STUDY SESSION 1: ETHICAL AND PROFESSIONAL STANDARDS (1)
CODE OF ETHICS AND STANDARDS OF PROFESSIONAL CONDUCT
Cross-Reference to CFA Institute Assigned Reading #1

The Code of Ethics consists of high-level objectives that are expected of all CFA Institute members and candidates. Be sure that you know the six components of the Code of Ethics and how the Professional Conduct Program (PCP) operates, including investigations into alleged violations of the Code and Standards.

CFA Institute Professional Conduct Program
All CFA Institute members and candidates enrolled in the CFA Program are required to comply with the Code and Standards. The CFA Institute Board of Governors maintains oversight and responsibility for the Professional Conduct Program (PCP) which, in conjunction with the Disciplinary Review Committee (DRC), is responsible for enforcement of the Code and Standards. The DRC is a volunteer committee of CFA charterholders who serve on panels to review conduct and partner with Professional Conduct staff to establish and review professional conduct policies. The CFA Institute Bylaws and Rules of Procedure for Professional Conduct (Rules of Procedure) form the basic structure for enforcing the Code and Standards. The Professional Conduct division is also responsible for enforcing testing policies of other CFA Institute education programs as well as the professional conduct of Certificate in Investment Performance Measurement (CIPM) certificants.

Professional Conduct inquiries come from a number of sources.

- Members and candidates must self-disclose on the annual Professional Conduct Statement all matters that question their professional conduct, such as involvement in civil litigation or a criminal investigation or being the subject of a written complaint.
- Written complaints received by Professional Conduct staff can bring about an investigation.
- CFA Institute staff may become aware of questionable conduct by a member or candidate through the media, regulatory notices, or another public source.
- Candidate conduct is monitored by proctors who complete reports on candidates suspected to have violated testing rules on exam day.
- CFA Institute may also conduct analyses of scores and exam materials after the exam, as well as monitor online and social media to detect disclosure of confidential exam information.

When an inquiry is initiated, the Professional Conduct staff conducts an investigation that may include:

- Requesting a written explanation from the member or candidate.
- Interviewing the member or candidate, complaining parties, and third parties.
- Collecting documents and records relevant to the investigation.

Upon reviewing the material obtained during the investigation, the Professional Conduct staff may:

- Take no disciplinary sanction.
- Issue a cautionary letter.
- Continue proceedings to discipline the member or candidate.
If the Professional Conduct staff believes a violation of the Code and Standards or testing policies has occurred, the member or candidate has the opportunity to reject or accept any charges and the proposed sanctions. If the member or candidate does not accept the charges and proposed sanction, the matter is referred to a panel composed of DRC members. Panels review materials and presentations from Professional Conduct staff and from the member or candidate. The panel’s task is to determine whether a violation of the Code and Standards or testing policies occurred and, if so, what sanction should be imposed.

Sanctions imposed by CFA Institute may have significant consequences; they include public censure, suspension of membership and use of the CFA designation, and revocation of the CFA charter. Candidates enrolled in the CFA Program who have violated the Code and Standards or testing policies may be suspended or prohibited from further participation in the CFA Program. CFA Institute does not impose fines on those who have violated the Standards.

Adoption of the Code and Standards
The Code and Standards apply to individual members of CFA Institute and candidates in the CFA Program. CFA Institute does encourage firms to adopt the Code and Standards, however, as part of their code of ethics. Those who claim compliance should fully understand the requirements of each of the principles of the Code and Standards.

Once a party—nonmember or firm—ensures its code of ethics meets the principles of the Code and Standards, that party should make the following statement whenever claiming compliance:

“[Insert name of party] claims compliance with the CFA Institute Code of Ethics and Standards of Professional Conduct. This claim has not been verified by CFA Institute.”

CFA Institute welcomes public acknowledgment, when appropriate, that firms are complying with the CFA Institute Code of Ethics and Standards of Professional Conduct and encourages firms to notify it of the adoption plans.
The Code of Ethics

Members of CFA Institute (including CFA charterholders) and candidates for the CFA designation ("Members and Candidates") must:

- Act with integrity, competence, diligence, and 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.
- Practice and encourage others to practice in a professional and ethical manner that will reflect credit on themselves and the profession.
- Promote the integrity and viability of the global capital markets for the ultimate benefit of society.
- Maintain and improve their professional competence and strive to maintain and improve the competence of other investment professionals.

STANDARDS OF PROFESSIONAL CONDUCT

I. Professionalism
   A. Knowledge of the Law
   B. Independence and Objectivity
   C. Misrepresentation
   D. Misconduct

II. Integrity of Capital Markets
   A. Material Nonpublic 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. Responsibilities of Supervisors

V. Investment Analysis, Recommendations and Actions
   A. Diligence and Reasonable Basis
   B. Communication with Clients and Prospective Clients
   C. Record Retention

VI. Conflicts of Interest
   A. Disclosure of Conflicts
   B. Priority of Transactions
   C. Referral Fees

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VII. Responsibilities as a CFA Institute Member or CFA Candidate
A. Conduct as Participants in CFA Institute Programs
B. Reference to CFA Institute, the CFA Designation, and the CFA Program

The Code of Ethics and the Standards of Practice apply to all candidates in the CFA program and members of CFA Institute. All examples and other extracts from the Standards of Practice Handbook that are included in this reading are reprinted with permission of CFA Institute.
The seven Standards of Professional Conduct contain detailed rules of minimum behavior that are required of all CFA candidates and charterholders. As in previous levels, you do not need to know the standard letter and number but must know all the requirements, recommendations, and best practices relevant to each section.

STANDARD I(A): KNOWLEDGE OF THE LAW

The Standard

Members and candidates must understand and comply with all applicable laws, rules, and regulations (including the CFA Institute Code of Ethics and Standards of Professional Conduct) of any government, regulatory organization, licensing agency, or professional association governing their professional activities. In the event of conflict, members and candidates must comply with the more strict law, rule, regulation or CFA Institute standard. Members and candidates must not knowingly participate or assist in and must dissociate from any violation of such laws, rules, or regulations.

Guidance

- Members and candidates must understand the applicable laws and regulations of the countries and jurisdictions where they engage in professional activities.
- On the basis of their reasonable and good faith understanding, members and candidates must comply with the laws and regulations that directly govern their professional activities.
- When questions arise, members and candidates should know their firm’s policies and procedures for accessing compliance guidance.
- Members and candidates must remain vigilant in maintaining their knowledge of the requirements for their professional activities.

Relationship between the Code and Standards and Applicable Law

- When applicable law and the Code and Standards require different conduct, members and candidates must follow the stricter of the applicable law or the Code and Standards.
  - “Applicable law” is the law that governs the member’s or candidate’s conduct. Which law applies will depend on the particular facts and circumstances of each case.
  - The “more strict” law or regulation is the law or regulation that imposes greater restrictions on the action of the member or candidate, or calls for the member or candidate to exert a greater degree of action that protects the interests of investors.

Global Application of the Code and Standards

Members and candidates who practice in multiple jurisdictions may be subject to varied securities laws and regulations. The following chart provides illustrations involving a member who may be subject to the securities laws and regulations of three different types of countries:
<table>
<thead>
<tr>
<th>Applicable Law</th>
<th>Duties</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Member resides in NS country, does business in LS country; LS law applies.</td>
<td>Member must adhere to the Code and Standards.</td>
<td>Because applicable law is less strict than the Code and Standards, the member must adhere to the Code and Standards.</td>
</tr>
<tr>
<td>Member resides in NS country, does business in MS country; MS law applies.</td>
<td>Member must adhere to the law of MS country.</td>
<td>Because applicable law is stricter than the Code and Standards, member must adhere to the more strict applicable law.</td>
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</tr>
<tr>
<td>Member resides in LS country, does business in NS country; LS law applies, but it states that law of locality where business is conducted governs.</td>
<td>Member must adhere to the Code and Standards.</td>
<td>Because applicable law states that the law of the locality where the business is conducted governs and there is no local law, the member must adhere to the Code and Standards.</td>
</tr>
<tr>
<td>Member resides in LS country, does business in MS country; MS law applies.</td>
<td>Member must adhere to the law of MS country.</td>
<td>Because applicable law states that the law of the locality where the business is conducted governs and the law of the client’s home country is stricter than the Code and Standards, member must adhere to the Code and Standards.</td>
</tr>
<tr>
<td>Member resides in MS country, does business in LS country; MS law applies.</td>
<td>Member must adhere to the law of MS country.</td>
<td>Because applicable law states that the law of the client’s home country governs (which is less strict than the Code and Standards), member must adhere to the Code and Standards.</td>
</tr>
<tr>
<td>Member resides in MS country, does business in LS country with a client who is a citizen of LS country; MS law applies, but it states that the law of the client’s home country governs.</td>
<td>Member must adhere to the Code and Standards.</td>
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</table>
Participation in or Association with Violations by Others

- Members and candidates are responsible for violations in which they knowingly participate or assist. Standard I(A) applies when members and candidates know or should know that their conduct may contribute to a violation of applicable laws, rules, or regulations or the Code and Standards.
- If a member or candidate has reasonable grounds to believe that imminent or ongoing client or employer activities are illegal or unethical, the member or candidate must dissociate, or separate, from the activity.
- In extreme cases, dissociation may require a member or candidate to leave his or her employment.
- Members and candidates may take the following steps before dissociating from ethical violations of others when direct discussions with the person or persons committing the violation are unsuccessful.
  - Attempt to stop the behavior by bringing it to the attention of the employer through a supervisor or the firm’s compliance department.
  - If this attempt is unsuccessful, then members and candidates have a responsibility to step away and dissociate from the activity. Inaction combined with continuing association with those involved in illegal or unethical conduct may be construed as participation or assistance in the illegal or unethical conduct.
- CFA Institute strongly encourages members and candidates to report potential violations of the Code and Standards committed by fellow members and candidates, although a failure to report is less likely to be construed as a violation than a failure to dissociate from unethical conduct.

Investment Products and Applicable Laws

- Members and candidates involved in creating or maintaining investment services or investment products or packages of securities and/or derivatives should be mindful of where these products or packages will be sold as well as their places of origination.
- They should understand the applicable laws and regulations of the countries or regions of origination and expected sale, and should make reasonable efforts to review whether associated firms that are distributing products or services developed by their employing firms also abide by the laws and regulations of the countries and regions of distribution.
- Finally, they should undertake the necessary due diligence when transacting cross-border business to understand the multiple applicable laws and regulations in order to protect the reputation of their firms and themselves.

Recommended Procedures for Compliance

Members and Candidates

Suggested methods by which members and candidates can acquire and maintain understanding of applicable laws, rules, and regulations include the following:

- **Stay informed:** Members and candidates should establish or encourage their employers to establish a procedure by which employees are regularly informed about changes in applicable laws, rules, regulations, and case law.
- **Review procedures:** Members and candidates should review, or encourage their employers to review, the firm’s written compliance procedures on a regular basis to ensure that the procedures reflect current law and provide adequate guidance to employees about what is permissible conduct under the law and/or the Code and Standards.
• **Maintain current files**: Members and candidates should maintain or encourage their employers to maintain readily accessible current reference copies of applicable statutes, rules, regulations, and important cases.

**Distribution Area Laws**

- Members and candidates should make reasonable efforts to understand the applicable laws—both country and regional—for the countries and regions where their investment products are developed and are most likely to be distributed to clients.

**Legal Counsel**

- When in doubt about the appropriate action to undertake, it is recommended that a member or candidate seek the advice of compliance personnel or legal counsel concerning legal requirements.
- If a potential violation is being committed by a fellow employee, it may also be prudent for the member or candidate to seek the advice of the firm’s compliance department or legal counsel.

**Dissociation**

- When dissociating from an activity that violates the Code and Standards, members and candidates should document the violation and urge their firms to attempt to persuade the perpetrator(s) to cease such conduct. Note that in order to dissociate from the conduct, a member or candidate may have to resign his or her employment.

**Firms**

Members and candidates should encourage their firms to consider the following policies and procedures to support the principles of Standard I(A):

- Develop and/or adopt a code of ethics.
- Provide information on applicable laws.
- Establish procedures for reporting violations.

**STANDARD I(B) INDEPENDENCE AND OBJECTIVITY**

**The Standard**

Members and candidates must use reasonable care and judgment to achieve and maintain independence and objectivity in their professional activities. Members and candidates must not offer, solicit, or accept any gift, benefit, compensation, or consideration that reasonably could be expected to compromise their own or another’s independence and objectivity.

**Guidance**

- Members and candidates should endeavor to avoid situations that could cause or be perceived to cause a loss of independence or objectivity in recommending investments or taking investment action.
- Modest gifts and entertainment are acceptable, but special care must be taken by members and candidates to resist subtle and not-so-subtle pressures to act in conflict with the interests of their clients. Best practice dictates that members and candidates reject any offer of gift or entertainment that could be expected to threaten their independence and objectivity.
Receiving a gift, benefit, or consideration from a client can be distinguished from gifts given by entities seeking to influence a member or candidate to the detriment of other clients.

When possible, prior to accepting “bonuses” or gifts from clients, members and candidates should disclose to their employers such benefits offered by clients. If notification is not possible prior to acceptance, members and candidates must disclose to their employer benefits previously accepted from clients.

Members and candidates are personally responsible for maintaining independence and objectivity when preparing research reports, making investment recommendations, and taking investment action on behalf of clients. Recommendations must convey the member’s or candidate’s true opinions, free of bias from internal or external pressures, and be stated in clear and unambiguous language.

When seeking corporate financial support for conventions, seminars, or even weekly society luncheons, the members or candidates responsible for the activities should evaluate both the actual effect of such solicitations on their independence and whether their objectivity might be perceived to be compromised in the eyes of their clients.

Investment-Banking Relationships

- Some sell-side firms may exert pressure on their analysts to issue favorable research reports on current or prospective investment banking clients. Members and candidates must not succumb to such pressures.
- Allowing analysts to work with investment bankers is appropriate only when the conflicts are adequately and effectively managed and disclosed. Firm managers have a responsibility to provide an environment in which analysts are neither coerced nor enticed into issuing research that does not reflect their true opinions. Firms should require public disclosure of actual conflicts of interest to investors.
- Any “firewalls” between the investment banking and research functions must be managed to minimize conflicts of interest. Key elements of enhanced firewalls include:
  - Separate reporting structures for personnel on the research side and personnel on the investment banking side.
  - Compensation arrangements that minimize pressures on research analysts and reward objectivity and accuracy. Ideally, compensation should be tied to the quality of the research and not the operating performance of the investment bank.

Public Companies

- Analysts may be pressured to issue favorable reports and recommendations by the companies they follow. In making an investment recommendation, the analyst is responsible for anticipating, interpreting, and assessing a company’s prospects and stock price performance in a factual manner.
- Due diligence in financial research and analysis involves gathering information from a wide variety of sources, including public disclosure documents (such as proxy statements, annual reports, and other regulatory filings) and also company management and investor-relations personnel, suppliers, customers, competitors, and other relevant sources. Research analysts may justifiably fear that companies will limit their ability to conduct thorough research by denying analysts who have “negative” views direct access to company managers and/or barring them from conference calls and other communication venues. This concern may make it difficult for them to conduct the comprehensive research needed to make objective recommendations.
Buy-Side Clients
- Portfolio managers may have significant positions in the security of a company under review. A rating downgrade may adversely affect portfolio performance, particularly in the short term, because the sensitivity of stock prices to ratings changes has increased in recent years. A downgrade may also affect the manager’s compensation, which is usually tied to portfolio performance. Moreover, portfolio performance is subject to media and public scrutiny, which may affect the manager’s professional reputation. Consequently, some portfolio managers implicitly or explicitly support sell-side ratings inflation.
- Portfolio managers have a responsibility to respect and foster the intellectual honesty of sell-side research. Therefore, it is improper for portfolio managers to threaten or engage in retaliatory practices, such as reporting sell-side analysts to the covered company in order to instigate negative corporate reactions.

Fund Manager and Custodial Relationships
- Research analysts are not the only people who must be concerned with maintaining their independence. Members and candidates who are responsible for hiring and retaining outside managers and third-party custodians should not accept gifts, entertainment, or travel funding that may be perceived as impairing their decisions.

Credit Rating Agency Opinions
- Members and candidates employed at rating agencies should ensure that procedures and processes at the agencies prevent undue influences from a sponsoring company during the analysis. Members and candidates should abide by their agencies’ and the industry’s standards of conduct regarding the analytical process and the distribution of their reports.
- When using information provided by credit rating agencies, members and candidates should be mindful of the potential conflicts of interest. And because of the potential conflicts, members and candidates may need to independently validate the rating granted.

Issuer-Paid Research
- Some companies hire analysts to produce research reports in case of lack of coverage from sell-side research, or to increase the company’s visibility in financial markets.
- Analysts must engage in thorough, independent, and unbiased analysis and must fully disclose potential conflicts, including the nature of their compensation. It should also be clearly mentioned in the report that the research has been paid for by the subject company. At a minimum, research should include a thorough analysis of the company’s financial statements based on publicly disclosed information, benchmarking within a peer group, and industry analysis.
- Analysts must try to limit the type of compensation they accept for conducting research. This compensation can be direct, such as payment based on the conclusions of the report or more indirect, such as stock warrants or other equity instruments that could increase in value based on positive coverage in the report. In those instances, analysts would have an incentive to avoid negative information or conclusions that would diminish their potential compensation.
- Best practice is for analysts to accept only a flat fee for their work prior to writing the report, without regard to their conclusions or the report’s recommendations.

Travel Funding
- The benefits related to accepting paid travel extend beyond the cost savings to the member or candidate and his firm, such as the chance to talk exclusively with the
executives of a company or learning more about the investment options provided by an investment organization. Acceptance also comes with potential concerns; for example, members and candidates may be influenced by these discussions when flying on a corporate or chartered jet, or attending sponsored conferences where many expenses, including airfare and lodging, are covered.

- To avoid the appearance of compromising their independence and objectivity, best practice dictates that analysts always use commercial transportation at their expense or at the expense of their firm rather than accept paid travel arrangements from an outside company.
- In case of unavailability of commercial travel, they may accept modestly arranged travel to participate in appropriate information gathering events, such as a property tour.

Performance Measurement and Attribution

- Members and candidates working within a firm’s investment performance measurement department may also be presented with situations that challenge their independence and objectivity. As performance analysts, their analyses may reveal instances where managers may appear to have strayed from their mandate. Additionally, the performance analyst may receive requests to alter the construction of composite indices owing to negative results for a selected account or fund. Members or candidates must not allow internal or external influences to affect their independence and objectivity as they faithfully complete their performance calculation and analysis-related responsibilities.

Influence During the Manager Selection/Procurement Process

- When serving in a hiring capacity, members and candidates should not solicit gifts, contributions, or other compensation that may affect their independence and objectivity. Solicitations do not have to benefit members and candidates personally to conflict with Standard I(B). Requesting contributions to a favorite charity or political organization may also be perceived as an attempt to influence the decision-making process. Additionally, members and candidates serving in a hiring capacity should refuse gifts, donations, and other offered compensation that may be perceived to influence their decision-making process.
- When working to earn a new investment allocation, members and candidates should not offer gifts, contributions, or other compensation to influence the decision of the hiring representative. The offering of these items with the intent to impair the independence and objectivity of another person would not comply with Standard I(B). Such prohibited actions may include offering donations to a charitable organization or political candidate referred by the hiring representative.

Recommended Procedures for Compliance

Members and candidates should adhere to the following practices and should encourage their firms to establish procedures to avoid violations of Standard I(B):

- **Protect the integrity of opinions:** Members, candidates, and their firms should establish policies stating that every research report concerning the securities of a corporate client should reflect the unbiased opinion of the analyst.
- **Create a restricted list:** If the firm is unwilling to permit dissemination of adverse opinions about a corporate client, members and candidates should encourage the firm to remove the controversial company from the research universe and put it on a restricted list so that the firm disseminates only factual information about the company and not the analyst’s recommendation.
- **Restrict special cost arrangements:** When attending meetings at an issuer’s headquarters, members and candidates should pay for commercial transportation and
hotel charges. No corporate issuer should reimburse members or candidates for air transportation. Members and candidates should encourage issuers to limit the use of corporate aircraft to situations in which commercial transportation is not available or in which efficient movement could not otherwise be arranged.

- **Limit gifts:** Members and candidates must limit the acceptance of gratuities and/or gifts to token items. Standard I(B) does not preclude customary, ordinary business-related entertainment as long as its purpose is not to influence or reward members or candidates. Firms should consider a strict value limit for acceptable gifts that is based on the local or regional customs and should address whether the limit is per gift or an aggregate annual value.

- **Restrict investments:** Members and candidates should encourage their investment firms to develop formal policies related to employee purchases of equity or equity-related IPOs. Firms should require prior approval for employee participation in IPOs, with prompt disclosure of investment actions taken following the offering. Strict limits should be imposed on investment personnel acquiring securities in private placements. Note that a restriction is not a complete prohibition.

- **Review procedures:** Members and candidates should encourage their firms to implement effective supervisory and review procedures to ensure that analysts and portfolio managers comply with policies relating to their personal investment activities.

- **Independence policy:** Members, candidates, and their firms should establish a formal written policy on the independence and objectivity of research and implement reporting structures and review procedures to ensure that research analysts do not report to and are not supervised or controlled by any department of the firm that could compromise the independence of the analyst.

- **Appointed officer:** Firms should appoint a senior officer with oversight responsibilities for compliance with the firm’s code of ethics and all regulations concerning its business.

### STANDARD I(C) MISREPRESENTATION

#### The Standard

Members and candidates must not knowingly make any misrepresentations relating to investment analysis, recommendations, actions, or other professional activities.

#### Guidance

- A misrepresentation is any untrue statement or omission of a fact or any statement that is otherwise false or misleading.

- A member or candidate must not knowingly omit or misrepresent information or give a false impression of a firm, organization, or security in the member’s or candidate’s oral representations, advertising (whether in the press or through brochures), electronic communications, or written materials (whether publicly disseminated or not).

  - In this context, “knowingly” means that the member or candidate either knows or should have known that the misrepresentation was being made or that omitted information could alter the investment decision-making process.

- Members and candidates who use webpages should regularly monitor materials posted on these sites to ensure that they contain current information. Members and candidates should also ensure that all reasonable precautions have been taken to protect the site’s integrity and security and that the site does not misrepresent any information and does provide full disclosure.

- Members and candidates should not guarantee clients any specific return on volatile investments. Most investments contain some element of risk that makes their return inherently unpredictable. For such investments, guaranteeing either a particular rate of
return or a guaranteed preservation of investment capital (e.g., “I can guarantee that you will earn 8% on equities this year” or “I can guarantee that you will not lose money on this investment”) is misleading to investors.

- Note that Standard I(C) does not prohibit members and candidates from providing clients with information on investment products that have guarantees built into the structure of the products themselves or for which an institution has agreed to cover any losses.

**Impact on Investment Practice**

- Members and candidates must not misrepresent any aspect of their practice, including (but not limited to) their qualifications or credentials, the qualifications or services provided by their firm, their performance record and the record of their firm, and the characteristics of an investment.
- Members and candidates should exercise care and diligence when incorporating third-party information. Misrepresentations resulting from the use of the credit ratings, research, testimonials, or marketing materials of outside parties become the responsibility of the investment professional when it affects that professional’s business practices.
- Members and candidates must disclose their intended use of external managers and must not represent those managers’ investment practices as their own.

**Performance Reporting**

- Members and candidates should not misrepresent the success of their performance record by presenting benchmarks that are not comparable to their strategies. The benchmark’s results should be reported on a basis comparable to that of the fund’s or client’s results.
- Note that Standard I(C) does not require that a benchmark always be provided in order to comply. Some investment strategies may not lend themselves to displaying an appropriate benchmark because of the complexity or diversity of the investments included.
- Members and candidates should discuss with clients on a continuous basis the appropriate benchmark to be used for performance evaluations and related fee calculations.
- Members and candidates should take reasonable steps to provide accurate and reliable security pricing information to clients on a consistent basis. Changing pricing providers should not be based solely on the justification that the new provider reports a higher current value of a security.

**Social Media**

- When communicating through social media channels, members and candidates should provide only the same information they are allowed to distribute to clients and potential clients through other traditional forms of communication.
- Along with understanding and following existing and newly developing rules and regulations regarding the allowed use of social media, members and candidates should also ensure that all communications in this format adhere to the requirements of the Code and Standards.
- The perceived anonymity granted through these platforms may entice individuals to misrepresent their qualifications or abilities or those of their employer. Actions undertaken through social media that knowingly misrepresent investment recommendations or professional activities are considered a violation of Standard I(C).
Omissions

- Members and candidates should not knowingly omit inputs used in any models and processes they use to scan for new investment opportunities, to develop investment vehicles, and to produce investment recommendations and ratings as resulting outcomes may provide misleading information. Further, members and candidates should not present outcomes from their models as facts because they only represent expected results.
- Members and candidates should encourage their firms to develop strict policies for composite development to prevent cherry picking—situations in which selected accounts are presented as representative of the firm’s abilities. The omission of any accounts appropriate for the defined composite may misrepresent to clients the success of the manager’s implementation of its strategy.

Plagiarism

- Plagiarism refers to the practice of copying, or using in substantially the same form, materials prepared by others without acknowledging the source of the material or identifying the author and publisher of the material. Plagiarism includes:
  - Taking a research report or study performed by another firm or person, changing the names, and releasing the material as one’s own original analysis.
  - Using excerpts from articles or reports prepared by others either verbatim or with only slight changes in wording without acknowledgment.
  - Citing specific quotations supposedly attributable to “leading analysts” and “investment experts” without specific reference.
  - Presenting statistical estimates of forecasts prepared by others with the source identified but without qualifying statements or caveats that may have been used.
  - Using charts and graphs without stating their sources.
  - Copying proprietary computerized spreadsheets or algorithms without seeking the cooperation or authorization of their creators.

- In the case of distributing third-party, outsourced research, members and candidates can use and distribute these reports as long as they do not represent themselves as the author of the report. They may add value to clients by sifting through research and repackaging it for them, but should disclose that the research being presented to clients comes from an outside source.

- The standard also applies to plagiarism in oral communications, such as through group meetings; visits with associates, clients, and customers; use of audio/video media (which is rapidly increasing); and telecommunications, such as through electronic data transfer and the outright copying of electronic media. One of the most egregious practices in violation of this standard is the preparation of research reports based on multiple sources of information without acknowledging the sources. Such information would include, for example, ideas, statistical compilations, and forecasts combined to give the appearance of original work.

Work Completed for Employer

- Members and candidates may use research conducted by other analysts within their firm. Any research reports prepared by the analysts are the property of the firm and may be issued by it even if the original analysts are no longer with the firm.
- Therefore, members and candidates are allowed to use the research conducted by analysts who were previously employed at their firms. However, they cannot reissue a previously released report solely under their own name.
Recommended Procedures for Compliance

Factual presentations: Firms should provide guidance for employees who make written or oral presentations to clients or potential clients by providing a written list of the firm’s available services and a description of the firm’s qualifications. Firms can also help prevent misrepresentation by specifically designating which employees are authorized to speak on behalf of the firm.

Qualification summary: In order to ensure accurate presentations to clients, the member or candidate should prepare a summary of her own qualifications and experience, as well as a list of the services she is capable of performing.

Verify outside information: When providing information to clients from third parties, members and candidates should ensure the accuracy of the marketing and distribution materials that pertain to the third party’s capabilities, services, and products. This is because inaccurate information can damage their individual and their firm’s reputations as well as the integrity of the capital markets.

Maintain webpages: If they publish a webpage, members and candidates should regularly monitor materials posted to the site to ensure the site maintains current information.

Plagiarism policy: To avoid plagiarism in preparing research reports or conclusions of analysis, members and candidates should take the following steps:

- Maintain copies: Keep copies of all research reports, articles containing research ideas, material with new statistical methodology, and other materials that were relied on in preparing the research report.
- Attribute quotations: Attribute to their sources any direct quotations, including projections, tables, statistics, model/product ideas, and new methodologies prepared by persons other than recognized financial and statistical reporting services or similar sources.
- Attribute summaries: Attribute to their sources paraphrases or summaries of material prepared by others.

STANDARD I(D) MISCONDUCT

The Standard

Members and candidates must not engage in any professional conduct involving dishonesty, fraud, or deceit, or commit any act that reflects adversely on their professional reputation, integrity, or competence.

Guidance

- While Standard I(A) addresses the obligation of members and candidates to comply with applicable law that governs their professional activities, Standard I(D) addresses all conduct that reflects poorly on the professional integrity, good reputation, or competence of members and candidates. Any act that involves lying, cheating, stealing, or other dishonest conduct is a violation of this standard if the offense reflects adversely on a member’s or candidate’s professional activities.
- Conduct that damages trustworthiness or competence may include behavior that, although not illegal, nevertheless negatively affects a member’s or candidate’s ability to perform his or her responsibilities. For example:
Abusing alcohol during business hours might constitute a violation of this standard because it could have a detrimental effect on the member’s or candidate’s ability to fulfill his or her professional responsibilities.

- Personal bankruptcy may not reflect on the integrity or trustworthiness of the person declaring bankruptcy, but if the circumstances of the bankruptcy involve fraudulent or deceitful business conduct, the bankruptcy may be a violation of this standard.

- In some cases, the absence of appropriate conduct or the lack of sufficient effort may be a violation of Standard I(D). The integrity of the investment profession is built on trust. A member or candidate—whether an investment banker, rating or research analyst, or portfolio manager—is expected to conduct the necessary due diligence to properly understand the nature and risks of an investment before making an investment recommendation. By not taking these steps and, instead, relying on someone else in the process to perform them, members or candidates may violate the trust their clients have placed in them. This loss of trust may have a significant impact on the reputation of the member or candidate and the operations of the financial market as a whole.

- Note that Standard I(D) or any other standard should not be used to settle personal, political, or other disputes unrelated to professional ethics.

Recommended Procedures for Compliance

Members and candidates should encourage their firms to adopt the following policies and procedures to support the principles of Standard I(D):

- **Code of ethics:** Develop and/or adopt a code of ethics to which every employee must subscribe, and make clear that any personal behavior that reflects poorly on the individual involved, the institution as a whole, or the investment industry will not be tolerated.

- **List of violations:** Disseminate to all employees a list of potential violations and associated disciplinary sanctions, up to and including dismissal from the firm.

- **Employee references:** Check references of potential employees to ensure that they are of good character and not ineligible to work in the investment industry because of past infractions of the law.

**STANDARD II(A) MATERIAL NONPUBLIC INFORMATION**

The Standard

Members and candidates who possess material nonpublic information that could affect the value of an investment must not act or cause others to act on the information.

Guidance

- Standard II(A) is related to information that is material and is nonpublic. Such information must not be used for direct buying and selling of individual securities or bonds, nor to influence investment actions related to derivatives, mutual funds, or other alternative investments.

Material Information

Information is “material” if its disclosure would likely have an impact on the price of a security, or if reasonable investors would want to know the information before making an investment.
decision. Material information may include, but is not limited to, information relating to the following:

- Earnings.
- Mergers, acquisitions, tender offers, or joint ventures.
- Changes in assets.
- Innovative products, processes, or discoveries.
- New licenses, patents, registered trademarks, or regulatory approval/rejection of a product.
- Developments regarding customers or suppliers (e.g., the acquisition or loss of a contract).
- Changes in management.
- Change in auditor notification or the fact that the issuer may no longer rely on an auditor’s report or qualified opinion.
- Events regarding the issuer’s securities (e.g., defaults on senior securities, calls of securities for redemption, repurchase plans, stock splits, changes in dividends, changes to the rights of security holders, public or private sales of additional securities, and changes in credit ratings).
- Bankruptcies.
- Significant legal disputes.
- Government reports of economic trends (employment, housing starts, currency information, etc.).
- Orders for large trades before they are executed.
- New or changing equity or debt ratings issued by a third party (e.g., sell-side recommendations and credit ratings).
- To determine if information is material, members and candidates should consider the source of information and the information’s likely effect on the relevant stock price.
  - The less reliable a source, such as a rumor, the less likely the information provided would be considered material.
  - The more ambiguous the effect on price, the less material the information becomes.
  - If it is unclear whether the information will affect the price of a security and to what extent, information may not be considered material.

Nonpublic Information
- Information is “nonpublic” until it has been disseminated or is available to the marketplace in general (as opposed to a select group of investors). “Disseminated” can be defined as “made known.”
  - For example, a company report of profits that is posted on the Internet and distributed widely through a press release or accompanied by a filing has been effectively disseminated to the marketplace.
- Members and candidates must be particularly aware of information that is selectively disclosed by corporations to a small group of investors, analysts, or other market participants. Information that is made available to analysts remains nonpublic until it is disseminated to investors in general.
- Analysts should also be alert to the possibility that they are selectively receiving material nonpublic information when a company provides them with guidance or interpretation of such publicly available information as financial statements or regulatory filings.
- A member or candidate may use insider information provided legitimately by the source company for the specific purpose of conducting due diligence according to the business agreement between the parties for such activities as mergers, loan underwriting, credit ratings, and offering engagements. However, the use of insider information provided by
the source company for other purposes, especially to trade or entice others to trade the securities of the firm, conflicts with this standard.

**Mosaic Theory**
- A financial analyst may use significant conclusions derived from the analysis of public information and nonmaterial nonpublic information as the basis for investment recommendations and decisions. Under the “mosaic theory,” financial analysts are free to act on this collection, or mosaic, of information without risking violation, even when the conclusion they reach would have been material inside information had the company communicated the same.
- Investment professionals should note, however, that although analysts are free to use mosaic information in their research reports, they should save and document all their research [see Standard V(C)].

**Social Media**
- Members and candidates participating in online discussion forums/groups with membership limitations should verify that material information obtained from these sources can also be accessed from a source that would be considered available to the public (e.g., company filings, webpages, and press releases).
- Members and candidates may use social media platforms to communicate with clients or investors without conflicting with this standard.
- Members and candidates, as required by Standard I(A), should also complete all appropriate regulatory filings related to information distributed through social media platforms.

**Using Industry Experts**
- The increased demand for insights for understanding the complexities of some industries has led to an expansion of engagement with outside experts. Members and candidates may provide compensation to individuals for their insights without violating this standard.
- However, members and candidates are ultimately responsible for ensuring that they are not requesting or acting on confidential information received from external experts, which is in violation of security regulations and laws or duties to others.

**Investment Research Reports**
- It might often be the case that reports prepared by well-known analysts may have an effect on the market and thus may be considered material information. Theoretically, such a report might have to be made public before it was distributed to clients. However, since the analyst is not a company insider, and presumably prepared the report based on publicly available information, the report does not need to be made public just because its conclusions are material. Investors who want to use that report can become clients of the analyst.

**Recommended Procedures for Compliance**

**Achieve public dissemination:** If a member or candidate determines that some nonpublic information is material, she should encourage the issuer to make the information public. If public dissemination is not possible, she must communicate the information only to the designated supervisory and compliance personnel in her firm and must not take investment action on the basis of the information.
Adopt compliance procedures: Members and candidates should encourage their firms to adopt compliance procedures to prevent the misuse of material nonpublic information. Particularly important is improving compliance in areas such as review of employee and proprietary trading, documentation of firm procedures, and the supervision of interdepartmental communications in multi-service firms.

Adopt disclosure procedures: Members and candidates should encourage their firms to develop and follow disclosure policies designed to ensure that information is disseminated in the marketplace in an equitable manner. An issuing company should not discriminate among analysts in the provision of information or blacklist particular analysts who have given negative reports on the company in the past.

Issue press releases: Companies should consider issuing press releases prior to analyst meetings and conference calls and scripting those meetings and calls to decrease the chance that further information will be disclosed.

Firewall elements: An information barrier commonly referred to as a “firewall” is the most widely used approach to prevent communication of material nonpublic information within firms. The minimum elements of such a system include, but are not limited to, the following:

- Substantial control of relevant interdepartmental communications, preferably through a clearance area within the firm in either the compliance or legal department;
- Review of employee trading through the maintenance of “watch,” “restricted,” and “rumor” lists;
- Documentation of the procedures designed to limit the flow of information between departments and of the enforcement actions taken pursuant to those procedures;
- Heightened review or restriction of proprietary trading while a firm is in possession of material nonpublic information.

Appropriate interdepartmental communications: Based on the size of the firm, procedures concerning interdepartmental communication, the review of trading activity, and the investigation of possible violations should be compiled and formalized.

Physical separation of departments: As a practical matter, to the extent possible, firms should consider the physical separation of departments and files to prevent the communication of sensitive information.

Prevention of personnel overlap: There should be no overlap of personnel between the investment banking and corporate finance areas of a brokerage firm and the sales and research departments or between a bank’s commercial lending department and its trust and research departments. For a firewall to be effective in a multi-service firm, an employee can be allowed to be on only one side of the wall at any given time.

A reporting system: The least a firm should do to protect itself from liability is have an information barrier in place. It should authorize people to review and approve communications between departments. A single supervisor or compliance officer should have the specific authority and responsibility of deciding whether or not information is material and whether it is sufficiently public to be used as the basis for investment decisions.

Personal trading limitations: Firms should also consider restrictions or prohibitions on personal trading by employees and should carefully monitor both proprietary trading and personal trading by employees. Further, they should require employees to make periodic...
reports (to the extent that such reporting is not already required by securities laws) of their own transactions and transactions made for the benefit of family members.

Securities should be placed on a restricted list when a firm has or may have material nonpublic information. Further, the watch list (seen only by compliance personnel) should be shown to only the few people responsible for compliance to monitor transactions in specified securities. The use of a watch list in combination with a restricted list has become a common means of ensuring an effective procedure.

**Record maintenance:** Multi-service firms should maintain written records of communications among various departments. Firms should place a high priority on training and should consider instituting comprehensive training programs, to enable employees to make informed decisions.

**Proprietary trading procedures:** Procedures concerning the restriction or review of a firm’s proprietary trading while it possesses material nonpublic information will necessarily depend on the types of proprietary trading in which a firm may engage. For example, when a firm acts as a market maker, a prohibition on proprietary trading may be counterproductive to the goals of maintaining the confidentiality of information and market liquidity. However, a firm should suspend arbitrage activity when a security is placed on the watch list.

**Communication to all employees:** Written compliance policies and guidelines should be circulated to all employees of a firm. Further, they must be given sufficient training to either be able to make an informed decision or to realize that they need to consult a compliance officer before engaging in questionable transactions.

**STANDARD II(B) MARKET MANIPULATION**

**The Standard**

Members and candidates must not engage in practices that distort prices or artificially inflate trading volume with the intent to mislead market participants.

**Guidance**

- Members and candidates must uphold market integrity by prohibiting market manipulation. Market manipulation includes practices that distort security prices or trading volume with the intent to deceive people or entities that rely on information in the market.
- Market manipulation includes (1) the dissemination of false or misleading information and (2) transactions that deceive or would be likely to mislead market participants by distorting the price-setting mechanism of financial instruments.

**Information-Based Manipulation**

- Information-based manipulation includes, but is not limited to, spreading false rumors to induce trading by others.
  - For example, members and candidates must refrain from “pumping up” the price of an investment by issuing misleading positive information or overly optimistic projections of a security’s worth only to later “dump” the investment (i.e., sell it) once the price, fueled by the misleading information’s effect on other market participants, reaches an artificially high level.
Transaction-Based Manipulation

- Transaction-based manipulation involves instances where a member or candidate knew or should have known that his or her actions could affect the pricing of a security. This type of manipulation includes, but is not limited to, the following:
  - Transactions that artificially affect prices or volume to give the impression of activity or price movement in a financial instrument, which represent a diversion from the expectations of a fair and efficient market.
  - Securing a controlling, dominant position in a financial instrument to exploit and manipulate the price of a related derivative and/or the underlying asset.

Note that Standard II(B) is not intended to preclude transactions undertaken on legitimate trading strategies based on perceived market inefficiencies. The intent of the action is critical to determining whether it is a violation of this standard.

STANDARD III(A) LOYALTY, PRUDENCE, AND CARE

The Standard

Members and candidates have a duty of loyalty to their clients and must act with reasonable care and exercise prudent judgment. Members and candidates must act for the benefit of their clients and place their clients’ interests before their employer’s or their own interests.

Guidance

- Standard III(A) clarifies that client interests are paramount. A member’s or candidate’s responsibility to a client includes a duty of loyalty and a duty to exercise reasonable care. Investment actions must be carried out for the sole benefit of the client and in a manner the member or candidate believes, given the known facts and circumstances, to be in the best interest of the client. Members and candidates must exercise the same level of prudence, judgment, and care that they would apply in the management and disposition of their own interests in similar circumstances.

  Prudence requires caution and discretion. The exercise of prudence by investment professionals requires that they act with the care, skill, and diligence that a reasonable person acting in a like capacity and familiar with such matters would use. In the context of managing a client’s portfolio, prudence requires following the investment parameters set forth by the client and balancing risk and return. Acting with care requires members and candidates to act in a prudent and judicious manner in avoiding harm to clients.

- Standard III(A), however, is not a substitute for a member’s or candidate’s legal or regulatory obligations. As stated in Standard I(A), members and candidates must abide by the most strict requirements imposed on them by regulators or the Code and Standards, including any legally imposed fiduciary duty.

- Members and candidates must also be aware of whether they have “custody” or effective control of client assets. If so, a heightened level of responsibility arises. Members and candidates are considered to have custody if they have any direct or indirect access to client funds. Members and candidates must manage any pool of assets in their control in accordance with the terms of the governing documents (such as trust documents and investment management agreements), which are the primary determinant of the manager’s powers and duties.

Understanding the Application of Loyalty, Prudence, and Care

- Standard III(A) establishes a minimum benchmark for the duties of loyalty, prudence, and care that are required of all members and candidates regardless of whether a legal fiduciary duty applies. Although fiduciary duty often encompasses the principles of
loyalty, prudence, and care, Standard III(A) does not render all members and candidates fiduciaries. The responsibilities of members and candidates for fulfilling their obligations under this standard depend greatly on the nature of their professional responsibilities and the relationships they have with clients.

- There is a large variety of professional relationships that members and candidates have with their clients. Standard III(A) requires them to fulfill the obligations outlined explicitly or implicitly in the client agreements to the best of their abilities and with loyalty, prudence, and care. Whether a member or candidate is structuring a new securitization transaction, completing a credit rating analysis, or leading a public company, he or she must work with prudence and care in delivering the agreed-on services.

Identifying the Actual Investment Client

- The first step for members and candidates in fulfilling their duty of loyalty to clients is to determine the identity of the “client” to whom the duty of loyalty is owed. In the context of an investment manager managing the personal assets of an individual, the client is easily identified. When the manager is responsible for the portfolios of pension plans or trusts, however, the client is not the person or entity who hires the manager but, rather, the beneficiaries of the plan or trust. The duty of loyalty is owed to the ultimate beneficiaries.
- Members and candidates managing a fund to an index or an expected mandate owe the duty of loyalty, prudence, and care to invest in a manner consistent with the stated mandate. The decisions of a fund’s manager, although benefiting all fund investors, do not have to be based on an individual investor’s requirements and risk profile. Client loyalty and care for those investing in the fund are the responsibility of members and candidates who have an advisory relationship with those individuals.

Developing the Client’s Portfolio

- Professional investment managers should ensure that the client’s objectives and expectations for the performance of the account are realistic and suitable to the client’s circumstances and that the risks involved are appropriate. In most circumstances, recommended investment strategies should relate to the long-term objectives and circumstances of the client.
- When members and candidates cannot avoid potential conflicts between their firm and clients’ interests, they must provide clear and factual disclosures of the circumstances to the clients.
- Members and candidates must follow any guidelines set by their clients for the management of their assets.
- Investment decisions must be judged in the context of the total portfolio rather than by individual investments within the portfolio. The member’s or candidate’s duty is satisfied with respect to a particular investment if the individual has thoroughly considered the investment’s place in the overall portfolio, the risk of loss and opportunity for gains, tax implications, and the diversification, liquidity, cash flow, and overall return requirements of the assets or the portion of the assets for which the manager is responsible.

Soft Commission Policies

- An investment manager often has discretion over the selection of brokers executing transactions. Conflicts may arise when an investment manager uses client brokerage to purchase research services, a practice commonly called “soft dollars” or “soft commissions.” A member or candidate who pays a higher brokerage commission than he
or she would normally pay to allow for the purchase of goods or services, without corresponding benefit to the client, violates the duty of loyalty to the client.

- From time to time, a client will direct a manager to use the client’s brokerage to purchase goods or services for the client, a practice that is commonly called “directed brokerage.” Because brokerage commission is an asset of the client and is used to benefit that client, not the manager, such a practice does not violate any duty of loyalty. However, a member or candidate is obligated to seek “best price” and “best execution” and be assured by the client that the goods or services purchased from the brokerage will benefit the account beneficiaries. In addition, the member or candidate should disclose to the client that the client may not be getting best execution from the directed brokerage.
  - “Best execution” refers to a trading process that seeks to maximize the value of the client’s portfolio within the client’s stated investment objectives and constraints.

**Proxy Voting Policies**

- Part of a member’s or candidate’s duty of loyalty includes voting proxies in an informed and responsible manner. Proxies have economic value to a client, and members and candidates must ensure that they properly safeguard and maximize this value.
- An investment manager who fails to vote, casts a vote without considering the impact of the question, or votes blindly with management on non-routine governance issues (e.g., a change in company capitalization) may violate this standard. Voting of proxies is an integral part of the management of investments.
- A cost-benefit analysis may show that voting all proxies may not benefit the client, so voting proxies may not be necessary in all instances.
- Members and candidates should disclose to clients their proxy voting policies.

**Recommended Procedures for Compliance**

**Regular Account Information**

Members and candidates with control of client assets should:

- Submit to each client, at least quarterly, an itemized statement showing the funds and securities in the custody or possession of the member or candidate plus all debits, credits, and transactions that occurred during the period.
- Disclose to the client where the assets are to be maintained, as well as where or when they are moved.
- Separate the client’s assets from any other party’s assets, including the member’s or candidate’s own assets.

**Client Approval**

- If a member or candidate is uncertain about the appropriate course of action with respect to a client, the member or candidate should consider what he or she would expect or demand if the member or candidate were the client.
- If in doubt, a member or candidate should disclose the questionable matter in writing to the client and obtain client approval.

**Firm Policies**

Members and candidates should address and encourage their firms to address the following topics when drafting the statements or manuals containing their policies and procedures regarding responsibilities to clients:
• **Follow all applicable rules and laws:** Members and candidates must follow all legal requirements and applicable provisions of the Code and Standards.

• **Establish the investment objectives of the client:** Make a reasonable inquiry into a client’s investment experience, risk and return objectives, and financial constraints prior to making investment recommendations or taking investment actions.

• **Consider all the information when taking actions:** When taking investment actions, members and candidates must consider the appropriateness and suitability of the investment relative to (1) the client’s needs and circumstances, (2) the investment’s basic characteristics, and (3) the basic characteristics of the total portfolio.

• **Diversify:** Members and candidates should diversify investments to reduce the risk of loss, unless diversification is not consistent with plan guidelines or is contrary to the account objectives.

• **Carry out regular reviews:** Members and candidates should establish regular review schedules to ensure that the investments held in the account adhere to the terms of the governing documents.

• **Deal fairly with all clients with respect to investment actions:** Members and candidates must not favor some clients over others and should establish policies for allocating trades and disseminating investment recommendations.

• **Disclose conflicts of interest:** Members and candidates must disclose all actual and potential conflicts of interest so that clients can evaluate those conflicts.

• **Disclose compensation arrangements:** Members and candidates should make their clients aware of all forms of manager compensation.

• **Vote proxies:** In most cases, members and candidates should determine who is authorized to vote shares and vote proxies in the best interests of the clients and ultimate beneficiaries.

• **Maintain confidentiality:** Members and candidates must preserve the confidentiality of client information.

• **Seek best execution:** Unless directed by the client as ultimate beneficiary, members and candidates must seek best execution for their clients. (Best execution is defined in the preceding text.)

• **Place client interests first:** Members and candidates must serve the best interests of clients.

**Standard III(B) Fair Dealing**

**The Standard**

Members and candidates must deal fairly and objectively with all clients when providing investment analysis, making investment recommendations, taking investment action, or engaging in other professional activities.

**Guidance**

- Standard III(B) requires members and candidates to treat all clients fairly when disseminating investment recommendations or making material changes to prior investment recommendations, or when taking investment action with regard to general purchases, new issues, or secondary offerings.

- The term “fairly” implies that the member or candidate must take care not to discriminate against any clients when disseminating investment recommendations or taking investment action. Standard III(B) does not state “equally” because members and candidates could not possibly reach all clients at exactly the same time. Further, each client has unique needs, investment criteria, and investment objectives, so not all investment opportunities are suitable for all clients.
Members and candidates may provide more personal, specialized, or in-depth service to clients who are willing to pay for premium services through higher management fees or higher levels of brokerage. Members and candidates may differentiate their services to clients, but different levels of service must not disadvantage or negatively affect clients. In addition, the different service levels should be disclosed to clients and prospective clients and should be available to everyone (i.e., different service levels should not be offered selectively).

**Investment Recommendations**

- An investment recommendation is any opinion expressed by a member or candidate in regard to purchasing, selling, or holding a given security or other investment. The opinion may be disseminated to customers or clients through an initial detailed research report, through a brief update report, by addition to or deletion from a list of recommended securities, or simply by oral communication. A recommendation that is distributed to anyone outside the organization is considered a communication for general distribution under Standard III(B).
- Each member or candidate is obligated to ensure that information is disseminated in such a manner that all clients have a fair opportunity to act on every recommendation. Members and candidates should encourage their firms to design an equitable system to prevent selective or discriminatory disclosure and should inform clients about what kind of communications they will receive.
- The duty to clients imposed by Standard III(B) may be more critical when members or candidates change their recommendations than when they make initial recommendations. Material changes in a member’s or candidate’s prior investment recommendations because of subsequent research should be communicated to all current clients; particular care should be taken that the information reaches those clients who the member or candidate knows have acted on or been affected by the earlier advice.
- Clients who do not know that the member or candidate has changed a recommendation and who, therefore, place orders contrary to a current recommendation should be advised of the changed recommendation before the order is accepted.

**Investment Action**

- Members or candidates must treat all clients fairly in light of their investment objectives and circumstances. For example, when making investments in new offerings or in secondary financings, members and candidates should distribute the issues to all customers for whom the investments are appropriate in a manner consistent with the policies of the firm for allocating blocks of stock. If the issue is oversubscribed, then the issue should be prorated to all subscribers. If the issue is oversubscribed, members and candidates should forgo any sales to themselves or their immediate families in order to free up additional shares for clients.
  - If the investment professional’s family-member accounts are managed similarly to the accounts of other clients of the firm, however, the family-member accounts should not be excluded from buying such shares.
- Members and candidates must make every effort to treat all individual and institutional clients in a fair and impartial manner.
- Members and candidates should disclose to clients and prospective clients the documented allocation procedures they or their firms have in place and how the procedures would affect the client or prospect. The disclosure should be clear and complete so that the client can make an informed investment decision. Even when complete disclosure is made, however, members and candidates must put client interests ahead of their own. A member’s or candidate’s duty of fairness and loyalty to clients can never be overridden by client consent to patently unfair allocation procedures.
• Treating clients fairly also means that members and candidates should not take
advantage of their position in the industry to the detriment of clients. For instance, in the
context of IPOs, members and candidates must make bona fide public distributions of
“hot issue” securities (defined as securities of a public offering that are trading at a
premium in the secondary market whenever such trading commences because of the
great demand for the securities). Members and candidates are prohibited from
withholding such securities for their own benefit and must not use such securities as a
reward or incentive to gain benefit.

Recommended Procedures for Compliance

Develop Firm Policies
• A member or candidate should recommend appropriate procedures to management if
none are in place.
• A member or candidate should make management aware of possible violations of fair-
dealing practices within the firm when they come to the attention of the member or
candidate.
• Although a member or candidate need not communicate a recommendation to all
customers, the selection process by which customers receive information should be
based on suitability and known interest, not on any preferred or favored status.

A common practice to assure fair dealing is to communicate recommendations simultaneously
within the firm and to customers. Members and candidates should consider the following points
when establishing fair-dealing compliance procedures:

• Limit the number of people involved.
• Shorten the time frame between decision and dissemination.
• Publish guidelines for pre-dissemination behavior.
• Simultaneous dissemination.
• Maintain a list of clients and their holdings.
• Develop and document trade allocation procedures that ensure:
  ○ Fairness to advisory clients, both in priority of execution of orders and in the
    allocation of the price obtained in execution of block orders or trades.
  ○ Timeliness and efficiency in the execution of orders.
  ○ Accuracy of the member’s or candidate’s records as to trade orders and client
    account positions.

With these principles in mind, members and candidates should develop or encourage their firm
to develop written allocation procedures, with particular attention to procedures for block trades
and new issues. Procedures to consider are as follows:

• Requiring orders and modifications or cancellations of orders to be documented and time
  stamped.
• Processing and executing orders on a first-in, first-out basis with consideration of
  bundling orders for efficiency as appropriate for the asset class or the security.
• Developing a policy to address such issues as calculating execution prices and “partial
  fills” when trades are grouped, or in a block, for efficiency.
• Giving all client accounts participating in a block trade the same execution price and
  charging the same commission.
• When the full amount of the block order is not executed, allocating partially executed
  orders among the participating client accounts pro rata on the basis of order size while
  not going below an established minimum lot size for some securities (e.g., bonds).
• When allocating trades for new issues, obtaining advance indications of interest, allocating securities by client (rather than portfolio manager), and providing a method for calculating allocations.

**Disclose Trade Allocation Procedures**
• Members and candidates should disclose to clients and prospective clients how they select accounts to participate in an order and how they determine the amount of securities each account will buy or sell. Trade allocation procedures must be fair and equitable, and disclosure of inequitable allocation methods does not relieve the member or candidate of this obligation.

**Establish Systematic Account Review**
• Member and candidate supervisors should review each account on a regular basis to ensure that no client or customer is being given preferential treatment and that the investment actions taken for each account are suitable for each account’s objectives.
• Because investments should be based on individual needs and circumstances, an investment manager may have good reasons for placing a given security or other investment in one account while selling it from another account and should fully document the reasons behind both sides of the transaction.
• Members and candidates should encourage firms to establish review procedures, however, to detect whether trading in one account is being used to benefit a favored client.

**Disclose Levels of Service**
• Members and candidates should disclose to all clients whether the organization offers different levels of service to clients for the same fee or different fees.
• Different levels of service should not be offered to clients selectively.

**Standard III(C) Suitability**

**The Standard**
1. When members and candidates are in an **advisory relationship with a client**, they must:
   a. Make a reasonable inquiry into a client’s or prospective client’s investment experience, risk and return objectives, and financial constraints prior to making any investment recommendation or taking investment action and must reassess and update this information regularly.
   b. Determine that an investment is suitable to the client’s financial situation and consistent with the client’s written objectives, mandates, and constraints before making an investment recommendation or taking investment action.
   c. Judge the suitability of investments in the context of the client’s total portfolio.
2. When members and candidates are **responsible for managing a portfolio to a specific mandate, strategy, or style**, they must make only investment recommendations or take only investment actions that are consistent with the stated objectives and constraints of the portfolio. In other words, there is no need for an investment policy statement when managing to a specific mandate.

**Guidance**
• Standard III(C) requires that members and candidates who are in an investment advisory relationship with clients consider carefully the needs, circumstances, and objectives of
the clients when determining the appropriateness and suitability of a given investment or course of investment action.

- In judging the suitability of a potential investment, the member or candidate should review many aspects of the client’s knowledge, experience related to investing, and financial situation. These aspects include, but are not limited to, the risk profile of the investment as compared with the constraints of the client, the impact of the investment on the diversity of the portfolio, and whether the client has the means or net worth to assume the associated risk. The investment professional’s determination of suitability should reflect only the investment recommendations or actions that a prudent person would be willing to undertake. Not every investment opportunity will be suitable for every portfolio, regardless of the potential return being offered.
- The responsibilities of members and candidates to gather information and make a suitability analysis prior to making a recommendation or taking investment action fall on those members and candidates who provide investment advice in the course of an advisory relationship with a client. Other members and candidates who are simply executing specific instructions for retail clients when buying or selling securities, may not have the opportunity to judge the suitability of a particular investment for the ultimate client.

**Developing an Investment Policy When an Advisory Relationship Exists**

- When an advisory relationship exists, members and candidates must gather client information at the inception of the relationship. Such information includes the client’s financial circumstances, personal data (such as age and occupation) that are relevant to investment decisions, attitudes toward risk, and objectives in investing. This information should be incorporated into a written investment policy statement (IPS) that addresses the client’s risk tolerance, return requirements, and all investment constraints (including time horizon, liquidity needs, tax concerns, legal and regulatory factors, and unique circumstances).
- The IPS also should identify and describe the roles and responsibilities of the parties to the advisory relationship and investment process, as well as schedules for review and evaluation of the IPS.
- After formulating long-term capital market expectations, members and candidates can assist in developing an appropriate strategic asset allocation and investment program for the client, whether these are presented in separate documents or incorporated in the IPS or in appendices to the IPS.

**Understanding the Client’s Risk Profile**

- The investment professional must consider the possibilities of rapidly changing investment environments and their likely impact on a client’s holdings, both individual securities and the collective portfolio.
- The risk of many investment strategies can and should be analyzed and quantified in advance.
- Members and candidates should pay careful attention to the leverage inherent in many synthetic investment vehicles or products when considering them for use in a client’s investment program.

**Updating an Investment Policy**

- Updating the IPS should be repeated at least annually and also prior to material changes to any specific investment recommendations or decisions on behalf of the client.
  - For an individual client, important changes might include the number of dependents, personal tax status, health, liquidity needs, risk tolerance, amount of...
wealth beyond that represented in the portfolio, and extent to which compensation and other income provide for current income needs.

- For an institutional client, such changes might relate to the magnitude of unfunded liabilities in a pension fund, the withdrawal privileges in an employee savings plan, or the distribution requirements of a charitable foundation.

- If clients withhold information about their financial portfolios, the suitability analysis conducted by members and candidates cannot be expected to be complete; it must be based on the information provided.

The Need for Diversification

- The unique characteristics (or risks) of an individual investment may become partially or entirely neutralized when it is combined with other individual investments within a portfolio. Therefore, a reasonable amount of diversification is thus the norm for many portfolios.
- An investment with high relative risk on its own may be a suitable investment in the context of the entire portfolio or when the client’s stated objectives contemplate speculative or risky investments.
- Members and candidates can be responsible for assessing the suitability of an investment only on the basis of the information and criteria actually provided by the client.

Addressing Unsolicited Trading Requests

- If an unsolicited request is expected to have only a minimum impact on the entire portfolio because the size of the requested trade is small or the trade would result in a limited change to the portfolio’s risk profile, the member or candidate should focus on educating the investor on how the request deviates from the current policy statement, and then she may follow her firm’s policies regarding the necessary client approval for executing unsuitable trades. At a minimum, the client should acknowledge the discussion and accept the conditions that make the recommendation unsuitable.
- If an unsolicited request is expected to have a material impact on the portfolio, the member or candidate should use this opportunity to update the investment policy statement. Doing so would allow the client to fully understand the potential effect of the requested trade on his or her current goals or risk levels.
- If the client declines to modify her policy statements while insisting an unsolicited trade be made, the member or candidate will need to evaluate the effectiveness of her services to the client. The options available to the members or candidates will depend on the services provided by their employer. Some firms may allow for the trade to be executed in a new unmanaged account. If alternative options are not available, members and candidates ultimately will need to determine whether they should continue the advisory arrangement with the client.

Managing to an Index or Mandate

Some members and candidates do not manage money for individuals but are responsible for managing a fund to an index or an expected mandate. The responsibility of these members and candidates is to invest in a manner consistent with the stated mandate but without having to prepare the IPS for the client.

Recommended Procedures for Compliance

Investment Policy Statement

In formulating an investment policy for the client, the member or candidate should take the following into consideration:
- **Client identification**—(1) type and nature of client, (2) the existence of separate beneficiaries, and (3) approximate portion of total client assets that the member or candidate is managing.
- **Investor objectives**—(1) return objectives (income, growth in principal, maintenance of purchasing power) and (2) risk tolerance (suitability, stability of values).
- **Investor constraints**—(1) liquidity needs, (2) expected cash flows (patterns of additions and/or withdrawals), (3) investable funds (assets and liabilities or other commitments), (4) time horizon, (5) tax considerations, (6) regulatory and legal circumstances, (7) investor preferences, prohibitions, circumstances, and unique needs, and (8) proxy voting responsibilities and guidance.
- **Performance measurement benchmarks.**

**Regular Updates**
- The investor’s objectives and constraints should be maintained and reviewed periodically to reflect any changes in the client’s circumstances.

**Suitability Test Policies**
- With the increase in regulatory required suitability tests, members and candidates should encourage their firms to develop related policies and procedures. The test procedures should require the investment professional to look beyond the potential return of the investment and include the following:
  - An analysis of the impact on the portfolio’s diversification.
  - A comparison of the investment risks with the client’s assessed risk tolerance.
  - The fit of the investment with the required investment strategy.

**Standard III(D) Performance Presentation**

**The Standard**
When communicating investment performance information, members and candidates must make reasonable efforts to ensure that it is fair, accurate, and complete.

**Guidance**
- Members and candidates must provide credible performance information to clients and prospective clients and to avoid misstating performance or misleading clients and prospective clients about the investment performance of members or candidates or their firms.
- Standard III(D) covers any practice that would lead to misrepresentation of a member’s or candidate’s performance record, whether the practice involves performance presentation or performance measurement.
- Members and candidates should not state or imply that clients will obtain or benefit from a rate of return that was generated in the past.
- Research analysts promoting the success or accuracy of their recommendations must ensure that their claims are fair, accurate, and complete.
- If the presentation is brief, the member or candidate must make available to clients and prospects, on request, the detailed information supporting that communication. Best practice dictates that brief presentations include a reference to the limited nature of the information provided.
Recommended Procedures for Compliance

Apply the GIPS Standards
- Compliance with the GIPS standards is the best method to meet their obligations under Standard III(D).

Compliance without Applying GIPS Standards
Members and candidates can also meet their obligations under Standard III(D) by:
- Considering the knowledge and sophistication of the audience to whom a performance presentation is addressed.
- Presenting the performance of the weighted composite of similar portfolios rather than using a single representative account.
- Including terminated accounts as part of performance history with a clear indication of when the accounts were terminated.
- Including disclosures that fully explain the performance results being reported (for example, stating, when appropriate, that results are simulated when model results are used, clearly indicating when the performance record is that of a prior entity, or disclosing whether the performance is gross of fees, net of fees, or after tax).
- Maintaining the data and records used to calculate the performance being presented.

Standard III(E) Preservation of Confidentiality

The Standard
Members and candidates must keep information about current, former, and prospective clients confidential unless:

1. The information concerns illegal activities on the part of the client;
2. Disclosure is required by law; or
3. The client or prospective client permits disclosure of the information.

Guidance
- Members and candidates must preserve the confidentiality of information communicated to them by their clients, prospective clients, and former clients. This standard is applicable when (1) the member or candidate receives information because of his or her special ability to conduct a portion of the client’s business or personal affairs and (2) the member or candidate receives information that arises from or is relevant to that portion of the client’s business that is the subject of the special or confidential relationship.
- If disclosure of the information is required by law or the information concerns illegal activities by the client, however, the member or candidate may have an obligation to report the activities to the appropriate authorities.

Status of Client
- This standard protects the confidentiality of client information even if the person or entity is no longer a client of the member or candidate. Therefore, members and candidates must continue to maintain the confidentiality of client records even after the client relationship has ended.
- If a client or former client expressly authorizes the member or candidate to disclose information, however, the member or candidate may follow the terms of the authorization and provide the information.
Compliance with Laws
- As a general matter, members and candidates must comply with applicable law. If applicable law requires disclosure of client information in certain circumstances, members and candidates must comply with the law. Similarly, if applicable law requires members and candidates to maintain confidentiality, even if the information concerns illegal activities on the part of the client, members and candidates must not disclose such information.
- When in doubt, members and candidates should consult with their employer’s compliance personnel or legal counsel before disclosing confidential information about clients.

Electronic Information and Security
- Standard III(E) does not require members or candidates to become experts in information security technology, but they should have a thorough understanding of the policies of their employer.
- Members and candidates should encourage their firm to conduct regular periodic training on confidentiality procedures for all firm personnel, including portfolio associates, receptionists, and other non-investment staff who have routine direct contact with clients and their records.

Professional Conduct Investigations by CFA Institute
- The requirements of Standard III(E) are not intended to prevent members and candidates from cooperating with an investigation by the CFA Institute Professional Conduct Program (PCP). When permissible under applicable law, members and candidates shall consider the PCP an extension of themselves when requested to provide information about a client in support of a PCP investigation into their own conduct.

Recommended Procedures for Compliance
The simplest, most conservative, and most effective way to comply with Standard III(E) is to avoid disclosing any information received from a client except to authorized fellow employees who are also working for the client. In some instances, however, a member or candidate may want to disclose information received from clients that is outside the scope of the confidential relationship and does not involve illegal activities. Before making such a disclosure, a member or candidate should ask the following:
- In what context was the information disclosed? If disclosed in a discussion of work being performed for the client, is the information relevant to the work?
- Is the information background material that, if disclosed, will enable the member or candidate to improve service to the client?

Communicating with Clients
- Members and candidates should make reasonable efforts to ensure that firm-supported communication methods and compliance procedures follow practices designed for preventing accidental distribution of confidential information.
- Members and candidates should be diligent in discussing with clients the appropriate methods for providing confidential information. It is important to convey to clients that not all firm-sponsored resources may be appropriate for such communications.
Standard IV(A) Loyalty

The Standard
In matters related to their employment, members and candidates must act for the benefit of their employer and not deprive their employer of the advantage of their skills and abilities, divulge confidential information, or otherwise cause harm to their employer.

Guidance
- Members and candidates should protect the interests of their firm by refraining from any conduct that would injure the firm, deprive it of profit, or deprive it of the member’s or candidate’s skills and ability.
- Members and candidates must always place the interests of clients above the interests of their employer but should also consider the effects of their conduct on the sustainability and integrity of the employer firm.
- In matters related to their employment, members and candidates must comply with the policies and procedures established by their employers that govern the employer-employee relationship—to the extent that such policies and procedures do not conflict with applicable laws, rules, or regulations or the Code and Standards.
- The standard does not require members and candidates to subordinate important personal and family obligations to their work.

Employer Responsibilities
- Employers must recognize the duties and responsibilities that they owe to their employees if they expect to have content and productive employees.
- Members and candidates are encouraged to provide their employer with a copy of the Code and Standards.
- Employers are not obligated to adhere to the Code and Standards. In expecting to retain competent employees who are members and candidates, however, they should not develop conflicting policies and procedures.

Independent Practice
- Members and candidates must abstain from independent competitive activity that could conflict with the interests of their employer.
- Members and candidates who plan to engage in independent practice for compensation must notify their employer and describe the types of services they will render to prospective independent clients, the expected duration of the services, and the compensation for the services.
- Members and candidates should not render services until they receive consent from their employer to all of the terms of the arrangement.
  - “Practice” means any service that the employer currently makes available for remuneration.
  - “Undertaking independent practice” means engaging in competitive business, as opposed to making preparations to begin such practice.

Leaving an Employer
- When members and candidates are planning to leave their current employer, they must continue to act in the employer’s best interest. They must not engage in any activities that would conflict with this duty until their resignation becomes effective.
- Activities that might constitute a violation, especially in combination, include the following:
  - Misappropriation of trade secrets.
  - Misuse of confidential information.
○ Solicitation of the employer’s clients prior to cessation of employment.
○ Self-dealing (appropriating for one’s own property a business opportunity or
information belonging to one’s employer).
○ Misappropriation of clients or client lists.

• A departing employee is generally free to make arrangements or preparations to go into a
competitive business before terminating the relationship with his or her employer as long
as such preparations do not breach the employee’s duty of loyalty.

• A member or candidate who is contemplating seeking other employment must not
contact existing clients or potential clients prior to leaving his or her employer for
purposes of soliciting their business for the new employer. Once notice is provided to the
employer of the intent to resign, the member or candidate must follow the employer’s
policies and procedures related to notifying clients of his or her planned departure. In
addition, the member or candidate must not take records or files to a new employer
without the written permission of the previous employer.

• Once an employee has left the firm, the skills and experience that an employee obtained
while employed are not “confidential” or “privileged” information. Similarly, simple
knowledge of the names and existence of former clients is generally not confidential
information unless deemed such by an agreement or by law.

• Standard IV(A) does not prohibit experience or knowledge gained at one employer from
being used at another employer. Firm records or work performed on behalf of the firm
that is stored in paper copy or electronically for the member’s or candidate’s
convenience while employed, however, should be erased or returned to the employer
unless the firm gives permission to keep those records after employment ends.

• The standard does not prohibit former employees from contacting clients of their
previous firm as long as the contact information does not come from the records of the
former employer or violate an applicable “non-compete agreement.” Members and
candidates are free to use public information after departing to contact former clients
without violating Standard IV(A) as long as there is no specific agreement not to do so.

Use of Social Media
• Members and candidates should understand and abide by all applicable firm policies and
regulations as to the acceptable use of social media platforms to interact with clients and
prospective clients.

• Specific accounts and user profiles of members and candidates may be created for solely
professional reasons, including firm-approved accounts for client engagements. Such
firm-approved business-related accounts would be considered part of the firm’s assets,
thus requiring members and candidates to transfer or delete the accounts as directed by
their firm’s policies and procedures.

• Best practice for members and candidates is to maintain separate accounts for their
personal and professional social media activities. Members and candidates should
discuss with their employers how profiles should be treated when a single account
includes personal connections and also is used to conduct aspects of their professional
activities.

Whistleblowing
Sometimes, circumstances may arise (e.g., when an employer is engaged in illegal or unethical
activity) in which members and candidates must act contrary to their employer’s interests in
order to comply with their duties to the market and clients. In such instances, activities that
would normally violate a member’s or candidate’s duty to his or her employer (such as
contradicting employer instructions, violating certain policies and procedures, or preserving a
record by copying employer records) may be justified. However, such action would be
permitted only if the intent is clearly aimed at protecting clients or the integrity of the market, not for personal gain.

Nature of Employment

- Members and candidates must determine whether they are employees or independent contractors in order to determine the applicability of Standard IV(A). This issue will be decided largely by the degree of control exercised by the employing entity over the member or candidate. Factors determining control include whether the member’s or candidate’s hours, work location, and other parameters of the job are set; whether facilities are provided to the member or candidate; whether the member’s or candidate’s expenses are reimbursed; whether the member or candidate seeks work from other employers; and the number of clients or employers the member or candidate works for.
- A member’s or candidate’s duties within an independent contractor relationship are governed by the oral or written agreement between the member and the client. Members and candidates should take care to define clearly the scope of their responsibilities and the expectations of each client within the context of each relationship. Once a member or candidate establishes a relationship with a client, the member or candidate has a duty to abide by the terms of the agreement.

Recommended Procedures for Compliance

Competition Policy

- A member or candidate must understand any restrictions placed by the employer on offering similar services outside the firm while employed by the firm.
- If a member’s or candidate’s employer elects to have its employees sign a non-compete agreement as part of the employment agreement, the member or candidate should ensure that the details are clear and fully explained prior to signing the agreement.

Termination Policy

- Members and candidates should clearly understand the termination policies of their employer. Termination policies should:
  - Establish clear procedures regarding the resignation process, including addressing how the termination will be disclosed to clients and staff and whether updates posted through social media platforms will be allowed.
  - Outline the procedures for transferring ongoing research and account management responsibilities.
  - Address agreements that allow departing employees to remove specific client-related information upon resignation.

Incident-Reporting Procedures

- Members and candidates should be aware of their firm’s policies related to whistleblowing and encourage their firm to adopt industry best practices in this area.

Employee Classification

- Members and candidates should understand their status within their employer firm.

Standard IV(B) Additional Compensation Arrangements

The Standard
Members and candidates must not accept gifts, benefits, compensation, or consideration that competes with 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.
Guidance

- Members and candidates must obtain permission from their employer before accepting compensation or other benefits from third parties for the services rendered to the employer or for any services that might create a conflict with their employer’s interest.
  - Compensation and benefits include direct compensation by the client and any indirect compensation or other benefits received from third parties.
  - “Written consent” includes any form of communication that can be documented (for example, communication via e-mail that can be retrieved and documented).

Recommended Procedures for Compliance

- Members and candidates should make an immediate written report to their supervisor and compliance officer specifying any compensation they propose to receive for services in addition to the compensation or benefits received from their employer.
- The details of the report should be confirmed by the party offering the additional compensation, including performance incentives offered by clients.
- This written report should state the terms of any agreement under which a member or candidate will receive additional compensation; “terms” include the nature of the compensation, the approximate amount of compensation, and the duration of the agreement.

Standard IV(C) Responsibilities of Supervisors

The Standard
Members and candidates must make reasonable efforts to ensure that anyone subject to their supervision or authority complies with applicable laws, rules, regulations, and the Code and Standards.

Guidance

- Members and candidates must promote actions by all employees under their supervision and authority to comply with applicable laws, rules, regulations, and firm policies, and the Code and Standards.
- A member’s or candidate’s responsibilities under Standard IV(C) include instructing those subordinates to whom supervision is delegated about methods to promote compliance, including preventing and detecting violations of laws, rules, regulations, firm policies, and the Code and Standards.
- At a minimum, Standard IV(C) requires that members and candidates with supervisory responsibility make reasonable efforts to prevent and detect violations by ensuring the establishment of effective compliance systems. However, an effective compliance system goes beyond enacting a code of ethics, establishing policies and procedures to achieve compliance with the code and applicable law, and reviewing employee actions to determine whether they are following the rules.
- To be effective supervisors, members and candidates should implement education and training programs on a recurring or regular basis for employees under their supervision. Further, establishing incentives—monetary or otherwise—for employees not only to meet business goals but also to reward ethical behavior offers supervisors another way to assist employees in complying with their legal and ethical obligations.
- A member or candidate with supervisory responsibility should bring an inadequate compliance system to the attention of the firm’s senior managers and recommend corrective action. If the member or candidate clearly cannot discharge supervisory responsibilities because of the absence of a compliance system or because of an inadequate compliance system, the member or candidate should decline in writing to
accept supervisory responsibility until the firm adopts reasonable procedures to allow adequate exercise of supervisory responsibility.

**System for Supervision**
- Members and candidates with supervisory responsibility must understand what constitutes an adequate compliance system for their firms and make reasonable efforts to see that appropriate compliance procedures are established, documented, communicated to covered personnel, and followed.
  - “Adequate” procedures are those designed to meet industry standards, regulatory requirements, the requirements of the Code and Standards, and the circumstances of the firm.
  - To be effective, compliance procedures must be in place prior to the occurrence of a violation of the law or the Code and Standards.
- Once a supervisor learns that an employee has violated or may have violated the law or the Code and Standards, the supervisor must promptly initiate an assessment to determine the extent of the wrongdoing. Relying on an employee’s statements about the extent of the violation or assurances that the wrongdoing will not reoccur is not enough. Reporting the misconduct up the chain of command and warning the employee to cease the activity are also not enough. Pending the outcome of the investigation, a supervisor should take steps to ensure that the violation will not be repeated, such as placing limits on the employee’s activities or increasing the monitoring of the employee’s activities.

**Supervision Includes Detection**
- Members and candidates with supervisory responsibility must also make reasonable efforts to detect violations of laws, rules, regulations, firm policies, and the Code and Standards. If a member or candidate has adopted reasonable procedures and taken steps to institute an effective compliance program, then the member or candidate may not be in violation of Standard IV(C) if he or she does not detect violations that occur despite these efforts. The fact that violations do occur may indicate, however, that the compliance procedures are inadequate.
- In addition, in some cases, merely enacting such procedures may not be sufficient to fulfill the duty required by Standard IV(C). A member or candidate may be in violation of Standard IV(C) if he or she knows or should know that the procedures designed to promote compliance, including detecting and preventing violations, are not being followed.

**Recommended Procedures for Compliance**

**Codes of Ethics or Compliance Procedures**
- Members and candidates are encouraged to recommend that their employers adopt a code of ethics, and put in place specific policies and procedures needed to ensure compliance with the codes and with securities laws and regulations.
- Members and candidates should encourage their employers to provide their codes of ethics to clients.

**Adequate Compliance Procedures**
Adequate compliance procedures should:
- Be contained in a clearly written and accessible manual that is tailored to the firm’s operations.
- Be drafted so that the procedures are easy to understand.
Designate a compliance officer whose authority and responsibility are clearly defined and who has the necessary resources and authority to implement the firm’s compliance procedures.

- Describe the hierarchy of supervision and assign duties among supervisors.
- Implement a system of checks and balances.
- Outline the scope of the procedures.
- Outline procedures to document the monitoring and testing of compliance procedures.
- Outline permissible conduct.
- Delineate procedures for reporting violations and sanctions.

Once a compliance program is in place, a supervisor should:

- Disseminate the contents of the program to appropriate personnel.
- Periodically update procedures to ensure that the measures are adequate under the law.
- Continually educate personnel regarding the compliance procedures.
- Issue periodic reminders of the procedures to appropriate personnel.
- Incorporate a professional conduct evaluation as part of an employee’s performance review.
- Review the actions of employees to ensure compliance and identify violators.
- Take the necessary steps to enforce the procedures once a violation has occurred.

Once a violation is discovered, a supervisor should:

- Respond promptly.
- Conduct a thorough investigation of the activities to determine the scope of the wrongdoing.
- Increase supervision or place appropriate limitations on the wrongdoer pending the outcome of the investigation.
- Review procedures for potential changes necessary to prevent future violations from occurring.

**Implementation of Compliance Education and Training**

- Regular ethics and compliance training, in conjunction with the adoption of a code of ethics, is critical to investment firms seeking to establish a strong culture of integrity and to provide an environment in which employees routinely engage in ethical conduct in compliance with the law.

**Establish an Appropriate Incentive Structure**

- Supervisors and firms must look closely at their incentive structure to determine whether the structure encourages profits and returns at the expense of ethically appropriate conduct. Only when compensation and incentives are firmly tied to client interests and how outcomes are achieved, rather than how much is generated for the firm, will employees work to achieve a culture of integrity.

**Standard V(A) Diligence and Reasonable Basis**

**The Standard**

Members and candidates must:

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

Guidance
- The requirements for issuing conclusions based on research will vary in relation to the member’s or candidate’s role in the investment decision-making process, but the member or candidate must make reasonable efforts to cover all pertinent issues when arriving at a recommendation.
- Members and candidates enhance transparency by providing or offering to provide supporting information to clients when recommending a purchase or sale or when changing a recommendation.

Defining Diligence and Reasonable Basis
- As with determining the suitability of an investment for the client, the necessary level of research and analysis will differ with the product, security, or service being offered. The following list provides some, but definitely not all, examples of attributes to consider while forming the basis for a recommendation:
  - Global, regional, and country macroeconomic conditions.
  - A company’s operating and financial history.
  - The industry’s and sector’s current conditions and the stage of the business cycle.
  - A mutual fund’s fee structure and management history.
  - The output and potential limitations of quantitative models.
  - The quality of the assets included in a securitization.
  - The appropriateness of selected peer-group comparisons.
- The steps taken in developing a diligent and reasonable recommendation should minimize unexpected downside events.

Using Secondary or Third-Party Research
- If members and candidates rely on secondary or third-party research, they must make reasonable and diligent efforts to determine whether such research is sound.
  - Secondary research is defined as research conducted by someone else in the member’s or candidate’s firm.
  - Third-party research is research conducted by entities outside the member’s or candidate’s firm, such as a brokerage firm, bank, or research firm.
- Members and candidates should make reasonable inquiries into the source and accuracy of all data used in completing their investment analysis and recommendations.
- Criteria that a member or candidate can use in forming an opinion on whether research is sound include the following:
  - Assumptions used.
  - Rigor of the analysis performed.
  - Date/timeliness of the research.
  - Evaluation of the objectivity and independence of the recommendations.
- A member or candidate may rely on others in his or her firm to determine whether secondary or third-party research is sound and use the information in good faith unless the member or candidate has reason to question its validity or the processes and procedures used by those responsible for the research.
- A member or candidate should verify that the firm has a policy about the timely and consistent review of approved research providers to ensure that the quality of the research continues to meet the necessary standards. If such a policy is not in place at the firm, the member or candidate should encourage the development and adoption of a formal review practice.
Using Quantitatively Oriented Research

- Members and candidates must have an understanding of the parameters used in models and quantitative research that are incorporated into their investment recommendations. Although they are not required to become experts in every technical aspect of the models, they must understand the assumptions and limitations inherent in any model and how the results were used in the decision-making process.

- Members and candidates should make reasonable efforts to test the output of investment models and other pre-programmed analytical tools they use. Such validation should occur before incorporating the process into their methods, models, or analyses.

- Although not every model can test for every factor or outcome, members and candidates should ensure that their analyses incorporate a broad range of assumptions sufficient to capture the underlying characteristics of investments. The omission from the analysis of potentially negative outcomes or of levels of risk outside the norm may misrepresent the true economic value of an investment. The possible scenarios for analysis should include factors that are likely to have a substantial influence on the investment value and may include extremely positive and negative scenarios.

Developing Quantitatively Oriented Techniques

- Members and candidates involved in the development and oversight of quantitatively oriented models, methods, and algorithms must understand the technical aspects of the products they provide to clients. A thorough testing of the model and resulting analysis should be completed prior to product distribution.

- In reviewing the computer models or the resulting output, members and candidates need to pay particular attention to the assumptions used in the analysis and the rigor of the analysis to ensure that the model incorporates a wide range of possible input expectations, including negative market events.

Selecting External Advisers and Sub-Advisers

- Members and candidates must review managers as diligently as they review individual funds and securities.

- Members and candidates who are directly involved with the use of external advisers need to ensure that their firms have standardized criteria for reviewing these selected external advisers and managers. Such criteria would include, but would not be limited to, the following:
  - Reviewing the adviser’s established code of ethics,
  - Understanding the adviser’s compliance and internal control procedures,
  - Assessing the quality of the published return information, and
  - Reviewing the adviser’s investment process and adherence to its stated strategy.

Group Research and Decision Making

In some instances, a member or candidate will not agree with the view of the group. If, however, the member or candidate believes that the consensus opinion has a reasonable and adequate basis and is independent and objective, the member or candidate need not decline to be identified with the report. If the member or candidate is confident in the process, the member or candidate does not need to dissociate from the report even if it does not reflect his or her opinion.

Recommended Procedures for Compliance

Members and candidates should encourage their firms to consider the following policies and procedures to support the principles of Standard V(A):
Establish a policy requiring that research reports, credit ratings, and investment recommendations have a basis that can be substantiated as reasonable and adequate.

Develop detailed, written guidance for analysts (research, investment, or credit), supervisory analysts, and review committees that establishes the due diligence procedures for judging whether a particular recommendation has a reasonable and adequate basis.

Develop measurable criteria for assessing the quality of research, the reasonableness and adequacy of the basis for any recommendation or rating, and the accuracy of recommendations over time.

Develop detailed, written guidance that establishes minimum levels of scenario testing of all computer-based models used in developing, rating, and evaluating financial instruments.

Develop measurable criteria for assessing outside providers, including the quality of information being provided, the reasonableness and adequacy of the provider’s collection practices, and the accuracy of the information over time.

○ Adopt a standardized set of criteria for evaluating the adequacy of external advisers.

Standard V(B) Communication with Clients and Prospective Clients

The Standard
Members and candidates must:

1. Disclose to clients and prospective clients the basic format and general principles of the investment processes they use to analyze investments, select securities, and construct portfolios, and must promptly disclose any changes that might materially affect those processes.
2. Disclose to clients and prospective clients significant limitations and risks associated with the investment process.
3. Use reasonable judgment in identifying which factors are important to their investment analyses, recommendations, or actions, and include those factors in communications with clients and prospective clients.
4. Distinguish between fact and opinion in the presentation of investment analyses and recommendations.

Guidance

• Members and candidates should communicate in a recommendation the factors that were instrumental in making the investment recommendation. A critical part of this requirement is to distinguish clearly between opinions and facts.

• Follow-up communication of significant changes in the risk characteristics of a security or asset strategy is required.

• Providing regular updates to any changes in the risk characteristics is recommended.

Informing Clients of the Investment Process

• Members and candidates must adequately describe to clients and prospective clients the manner in which they conduct the investment decision-making process. Such disclosure should address factors that have positive and negative influences on the recommendations, including significant risks and limitations of the investment process used.

• The member or candidate must keep clients and other interested parties informed on an ongoing basis about changes to the investment process, especially newly identified significant risks and limitations.
• Members and candidates should inform the clients about the specialization or diversification expertise provided by the external adviser(s).

Different Forms of Communication
• Members and candidates using any social media service to communicate business information must be diligent in their efforts to avoid unintended problems because these services may not be available to all clients. When providing information to clients through new technologies, members and candidates should take reasonable steps to ensure that such delivery would treat all clients fairly and, if necessary, be considered publicly disseminated.
• If recommendations are contained in capsule form (such as a recommended stock list), members and candidates should notify clients that additional information and analyses are available from the producer of the report.

Identifying Risks and Limitations
• Members and candidates must outline to clients and prospective clients significant risks and limitations of the analysis contained in their investment products or recommendations.
• The appropriateness of risk disclosure should be assessed on the basis of what was known at the time the investment action was taken (often called an ex ante basis). Members and candidates must disclose significant risks known to them at the time of the disclosure.
• Members and candidates cannot be expected to disclose risks they are unaware of at the time recommendations or investment actions are made.
• Having no knowledge of a risk or limitation that subsequently triggers a loss may reveal a deficiency in the diligence and reasonable basis of the research of the member or candidate but may not reveal a breach of Standard V(B).

Report Presentation
• A report writer who has done adequate investigation may emphasize certain areas, touch briefly on others, and omit certain aspects deemed unimportant.
• Investment advice based on quantitative research and analysis must be supported by readily available reference material and should be applied in a manner consistent with previously applied methodology. If changes in methodology are made, they should be highlighted.

Distinction between Facts and Opinions in Reports
• Violations often occur when reports fail to separate the past from the future by not indicating that earnings estimates, changes in the outlook for dividends, or future market price information are opinions subject to future circumstances.
• In the case of complex quantitative analyses, members and candidates must clearly separate fact from statistical conjecture and should identify the known limitations of an analysis.
• Members and candidates should explicitly discuss with clients and prospective clients the assumptions used in the investment models and processes to generate the analysis. Caution should be used in promoting the perceived accuracy of any model or process to clients because the ultimate output is merely an estimate of future results and not a certainty.
Recommended Procedures for Compliance

- Members and candidates should encourage their firms to have a rigorous methodology for reviewing research that is created for publication and dissemination to clients.
- To assist in the after-the-fact review of a report, the member or candidate must maintain records indicating the nature of the research and should, if asked, be able to supply additional information to the client (or any user of the report) covering factors not included in the report.

Standard V(C) Record Retention

The Standard
Members and candidates must develop and maintain appropriate records to support their investment analyses, recommendations, actions, and other investment-related communications with clients and prospective clients.

Guidance
- Members and candidates must retain records that substantiate the scope of their research and reasons for their actions or conclusions. The retention requirement applies to decisions to buy or sell a security as well as reviews undertaken that do not lead to a change in position.
- Records may be maintained either in hard copy or electronic form.

New Media Records
- Members and candidates should understand that although employers and local regulators are developing digital media retention policies, these policies may lag behind the advent of new communication channels. Such lag places greater responsibility on the individual for ensuring that all relevant information is retained. Examples of non-print media formats that should be retained include, but are not limited to e-mails, text messages, blog posts, and Twitter posts.

Records Are Property of the Firm
- As a general matter, records created as part of a member’s or candidate’s professional activity on behalf of his or her employer are the property of the firm.
- When a member or candidate leaves a firm to seek other employment, the member or candidate cannot take the property of the firm, including original forms or copies of supporting records of the member’s or candidate’s work, to the new employer without the express consent of the previous employer.
- The member or candidate cannot use historical recommendations or research reports created at the previous firm because the supporting documentation is unavailable.
- For future use, the member or candidate must re-create the supporting records at the new firm with information gathered through public sources or directly from the covered company and not from memory or sources obtained at the previous employer.

Local Requirements
- Local regulators and firms may also implement policies detailing the applicable time frame for retaining research and client communication records. Fulfilling such regulatory and firm requirements satisfies the requirements of Standard V(C).
- In the absence of regulatory guidance or firm policies, CFA Institute recommends maintaining records for at least seven years. If there is a regulatory mandate to maintain records for less than seven years, then the member or candidate must follow this mandate.
Recommended Procedures for Compliance
The responsibility to maintain records that support investment action generally falls with the firm rather than individuals. Members and candidates must, however, archive research notes and other documents, either electronically or in hard copy, that support their current investment-related communications.

Standard VI(A) Disclosure of Conflicts

The Standard
Members and candidates must make full and fair disclosure of all matters that could reasonably be expected to impair their independence and objectivity or interfere with respective duties to their clients, prospective clients, and employer. Members and candidates must ensure that such disclosures are prominent, are delivered in plain language, and communicate the relevant information effectively.

Guidance
• Best practice is to avoid actual conflicts or the appearance of conflicts of interest when possible. Conflicts of interest often arise in the investment profession.
• When conflicts cannot be reasonably avoided, clear and complete disclosure of their existence is necessary.
• In making and updating disclosures of conflicts of interest, members and candidates should err on the side of caution to ensure that conflicts are effectively communicated.

Disclosure of Conflicts to Employers
• When reporting conflicts of interest to employers, members and candidates must give their employers enough information to assess the impact of the conflict.
• Members and candidates must take reasonable steps to avoid conflicts and, if they occur inadvertently, must report them promptly so that the employer and the member or candidate can resolve them as quickly and effectively as possible.
• Any potential conflict situation that could prevent clear judgment about or full commitment to the execution of a member’s or candidate’s duties to the employer should be reported to the member’s or candidate’s employer and promptly resolved.

Disclosure to Clients
• The most obvious conflicts of interest, which should always be disclosed, are relationships between an issuer and the member, the candidate, or his or her firm (such as a directorship or consultancy by a member; investment banking, underwriting, and financial relationships; broker/dealer market-making activities; and material beneficial ownership of stock).
• Disclosures should be made to clients regarding fee arrangements, sub-advisory agreements, or other situations involving nonstandard fee structures. Equally important is the disclosure of arrangements in which the firm benefits directly from investment recommendations. An obvious conflict of interest is the rebate of a portion of the service fee some classes of mutual funds charge to investors.

Cross-Departmental Conflicts
• Other circumstances can give rise to actual or potential conflicts of interest. For instance:
  ○ A sell-side analyst working for a broker/dealer may be encouraged, not only by members of her or his own firm but by corporate issuers themselves, to write research reports about particular companies.
  ○ A buy-side analyst is likely to be faced with similar conflicts as banks exercise their underwriting and security-dealing powers.
The marketing division may ask an analyst to recommend the stock of a certain company in order to obtain business from that company.

Members, candidates, and their firms should attempt to resolve situations presenting potential conflicts of interest or disclose them in accordance with the principles set forth in Standard VI(A).

Conflicts with Stock Ownership
- The most prevalent conflict requiring disclosure under Standard VI(A) is a member’s or candidate’s ownership of stock in companies that he or she recommends to clients or that clients hold. Clearly, the easiest method for preventing a conflict is to prohibit members and candidates from owning any such securities, but this approach is overly burdensome and discriminates against members and candidates. Therefore:
  - Sell-side members and candidates should disclose any materially beneficial ownership interest in a security or other investment that the member or candidate is recommending.
  - Buy-side members and candidates should disclose their procedures for reporting requirements for personal transactions.

Conflicts as a Director
- Service as a director poses three basic conflicts of interest.
  - A conflict may exist between the duties owed to clients and the duties owed to shareholders of the company.
  - Investment personnel who serve as directors may receive the securities or options to purchase securities of the company as compensation for serving on the board, which could raise questions about trading actions that might increase the value of those securities.
  - Board service creates the opportunity to receive material nonpublic information involving the company.
- When members or candidates providing investment services also serve as directors, they should be isolated from those making investment decisions by the use of firewalls or similar restrictions.

Recommended Procedures for Compliance
- Members or candidates should disclose special compensation arrangements with the employer that might conflict with client interests, such as bonuses based on short-term performance criteria, commissions, incentive fees, performance fees, and referral fees.
- Members’ and candidates’ firms are encouraged to include information on compensation packages in firms’ promotional literature.

Standard VI(B) Priority of Transactions

The Standard
Investment transactions for clients and employers must have priority over investment transactions in which a member or candidate is the beneficial owner.

Guidance
- This standard is designed to prevent any potential conflict of interest or the appearance of a conflict of interest with respect to personal transactions.
- Client interests have priority. Client transactions must take precedence over transactions made on behalf of the member’s or candidate’s firm or personal transactions.
Avoiding Potential Conflicts

- Although conflicts of interest exist, nothing is inherently unethical about individual managers, advisers, or mutual fund employees making money from personal investments as long as (1) the client is not disadvantaged by the trade, (2) the investment professional does not benefit personally from trades undertaken for clients, and (3) the investment professional complies with applicable regulatory requirements.
- Some situations occur in which a member or candidate may need to enter a personal transaction that runs counter to current recommendations or what the portfolio manager is doing for client portfolios such as personal financial hardship. In these situations, the same three criteria given in the preceding paragraph should be applied in the transaction so as to not violate Standard VI(B).

Personal Trading Secondary to Trading for Clients

- The objective of the standard is to prevent personal transactions from adversely affecting the interests of clients or employers. A member or candidate having the same investment positions or being co-invested with clients does not always create a conflict.
- Personal investment positions or transactions of members or candidates or their firm should never, however, adversely affect client investments.

Standards for Nonpublic Information

- Standard VI(B) covers the activities of members and candidates who have knowledge of pending transactions that may be made on behalf of their clients or employers, who have access to nonpublic information during the normal preparation of research recommendations, or who take investment actions.
- Members and candidates are prohibited from conveying nonpublic information to any person whose relationship to the member or candidate makes the member or candidate a beneficial owner of the person’s securities.
- Members and candidates must not convey this information to any other person if the nonpublic information can be deemed material.

Impact on All Accounts with Beneficial Ownership

- Members or candidates may undertake transactions in accounts for which they are a beneficial owner only after their clients and employers have had adequate opportunity to act on a recommendation.
- Personal transactions include those made for the member’s or candidate’s own account, for family (including spouse, children, and other immediate family members) accounts, and for accounts in which the member or candidate has a direct or indirect pecuniary interest, such as a trust or retirement account.
- Family accounts that are client accounts should be treated like any other firm account and should neither be given special treatment nor be disadvantaged because of the family relationship. If a member or candidate has a beneficial ownership in the account, however, the member or candidate may be subject to preclearance or reporting requirements of the employer or applicable law.

Recommended Procedures for Compliance

- Members and candidates should urge their firms to establish such policies and procedures.
- The specific provisions of each firm’s standards will vary, but all firms should adopt certain basic procedures to address the conflict areas created by personal investing. These procedures include the following:
  - Limited participation in equity IPOs.
○ Restrictions on private placements.
○ Establish blackout/restricted periods.
○ Reporting requirements, including:
  ■ Disclosure of holdings in which the employee has a beneficial interest.
  ■ Providing duplicate confirmations of transactions.
  ■ Preclearance procedures.
• Disclosure of policies to investors.

Standard VI(C) Referral Fees

The Standard
Members and candidates must disclose to their employer, clients, and prospective clients, as appropriate, any compensation, consideration, or benefit received from or paid to others for the recommendation of products or services.

Guidance
• Members and candidates must inform their employer, clients, and prospective clients of any benefit received for referrals of customers and clients.
• Members and candidates must disclose when they pay a fee or provide compensation to others who have referred prospective clients to the member or candidate.
• Appropriate disclosure means that members and candidates must advise the client or prospective client, before entry into any formal agreement for services, of any benefit given or received for the recommendation of any services provided by the member or candidate. In addition, the member or candidate must disclose the nature of the consideration or benefit.

Recommended Procedures for Compliance
• Members and candidates should encourage their employers to develop procedures related to referral fees. The firm may completely restrict such fees. If the firm does not adopt a strict prohibition of such fees, the procedures should indicate the appropriate steps for requesting approval.
• Employers should have investment professionals provide to the clients notification of approved referral fee programs and provide the employer regular (at least quarterly) updates on the amount and nature of compensation received.

Standard VII(A) Conduct as Participants in CFA Institute Programs

The Standard
Members and candidates 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.

Guidance
• Standard VII(A) prohibits any conduct that undermines the public’s confidence that the CFA charter represents a level of achievement based on merit and ethical conduct.
• Conduct covered includes but is not limited to:
  ○ Giving or receiving assistance (cheating) on any CFA Institute examinations,
  ○ Violating the rules, regulations, and testing policies of CFA Institute programs,
  ○ Providing confidential program or exam information to candidates or the public,
  ○ Disregarding or attempting to circumvent security measures established for any CFA Institute examinations,
Improperly using an association with CFA Institute to further personal or professional goals, and

Misrepresenting information on the Professional Conduct Statement or in the CFA Institute Continuing Education Program.

Confidential Program Information

- Examples of information that cannot be disclosed by candidates sitting for an exam include but are not limited to:
  - Specific details of questions appearing on the exam and
  - Broad topical areas and formulas tested or not tested on the exam.
- All aspects of the exam, including questions, broad topical areas, and formulas, tested or not tested, are considered confidential until such time as CFA Institute elects to release them publicly.

Additional CFA Program Restrictions

- Violating any of the testing policies, such as the calculator policy, personal belongings policy, or the Candidate Pledge, constitutes a violation of Standard VII(A).
- Examples of information that cannot be shared by members involved in developing, administering, or grading the exams include but are not limited to:
  - Questions appearing on the exam or under consideration.
  - Deliberation related to the exam process.
  - Information related to the scoring of questions.

Expressing an Opinion

- Standard VII(A) does not cover expressing opinions regarding CFA Institute, the CFA Program, or other CFA Institute programs.
- However, when expressing a personal opinion, a candidate is prohibited from disclosing content-specific information, including any actual exam question and the information as to subject matter covered or not covered in the exam.

Standard VII(B) Reference to CFA Institute, the CFA Designation, and the CFA Program

The Standard

When referring to CFA Institute, CFA Institute membership, the CFA designation, or candidacy in the CFA Program, members and candidates must not misrepresent or exaggerate the meaning or implications of membership in CFA Institute, holding the CFA designation, or candidacy in the CFA Program.

Guidance

- Standard VII(B) is intended to prevent promotional efforts that make promises or guarantees that are tied to the CFA designation. Individuals may refer to their CFA designation, CFA Institute membership, or candidacy in the CFA Program but must not exaggerate the meaning or implications of membership in CFA Institute, holding the CFA designation, or candidacy in the CFA Program.
- Standard VII(B) is not intended to prohibit factual statements related to the positive benefit of earning the CFA designation. However, statements referring to CFA Institute, the CFA designation, or the CFA Program that overstate the competency of an individual or imply, either directly or indirectly, that superior performance can be expected from someone with the CFA designation are not allowed under the standard.
- Statements that highlight or emphasize the commitment of CFA Institute members, CFA charterholders, and CFA candidates to ethical and professional conduct or mention the thoroughness and rigor of the CFA Program are appropriate.
Members and candidates may make claims about the relative merits of CFA Institute, the CFA Program, or the Code and Standards as long as those statements are implicitly or explicitly stated as the opinion of the speaker.

Standard VII(B) applies to any form of communication, including but not limited to communications made in electronic or written form (such as on firm letterhead, business cards, professional biographies, directory listings, printed advertising, firm brochures, or personal resumes), and oral statements made to the public, clients, or prospects.

CFA Institute Membership
The term “CFA Institute member” refers to “regular” and “affiliate” members of CFA Institute who have met the membership requirements as defined in the CFA Institute Bylaws. Once accepted as a CFA Institute member, the member must satisfy the following requirements to maintain his or her status:

- Remit annually to CFA Institute a completed Professional Conduct Statement, which renews the commitment to abide by the requirements of the Code and Standards and the CFA Institute Professional Conduct Program.
- Pay applicable CFA Institute membership dues on an annual basis.

If a CFA Institute member fails to meet any of these requirements, the individual is no longer considered an active member. Until membership is reactivated, individuals must not present themselves to others as active members. They may state, however, that they were CFA Institute members in the past or refer to the years when their membership was active.

Using the CFA Designation
Those who have earned the right to use the Chartered Financial Analyst designation may use the trademarks or registered marks “Chartered Financial Analyst” or “CFA” and are encouraged to do so but only in a manner that does not misrepresent or exaggerate the meaning or implications of the designation.

- The use of the designation may be accompanied by an accurate explanation of the requirements that have been met to earn the right to use the designation.
- “CFA charterholders” are those individuals who have earned the right to use the CFA designation granted by CFA Institute. These people have satisfied certain requirements, including completion of the CFA Program and required years of acceptable work experience. Once granted the right to use the designation, individuals must also satisfy the CFA Institute membership requirements (see above) to maintain their right to use the designation.
- If a CFA charterholder fails to meet any of the membership requirements, he or she forfeits the right to use the CFA designation. Until membership is reactivated, individuals must not present themselves to others as CFA charterholders. They may state, however, that they were charterholders in the past.
- Given the growing popularity of social media, where individuals may anonymously express their opinions, pseudonyms or online profile names created to hide a member’s identity should not be tagged with the CFA designation.

Referring to Candidacy in the CFA Program
Candidates in the CFA Program may refer to their participation in the CFA Program, but such references must clearly state that an individual is a candidate in the CFA Program and must not imply that the candidate has achieved any type of partial designation. A person is a candidate in the CFA Program if:
○ The person’s application for registration in the CFA Program has been accepted by CFA Institute, as evidenced by issuance of a notice of acceptance, and the person is enrolled to sit for a specified examination; or
○ The registered person has sat for a specified examination but exam results have not yet been received.

- If an individual is registered for the CFA Program but declines to sit for an exam or otherwise does not meet the definition of a candidate as described in the CFA Institute Bylaws, then that individual is no longer considered an active candidate. Once the person is enrolled to sit for a future examination, his or her CFA candidacy resumes.
- CFA candidates must never state or imply that they have a partial designation as a result of passing one or more levels, or cite an expected completion date of any level of the CFA Program. Final award of the charter is subject to meeting the CFA Program requirements and approval by the CFA Institute Board of Governors.
- If a candidate passes each level of the exam in consecutive years and wants to state that he or she did so, that is not a violation of Standard VII(B) because it is a statement of fact. If the candidate then goes on to claim or imply superior ability by obtaining the designation in only three years, however, he or she is in violation of Standard VII(B).

**Proper and Improper References to the CFA Designation**

<table>
<thead>
<tr>
<th>Proper References</th>
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<tbody>
<tr>
<td>“Completion of the CFA Program has enhanced my portfolio management skills.”</td>
<td>“CFA charterholders achieve better performance results.”</td>
</tr>
<tr>
<td>“John Smith passed all three CFA examinations in three consecutive years.”</td>
<td>“John Smith is among the elite, having passed all three CFA examinations in three consecutive attempts.”</td>
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<tr>
<td>“The CFA designation is globally recognized and attests to a charterholder’s success in a rigorous and comprehensive study program in the field of investment management and research analysis.”</td>
<td>“As a CFA charterholder, I am the most qualified to manage client investments.”</td>
</tr>
<tr>
<td>“The credibility that the CFA designation affords and the skills the CFA Program cultivates are key assets for my future career development.”</td>
<td>“As a CFA charterholder, Jane White provides the best value in trade execution.”</td>
</tr>
<tr>
<td>“I enrolled in the CFA Program to obtain the highest set of credentials in the global investment management industry.”</td>
<td>“Enrolling as a candidate in the CFA Program ensures one of becoming better at valuing debt securities.”</td>
</tr>
<tr>
<td>“I passed Level I of the CFA exam.”</td>
<td>“CFA, Level II”</td>
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<tr>
<td>“I am a 2010 Level III candidate in the CFA Program.”</td>
<td>“CFA, Expected 2011”</td>
</tr>
<tr>
<td>“I passed all three levels of the CFA Program and will be eligible for the CFA charter upon completion of the required work experience.”</td>
<td>“Level III CFA Candidate”</td>
</tr>
<tr>
<td>“As a CFA charterholder, I am committed to the highest ethical standards.”</td>
<td>“CFA, Expected 2011”</td>
</tr>
<tr>
<td>“John Smith, Charter Pending”</td>
<td>“John Smith, Charter Pending”</td>
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</table>
**Recommended Procedures for Compliance**

Members and candidates can reduce the risk of misrepresenting the CFA credential or misusing the CFA designation or CFA Institute marks by disseminating written guidance on Standard VII(B) to their firm’s compliance, legal, public relations, and marketing departments.

Covered persons should encourage their firms to create compliance department–approved templates consistent with the Standard.
Marcia Lopez

Lopez asks Hockett, her supervisor, to approve her business card request form, on which she append “CFA, Level I” after her name. Hockett tells Lopez to include the year she expects to receive her CFA charter.

Lopez violated Standard VII(B): Responsibilities as a CFA Institute Member or CFA Candidate, Reference to CFA Institute, the CFA Designation, and the CFA Program. While she can indicate participation in the program, she may not indicate an expected completion date for the designation or any level of the program.

Hockett violated Standard IV(C): Duties to Employers, Responsibilities of Supervisors by failing to ensure that anyone subject to their supervision or authority complies with applicable laws, rules, regulations, and the Code and Standards.

David Hockett and Team

Hockett’s wealth management team at BankGlobal receives calls directly from analysts with coverage information. This avoids the 45-minute period necessary to update BankGlobal’s website and email the changes to clients. Hockett’s team, however, acts immediately in discretionary accounts when they receive these analyst calls. This allows them to prevent discretionary accounts from being negatively affected when other clients receive and act on the information.

Hockett’s team violated Standard III(B): Duties to Clients, Fair Dealing by failing to ensure all clients are treated fairly in the dissemination of information. Hockett’s team favors their own preferential accounts over non-discretionary accounts and other accounts managed by other BankGlobal wealth teams.

[There was some initial confusion as to whether the reports themselves are considered “material nonpublic information.” In general, analyst reports which contain information that could affect an investor’s decisions are considered material and are considered nonpublic until appropriately disseminated. You do not need to be a company insider to possess and misuse material nonpublic information.]

The Kochanskis

Lopez recommends a balanced portfolio to clients without first determining their investment objectives, risk tolerance, investment horizon, and internal and external constraints.

Lopez violated Standard III(C): Duties to Clients, Suitability by failing to make proper inquiries into their investment experience, objectives, and constraints prior to making a recommendation. Lopez should have developed an investment policy statement (IPS) for her clients prior to making a recommendation. Further, such information should be regularly reassessed and updated if necessary.

Lopez develops the balanced portfolio and creates reports for the strategy based on only two equity and two fixed income top-performing portfolios. She averages returns from these four funds for each of the five years. She compares this to annual rates of return over a five-year
horizon for a composite portfolio of balanced-objective discretionary accounts of similar size. She does not include terminated accounts.

Lopez violated Standard III(D): Duties to Clients, Performance Presentation by failing to include terminated accounts and accounts of dissimilar size but with similar strategy.

Lopez did not violate the Standards by averaging returns for the four funds for each of the five years because she does not know the Kochanskis’ level of investment knowledge and can use this easy-to-understand method.

After finally meeting with the Kochanskis, Hockett discloses to a referring party that BankGlobal’s wealth management division achieves alpha in long-horizon conservative accounts by investing 15–20% of the portfolio in high-beta, apparently low-risk stocks. This allows the wealth management division to receive performance bonuses on quarterly results and avoids the need to revise each conservative client’s IPS.

Hockett violated Standard III(C)(2): Duties to Clients, Suitability, which states “When Members and Candidates are responsible for managing a portfolio to a specific mandate, strategy, or style, they must make only investment recommendations or take only investment actions that are consistent with the stated objectives and constraints of the portfolio.”

He violated this standard by (1) investing in inherently risk-high beta stocks and (2) managing portfolios with a long horizon to a short-term performance target to make his bonus.

Lopez then tweets that she opened an account for “Mr. Kochanski and his wife, Mary.”

Lopez violated Standard III(E): Duties to Clients, Preservation of Confidentiality. Members and candidates must maintain confidentiality of former, current, and prospective client personal information unless (1) the information concerns illegal activities, (2) the law requires disclosure, or (3) the parties permit disclosure.

**Castle Biotechnology**

**David Plume**

Plume was a biochemist at Castle Biotechnology (CB), a pharmaceutical holding company, for 15 years prior to becoming a biotech analyst at Global Capital Management (Global), which was acquired by CB. He was encouraged to become an analyst for Global because he could write perceptive research reports and help identify takeover targets. Plume receives 0.10% of gross proceeds for each IPO he works on for Global.

CB’s portfolio includes APBX and STRX, which Plume helped take public. Shortly after taking them public, Plume wrote a report claiming for each company that it was developing extraordinary drugs and that their share prices would double in 9–12 months. Three months after issuing the report, Plume shorts APBX in his personal portfolio and does not disclose the sale because he was never a beneficial owner of APBX’s stock.

Although the offering materials and prospectus indicated the relationship between CB, Global, and the two portfolio companies, Plume does not mention this in his research reports. He also does not disclose that he owns class A shares and options on CB’s stock. He does state, however, that “One or more directors, officers, and/or employees of Global Capital and its affiliated companies, or independent contractors affiliated with Global, may be a director of the issuer of the securities mentioned herein.”
Plume violated Standard I(B): Professionalism, Independence and Objectivity, because his annual bonus as an analyst depended on his IPO work, which obviously presents an opportunity for conflict of interest. This Standard states: “Members and Candidates must use reasonable care and judgment to achieve and maintain independence and objectivity in their professional activities. Members and Candidates must not offer, solicit, or accept any gift, benefit, compensation, or consideration that reasonably could be expected to compromise their own or another’s independence and objectivity.” There is evidence of this in his short sale of APBX shares shortly after the IPO. In addition to favoring APBX and STRX in his analytical reports, he may have excluded other more suitable companies from research reports.

Plume violated Standard VI(A): Conflicts of Interest, Disclosure of Conflicts, because he failed to disclose in his research reports that Global, his employer, was owned by CB, which also owned the biotech companies that were the report subject. Disclosure in the IPO materials was necessary but insufficient to prevent the violation. He also violated the Standard by failing to disclose his ownership of the preferred shares and options on CB stock. This indicates an indirect beneficial ownership in APBX and STRX.

[Note that the corporate chain of ownership is not ex ante a conflict of interest as was receiving a bonus based on the IPOs he analyzes.]

Sandra Benning

Benning worked at Kodiak securities prior to joining Global. While at Kodiak, Benning communicated with clients through personal accounts at Facebook, LinkedIn, and Twitter and through personal email. After leaving Kodiak, she communicated her departure through these platforms and encouraged her former clients to follow her to Global. Global paid her a signing bonus dependent on a percentage of former Kodiak clients following her to Global. Global also pays investment advisers a year-end bonus based on their clients’ IPO participation. Benning does not disclose either bonus.

Unless there is a noncompete agreement, Benning has not violated Standard IV(A): Duties to Employers, Loyalty, because Benning did not solicit Kodiak’s clients until she left and did not use Kodiak’s materials to do so.

Benning violated Standard VI(A): Conflicts of Interest, Disclosure of Conflicts by failing to disclose additional compensation. The sign-on bonus and bonus based on client IPO participation both present conflict of interest opportunities that must be disclosed.

Global plans a highly anticipated IPO for FTSX, one of CB’s portfolio companies. Global allocates shares of “hot issues” to institutional clients who plan on purchasing additional shares on the first day of trading in order to boost the post-issue price. Benning notifies clients on various business and personal platforms that confirming an indication of interest does not mean the order will be filled in full or in part.

Global uses the following criteria for allocating shares to clients indicating interest in an allocation and subsequent additional purchases after IPO:

- Account AUM
- Track record of similar investments
- Level of previous business with Global
- Size of a client’s anticipated long-term investment
- Existing or potential business relationships with Global
- Attendance at road shows and other indications of interest
On one day prior to the IPO, Benning telephones high-net-worth clients who had received allocations to tell them they will be excluded from future allocations if they “flip” (i.e., sell) the IPO shares immediately after issuance. She then calls her institutional clients to tell them they may flip their shares at the end of the first trading day.

Benning violated Standard II(B): Integrity of Capital Markets, Market Manipulation by allocating FTSX shares to institutional clients who plan to purchase additional shares when it begins trading. Such requirements are called “tie-in” agreements, which have a tendency to distort security prices to the detriment of market participants.

The practices described also violate Standard III(B): Duties to Clients, Fair Dealing.

**Claris Deacon**

Benning’s newest client Claris Deacon completed the following actions on each of three successive visits:

1. Signed a New Account Agreement and a Limited Trade Authorization form that gives Benning discretionary authority to transact securities,
2. Opened a cash management account that linked her brokerage account to an in-house checking (transaction) account, and
3. Signed an Option Account Application and Agreement authorizing equity option transactions in her account.

After the third meeting, Benning changed the language on Deacon’s form describing the types of suitable options and initialed the form on her behalf.

A week later, Deacon is traveling with her husband and calls Benning to tell her she’s having trouble transferring money from her brokerage account to her checking account. Benning finds that Global had not activated that linkage and receives Deacon’s verbal authorization to sign the account-linking form on Deacon’s behalf.

A month later, Deacon’s husband Steve calls to let Benning know that Claris has serious health issues. He convinces Benning to redeem $15,000 from Claris’ account and several additional redemptions and withdrawals over the next few weeks. Benning makes a note on the trade form each time Steve transacts in Claris’ account.

Benning violated Standard I(D): Professionalism, Misconduct by signing or initialing a form on behalf of a client. A telephone authorization is not enough.

Benning violated Standard III(A): Duties to Clients, Loyalty, Prudence, and Care by redeeming shares in Deacon’s account at Steve’s request without Claris’ signed authorization.

**Lionsgate Limited & Bank of Australia**

**Tony Hill and Team**

All employees aged 18 to 70 in Australia are required to contribute a percentage of earnings to a tax-advantaged retirement account known as a “superannuation fund.” Lionsgate Limited (LL) is a publicly listed Australian fund manager among the financial services firms that benefit from employees investing their money in the scheme. LL’s Victory Capital Fund (VCF) is an equity mutual fund managed by Tony Hill and his team.
Hill’s marketing material for VCF states that the fund delivered high gross-of-fees returns over that period, the best among Australian equity funds, and goes on to describe high annual returns and growing AUM.

Hill does not violate any standards with his statements. Standard III(D): Duties to Clients, Performance Presentation, only requires that covered persons make reasonable efforts to ensure the reporting is fair, accurate, and complete. Guidance to the Standard suggests methods to ensure compliance:

“Members and candidates can also meet their obligations under Standard III(D) by including disclosures that fully explain the performance results being reported (for example, stating, when appropriate, that results are simulated when model results are used, clearly indicating when the performance record is that of a prior entity, or disclosing whether the performance is gross of fees, net of fees, or after tax.)”

Hill makes a variety of uncompensated appearances in media, although the shows’ sponsors give “thank-you” bags containing wine, retail gift cards, restaurant gift certificates, and travel discounts on hotels and airfare. Hill does not disclose receipt of the gift bags.

Hill does not violate any standards by accepting the gifts. Standard IV(B): Duties to Employers, Additional Compensation Arrangements, only requires that covered persons not accept gifts, benefits, compensation, or consideration that might create or could be expected to create a conflict with an employer’s interest.

Note here that there is no indication Hill changed any position as the result of the gifts without written consent from all parties. Accepting the nominal gifts does not conflict with an employer’s interests.

As Hill became more of a media personality, Nicole Martin assumed more responsibility for investment decision-making. Although she and Hill both state publicly that he is in charge of investment decision-making, the last three years results were directly attributable to her and the other analysts.

Hill and Martin have both violated Standard V(B)1: Investment Analysis, Recommendations, and Actions, Communication with Clients and Prospective Clients by failing to disclose changes in investment management and reasons for performance.

Hill announces his resignation at a board meeting and indicated he is leaving to start his own firm. The board asks Hill to keep his resignation confidential until the end of LL’s fiscal year in two weeks. Hill agrees and, after the meeting, announces to his team a plan to resign and start his own firm. He asks his team to join him. Ten analysts agree to follow him; five decline and leave the meeting. Hill indicates the team will have to work after company hours to get things ready when he departs in two weeks. In their off hours, they file registration paperwork, lease office space, and make other preparations, telling their team they will begin to solicit former clients as soon as they leave LL.

Hill violated Standard IV(A): Duties to Employers, Loyalty by announcing his resignation to his team after agreeing in the board meeting to keep the news confidential. Hill would not have violated this Standard by discussing his resignation with his team prior to the board’s request for confidentiality.

Hill did not violate this standard by asking his team to join him at his new firm or to work during the interim two weeks because it was outside office hours. Guidance to Standard IV(A) states: “A departing employee is generally free to make arrangements or preparations to go into a competitive business before terminating the relationship with his or her employer as long as such preparations do not breach the employee’s duty of loyalty.”

Hill did not violate this standard by soliciting former clients after leaving LL unless he used client information obtained from LL without agreement.

**Rob Portman**

Rob Portman sells VCF to high net worth (HNW) individuals and to institutions. To make the fund more attractive to these investors, Portman always touts Tony Hill as the investments decision maker and refers to Martin as Hill’s assistant, although he knows Hill has assumed most responsibilities.

Portman violated Standard I(C): Professionalism, Misrepresentation. “Members and Candidates must not knowingly make any misrepresentations relating to investment analysis, recommendations, actions, or other professional activities.”

Portman asked LL’s Chief Investment Officer (CIO), who attended the board meeting at which Hill resigned, to verify the rumor. The CIO told him to ignore the rumor and go on with a planned event for prospective clients. Portman sells his shares in LL and VCF when he learns from Sky New Business Channel that the CIO and two other directors sold their own shares.

The directors violated Standard II(A): Integrity of Capital Markets, Material Nonpublic Information. They did not violate Standard IV(A): Duties to Employers, Loyalty by selling their shares in LL and VCF.

**Kirk Graeme**

Bank of Australia Financial Group (BOA) is part owner of LL, which is part of its wealth management group. Kirk Graeme, an LL analyst broadly respected for his insight on IPO shares, receives additional, issuer-paid compensation for new issue purchases. BOA’s Capital Markets Group is a member of the syndicate for new issues that Graeme purchases. As a syndicate member, BOA also shares in fees and commissions paid by the issuer although he receives only fee-based compensation from his wealth management clients.

BOA’s policy does not require disclosure on commission received for new issues because clients receive prospectuses that disclose commissions paid to the syndicate member. Graeme discloses his new issue commissions to clients who ask for the information.

Graeme violated Standard VI(A): Conflicts of Interest, Disclosure of Conflicts by failing to notify all clients of the conflict, not just clients who ask.

**The Delaneys**

The Delaney’s told Graeme, their advisor, that their account represented most of their investable assets, their horizon was 15 to 20 years, and they had low risk tolerance. Graeme purchased IPOs for their account, many of which were held for only five months.

Graeme violated Standard III(C)1: Duties to Clients, Suitability by failing to adhere to the Delaneys’ investment mandate relating to risk.
[Note that CFA Institute materials declare that the time horizon mandate was not violated by Graeme’s management of the Delaney’s account, although no rationale for this position was offered.]

Jane Balmer, Graeme’s supervisor, raised concerns about extensive IPO purchases and subsequent turnover in Graeme’s accounts. Balmer also reported this to the compliance officer. Graeme reduced his new issue purchases and turnover after his meeting with Balmer.

Balmer violated Standard IV(C): Duties to Employers, Responsibilities of Supervisors by relying solely on Graeme’s account and failing to initiate an investigation into the extent of Graeme’s wrongdoing.

**David Milgram**

David Milgram’s account has operated under his original IPS since Graeme opened his account five years ago. Milgram sent a letter to Balmer regarding the dismal performance of his account. Balmer discusses the account with Graeme but does not escalate the matter to the compliance director. Graeme and Balmer meet with Milgram and update his IPS during the meeting.

Graeme violated Standard III(C): Duties to Clients, Suitability by failing to properly update Milgram’s IPS. Guidance states that update should occur at least annually or whenever the investor’s situation undergoes material changes.

Balmer did not violate Standard IV(C): Duties to Employers, Responsibilities of Supervisors, because she initiated an investigation into the extent of Graeme’s wrongdoing and sat in on a meeting where he updated Milgram’s IPS. Guidance to this standard does not require escalation unless a resolution fails to occur.

**Gabby Sim**

Gabby Sim was recently hired by Global Harvest Bank (GHB) and received her orientation from Ahmed Yousoff, GHB’s chief investment officer (CIO). Yousoff meets with GHB’s president, Irene Wong, and board members David Tan and Audrey Chuong to discuss a memorandum of understanding with MGM2. The government of Saspara, through its Ministry of Finance, wholly owns MGM2, a strategic investment and development company charged with investments that establish global partnerships leading to foreign direct investment.

Yousoff and Wong decide to pay a portion of their fee to Tan and Chuong, who worked tirelessly on the MGM2 deal, but do not disclose the payment in the MOU. Chuong does not tell Yousoff that Bo Hie, a Sasparian businessman who helped start MGM2, recently hired her son into an executive role in GHB.

Yousoff does not violate Standard VI(C): Conflicts of Interest, Referral Fees, because the fee was paid to Yousoff, who does not need to explain the fee sharing arrangement. Tan and Chuong receive the reward for their efforts to bring MGM2 on as a client for GHB, not as a referral.

Chuong violated Standard VI(A): Conflicts of Interest, Disclosure of Conflicts by failing to disclose that Hie recently hired her son. Standard VI(A) requires members and candidates to fully disclose to clients, potential clients, and employers all actual and potential conflicts of interest. Hie hiring Chuong’s son could have resulted in GHB offering a special deal for MGM2 of which Yousoff was unaware.
Hie tells Sim that he wants to open an account under the name of his firm Bad Moon Rising, LTD, on which Hie has sole signatory authority. Hie refuses to answer discovery questions on the new account information form and writes Sim a $15 million check drawn on a Cayman Island bank account. Hie asks Sim to destroy all notes taken during their meeting and hands her a brief but insufficient information statement. Hie tells Sim that if she needs more information she should contact Tan and Chuong. She uses the information statement to prepare Hie’s IPS. Sim does not advise Yousoff that Hie promised her a year-end bonus.

Sim violated Standard V(C): Investment Analysis, Recommendations, and Actions, Record Retention, which states: “Members and Candidates must develop and maintain appropriate records to support their investment analyses, recommendations, actions, and other investment-related communications with clients and prospective clients.”

Sim does not violate Standard III(A): Duties to Clients, Loyalty, Prudence, and Care or III(E): Duties to Clients, Preservation of Confidentiality by keeping the notes as part of her file.

Sim also violated Standard III(C): Duties to Clients, Suitability by failing to gain enough information relevant to Sims investment situation. Guidance to the Standard states: “When an advisory relationship exists, members and candidates must gather client information at the inception of the relationship. Such information includes the client’s financial circumstances, personal data (such as age and occupation) that are relevant to investment decisions, attitudes toward risk, and objectives in investing. This information should be incorporated into a written investment policy statement (IPS) that addresses the client’s risk tolerance, return requirements, and all investment constraints (including time horizon, liquidity needs, tax concerns, legal and regulatory factors, and unique circumstances).” At the very least, the client’s statement of risk tolerance is insufficient.

Shortly after Sim opens the account, an MGM2 account in Saspara wires $70 million into Hie’s account. Hie provides a copy of an agreement between Bad Moon Rising and MGM2 and advises Sim that the money will be used by MGM2 to purchase United States real estate. She tells Yousoff, who tells her to contact Tan and Chuong. Sim calls Tan and Chuong to tell them about the deposit and faxes them a copy of the investment agreement Hie provided. After reviewing this information, the two board members confirm Hie’s identity and his role with MGM2.

Yousoff violated Standard IV(C): Duties to Employers, Responsibilities of Supervisors by failing to have Sim arrange a meeting for him with Hie and an official of MGM2.

Sim did not violate Standard III(E): Duties to Clients, Preservation of Confidentiality by discussing Hie’s information with Tan and Chuong because he had instructed her to do so. That the two board members also worked on the deal with MGM2 does not, by itself, allow Sim to share Hie’s information.

Sim later becomes suspicious regarding Hie’s behavior and is not reassured by Yousoff’s comments that the speed of Hie’s transactions are the important consideration, not their impropriety.

Sim’s first course of action in this matter should be to refer her concerns to GHB’s compliance department. Regarding potential violations by a fellow employee, Guidance to Standard I(A): Professionalism, Knowledge of the Law states: “When in doubt about the appropriate action to undertake, it is recommended that a member or candidate seek the advice of compliance personnel or legal counsel concerning legal requirements.”
Sim meets with Madam Tan Swee Neo, a retiree with most of her money in fixed certificates of deposit. She invests the remainder in lower-risk, dividend-paying securities of utilities. She wants to allocate more to conservative equities to earn money to pay for her grandson’s education.

Madame Tan says she wants to know more about GHB’s oil-linked structured notes with a high return. Sim provides Madame Tan with a brochure in English, which Tan does not understand. Sim proceeds to describe the notes in some detail, including the lack of guaranteed income and heavy withdrawal penalties, but Tan does not understand. Sim allows Tan to invest a large sum in the notes.

Sim violated Standard III(C): Duties to Clients, Suitability, when Madame Tan invested against her own mandate of low-risk fixed income and equity. Guidance states: “Members and candidates will need to make reasonable efforts to balance their clients’ trading requests with their responsibilities to follow the agreed-on investment policy statement.” Although Tan has some experience in real estate, she does not understand the investment she is making. Handing her a brochure in a different language and simply explaining there is no income guarantee is not enough if Tan does not understand the risk to her portfolio. In any event, Sim should update Tan’s IPS prior to making the investment.

One year later, Tan wants to change investment direction away from the structured notes due to underperformance and lack of confidence in oil prices. Sim reminds her of the withdrawal penalty but Tan refuses to listen and wants to redeem anyway. She is shocked to find her large investment became a small investment after she redeemed the oil-linked structured notes.

Sim violated Standard III(A): Duties to Clients, Loyalty, Prudence, and Care by immediately processing the redemption without helping Tan understand the redemption costs and ensuring her client had correct understanding of the economic environment.

Sim violated Standard III(C): Duties to Clients, Suitability by making the transaction when Tan’s behavior suggested she did not fully understand how this would affect her ability to pay for her grandchild’s education. Guidance to the Standard states: “Members and candidates will need to make reasonable efforts to balance their clients’ trading requests with their responsibilities to follow the agreed-on investment policy statement.”