Study Session 1: Ethical and Professional Standards

CODE OF ETHICS AND STANDARDS OF PROFESSIONAL CONDUCT; GUIDANCE FOR STANDARDS I–VII

Cross-Reference to CFA Institute Assigned Readings #1 & #2

All CFA Institute members and candidates enrolled in the CFA Program are required to comply with the Code of Ethics and the Standards of Professional Conduct (Code and Standards). The CFA Institute Bylaws and Rules of Procedure for Proceedings Related to Professional Conduct (Rules of Procedure) form the basic structure for enforcing the Code and Standards.

The Rules of Procedure are based on the following two principles:

1. Fair process.
2. Maintaining confidentiality of process.

The CFA Institute Board of Governors is responsible for implementing the Professional Conduct Program (PCP) through the Disciplinary Review Committee (DRC).

The CFA Institute Designated Officer, through the Professional Conduct staff, carries out professional conduct inquiries. Circumstances which can initiate an inquiry include:

- Information disclosed on the annual Professional Conduct Statement.
- Written complaints received by Professional Conduct staff.
- Questionable conduct as publicized by the media or any other source.
- A violation report submitted by a CFA examination proctor.

Once an inquiry is initiated, the Professional Conduct staff undertakes an investigation which can include:

- Requesting a written explanation.
- Interviewing related person(s).
- Collecting any supporting documents.

The information collected is reviewed by the Designated Officer, who may conclude that:

1. No disciplinary action is needed
2. A cautionary letter needs to be issued
3. Proceedings need to be continued.

If it is concluded that there has been a violation of the Code and Standards, the Designated Officer can propose a disciplinary sanction. The member or candidate has the right to accept or reject the decision. A rejection would require the matter to be referred to a hearing by a panel of CFA Institute members. Sanctions by CFA Institute may include condemnation by peers, consequences for current or future employment or suspension from the CFA program.

The adherence of investment professionals to ethical practices benefits all market participants.

- Clients are reassured that investment professionals they hire prioritize their interests.
- Investment professionals benefit from the more efficient and transparent operation of the market that integrity promotes.

Sound ethics is fundamental to capital markets and the investment profession as it increases investors' confidence in global financial markets. Ethics is also of paramount importance because of the interconnectedness of global financial markets, which gives rise to the issue of market sustainability. It is imperative that top management foster a strong culture of ethics not just among CFA charter holders and candidates but among all staff members who are involved directly or indirectly with client relations, the investment process, record keeping, and beyond.

However, new challenges continually arise for members and candidates in applying the Code and Standards. This is because ethical dilemmas are not unambiguously right or wrong and require a bit of judgment.

The CFA Institute Code of Ethics plays an integral role in maintaining the integrity of CFA Institute members and upholding professional excellence. All CFA Institute members and CFA candidates must abide by this code and are encouraged to notify their employers of any violations. Violations may result in disciplinary sanctions by CFA Institute, which may include revocation of membership, candidacy in the CFA program and the right to use the CFA designation.

The Code of Ethics requires all members and candidates to:

- Act with integrity, competence, diligence, respect, and in an ethical manner with the public, clients, prospective clients, employers, employees, colleagues in the investment profession, and other participants in the global capital markets.
- Place the integrity of the investment profession and the interests of clients above their own personal interests.
- Use reasonable care and exercise independent professional judgment when conducting investment analysis, making investment recommendations, taking investment actions, and engaging in other professional activities.
- Practice and encourage others to practice in a professional and ethical manner that will reflect credit on themselves and the profession.
- Promote the integrity of, and uphold the rules governing, capital markets.
- Maintain and improve their professional competence and strive to maintain and improve the competence of other investment professionals.

Standards of Professional Conduct:

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

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 best way to prepare for Ethics is to thoroughly read the Standards themselves, along with related guidance and examples.

CFA INSTITUTE RESEARCH OBJECTIVITY STANDARDS
Cross-Reference to CFA Institute Assigned Reading #3

When designing policies and procedures for implementing the CFA Institute Research Objectivity Standards, firms should strive to achieve the following objectives:

A. To prepare research reports, make investment recommendations, and take investment actions; and develop policies, procedures, and disclosures that always place the interests of investing clients before their employees' or the firm's interests.
B. To facilitate full, fair, meaningful, and specific disclosures of potential and actual conflicts of interest of the firm or its employees to its current and prospective clients.
C. To promote the creation and maintenance of effective policies and procedures that would minimize and manage conflicts of interest that may jeopardize the independence and objectivity of research.
D. To support self-regulation through voluntary industry development of, and adherence to, specific, measurable, and demonstrable standards that promote and reward independent and objective research.
E. To provide a work environment for all investment professionals that supports, encourages, and rewards ethical behavior and supports CFA Institute members, CFA charterholders, and CFA candidates in their adherence to the CFA Institute Code and Standards.

CFA Institute Research Objectivity Standards

1.0 Research Objectivity Policy

Requirements

Firms must have:

a. A formal written policy on the independence and objectivity of research (Policy) that must be:
    i. made available to clients and prospective clients (both investing and corporate); and
    ii. disseminated to all firm employees;
b. Supervisory procedures that reasonably ensure that the firm and its covered employees comply with the provisions of the policy and all applicable laws and regulations; and
c. A senior officer of the firm who attests annually to clients and prospective clients to the firm's implementation of, and adherence to, the Policy.

2.0 Public Appearances

Requirements

Firms that permit research analysts and other covered employees to present and discuss their research and recommendations in public appearances must require these employees to fully disclose personal and firm conflicts of interest to the host or interviewer and, whenever possible, to the audience.

3.0 Reasonable and Adequate Basis

Requirements

Firms must require research reports and recommendations to have a basis that can be substantiated as reasonable and adequate. An individual employee (supervisory analyst who is someone other than the author) or a group of employees (review committee) must be appointed to review and approve all research reports and recommendations.

4.0 Investment Banking

Requirements

Firms that engage in, or collaborate on, investment banking activities must:

a. Establish and implement effective policies and procedures that:
    i. segregate research analysts from the investment banking department; and
    ii. ensure that investment banking objectives or employees do not have the ability to influence or affect research or recommendations;
b. Implement reporting structures and review procedures that ensure that research analysts do not report to, and are not supervised or controlled by, investment banking or another department of the firm that could compromise the independence of the analyst; and
c. Implement procedures that prevent investment banking or corporate finance departments from reviewing, modifying, approving, or rejecting research reports and recommendations on their own authority.

5.0 Research Analyst Compensation

Requirements

Firms must establish and implement salary, bonus, and other compensation for research analysts that:

a. Align compensation with the quality of the research and the accuracy of the recommendations over time; and
b. Do not directly link compensation to investment banking or other corporate finance activities on which the analyst collaborated (either individually or in the aggregate).

6.0 Relationships with Subject Companies

Requirements

Firms must implement policies and procedures that manage the working relationships that research analysts develop with the management of subject companies.

Research analysts must be prohibited from:

a. Sharing with, or communicating to, a subject company, prior to publication, any section of a research report that might communicate the research analyst's proposed recommendation, rating, or price target; and
b. Directly or indirectly promising a subject company or other corporate issuer a favorable report or a specific price target, or from threatening to change reports, recommendations, or price targets.

7.0 Personal Investments and Trading

Requirements

Firms must have policies and procedures that:

a. Manage covered employees' "personal investments and trading activities" effectively.
b. Ensure that covered employees do not share information about the subject company or security with any person who could have the ability to trade in advance of ("front run") or otherwise disadvantage investing clients.
c. Ensure that covered employees and members of their immediate families do not have the ability to trade in advance of or otherwise disadvantage investing clients relative to themselves or the firm;
d. Prohibit covered employees and members of their immediate families from trading in a manner that is contrary to, or inconsistent with, the employees' or the firm's most recent, published recommendations or ratings, except in circumstances of extreme financial hardship; and
e. Prohibit covered employees and members of their immediate families from purchasing or receiving securities prior to an IPO for subject companies and other companies in the industry or industries assigned.

8.0 Timeliness of Research Reports and Recommendations

Requirements

Firms must issue research reports on subject companies on a timely and regular basis.

9.0 Compliance and Enforcement

Requirements

Firms must:

a. Have effective enforcement of their policies and compliance procedures to ensure research objectivity;
b. Implement appropriate disciplinary sanctions for covered employees, up to and including dismissal from the firm, for violations;
c. Monitor and audit the effectiveness of compliance procedures; and
d. Maintain records of the results of internal audits.

10.0 Disclosure

Requirements

Firms must provide full and fair disclosure of all conflicts of interest to which the firm or its covered employees are subject.

11.0 Rating System

Requirements

Firms must establish a rating system that:

a. Is useful for investors and for investment decision-making; and
b. Provides investors with information for assessing the suitability of the security to their own unique circumstances and constraints.