cheat the exam, or disclose information about it
- Other rules for volunteering
- You are free to express opinions, clearly stated as such

# SoPC: Responsibilities of Members

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## 7(B) References to CFA Institute, CFA Designation and Program:

- Must not misrepresent or exaggerate the meaning or implications of membership in CFA Institute, holding the CFA designation, or candidacy in the CFA Program.

### Key Points:

- Factual statements OK; misrepresentations are not.
- Know the types of memberships
- Know how to use the designation & marks

# Asset Manager Code of Conduct

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- Code & Standards are for individuals. Asset Manager Code is for firms.
- Asset Manager Code is voluntary.
- Helps create culture and ethical awareness for the firm.
- If the firm adopts the Code, it must make a claim of compliance.

# Asset Manager Code of Conduct

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- Ethical and Professional Responsibilities:
  1. Act in a professional and ethical manner at all times.
  2. Act for the benefit of clients
  3. Act with independence and objectivity
  4. Act with skill, competence, and diligence
  5. Communicate with clients in a timely and accurate manner
  6. Uphold the applicable rules governing capital markets

# Asset Manager Code of Conduct

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## A. Loyalty to Clients: Managers must...

1. Place client interests before their own
2. Preserve confidentiality of information communicated by clients within the scope of the Manager-client relationship
3. Refuse to participate in any business relationship or accept any gift that could reasonably be expected to affect their independence, objectivity, or loyalty to clients.

# Asset Manager Code of Conduct

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## B. Investment Process and Actions: Managers must...

1. Use reasonable care and prudent judgment when managing client assets.
2. Not engage in practices designed to distort prices or artificially inflate trading volume with the intent to mislead market participants.
3. Deal fairly and objectively with all clients when providing investment information, making investment recommendations, or taking investment action.
4. Have a reasonable and adequate basis for investment decisions.
5. When managing a portfolio or pooled fund according to a specific mandate, strategy, or style:
  - a. Take only investment actions that are consistent with the stated objectives and constraints of that portfolio or fund.
  - b. Provide adequate disclosures and information so investors can consider whether any proposed changes in the investment style or strategy meet their investment needs.
6. When managing separate accounts and before providing investment advice or taking investment action on behalf of the client:
  - a. Evaluate and understand the client's investment objectives, tolerance for risk, time horizon, liquidity needs, financial constraints, any unique circumstances (including tax considerations, legal or regulatory constraints, etc.) and any other relevant information that would affect investment policy.
  - b. Determine that an investment is suitable to a client's financial situation.

# Asset Manager Code of Conduct

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## C. Trading: Managers must...

1. Not act or cause others to act on material nonpublic information that could affect the value of a publicly traded investment.
2. Give priority to investments made on behalf of the client over those that benefit the Managers' own interests.
3. Use commissions generated from client trades to pay for only investment-related products or services that directly assist the Manager in its investment decision making process, and not in the management of the firm.
4. Maximize client portfolio value by seeking best execution for all client transactions.
5. Establish policies to ensure fair and equitable trade allocation among client accounts.

# Asset Manager Code of Conduct

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- D. Risk Management, Compliance, and Support: Managers must...
1. Develop and maintain policies and procedures to ensure that their activities comply with the provisions of this Code and all applicable legal and regulatory requirements.
  2. Appoint a compliance officer responsible for administering the policies and procedures and for investigating complaints regarding the conduct of the Manager or its personnel.
  3. Ensure that portfolio information provided to clients by the Manager is accurate and complete and arrange for independent third-party confirmation or review of such information.
  4. Maintain records for an appropriate period of time in an easily accessible format.
  5. Employ qualified staff and sufficient human and technological resources to thoroughly investigate, analyze, implement, and monitor investment decisions and actions.
  6. Establish a business-continuity plan to address disaster recovery or periodic disruptions of the financial markets.
  7. Establish a firmwide risk management process that identifies, measures, and manages the risk position of the Manager and its investments, including the sources, nature, and degree of risk exposure.

# Asset Manager Code of Conduct

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- E. Performance and Valuation: Managers must...
1. Present performance information that is fair, accurate, relevant, timely, and complete. Managers must not misrepresent the performance of individual portfolios or of their firm.
  2. Use fair-market prices to value client holdings and apply, in good faith, methods to determine the fair value of any securities for which no independent, third-party market quotation is readily available.

# Asset Manager Code of Conduct

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## F. Disclosures: Managers must...

1. Communicate with clients on an ongoing and timely basis.
2. Ensure that disclosures are truthful, accurate, complete, and understandable and are presented in a format that communicates the information effectively.
3. Include any material facts when making disclosures or providing information to clients regarding themselves, their personnel, investments, or the investment process.
4. Disclose the following:
  - a. Conflicts of interests generated by any relationships with brokers or other entities, other client accounts, fee structures, or other matters.
  - b. Regulatory or disciplinary action taken against the Manager or its personnel related to professional conduct.
  - c. The investment process, including information regarding lock-up periods, strategies, risk factors, and use of derivatives and leverage.
  - d. Management fees and other investment costs charged to investors, including what costs are included in the fees and the methodologies for determining fees and costs.
  - e. The amount of any soft or bundled commissions, the goods and/or services received in return, and how those goods and/or services benefit the client.
  - f. The performance of clients' investments on a regular and timely basis.
  - g. Valuation methods used to make investment decisions and value client holdings.
  - h. Shareholder voting policies.
  - i. Trade allocation policies.
  - j. Results of the review or audit of the fund or account.
  - k. Significant personnel or organizational changes that have occurred at the Manager.
  - l. Risk management processes.