Learning Module 2: Code of Ethics and Standards of Professional Conduct

LOS 2a: Code of Ethics and Standards of Professional Conduct

CFA Institute Professional Conduct Program and the Process for Enforcement of Code and Standards

Violations of the CFA codes and standards are reviewed through the CFA Institute's Professional Standards and Policy Committee (PSPC). This committee is authorized to conduct investigations and impose penalties. Within the PSPC, there are two subcommittees. First, the Disciplinary Review Committee (DRC) is charged with reviewing potential violations and enforcing the Code of Ethics. Second, the Standards of Practice Council (SPC) is charged with editing, deleting, or adding standards and distributing updated information to CFA members.

Causes for an investigation

CFA Institute members may be investigated based on:

1. Violation of the CFA Institute Articles of Incorporation, Bylaws, Code of Ethics, Standards of Professional Conduct, or Rules of Procedure or other applicable rules

2. Sanction or injunction imposed by a government or judicial agency, or public or private self-regulatory organization with jurisdiction over investment-related activities

3. Conviction of a felony, or (if the jurisdiction does not define a felony) any crime punishable by more than one year in prison

4. Ban or restriction (permanently or indefinitely) from registration under a jurisdiction's securities laws or any restriction related to any investment-related professional activity

5. Failure to complete, sign and return the Professional Conduct Statement

6. Falsifying information on a candidate or society membership application

7. Failure to cooperate with the CFA Institute's inquiry and investigation into one's own conduct or the conduct of another member

8. Any other good cause

Consequences

If found to be in violation of codes and standards, members are subject to censure, suspension, or revocation of membership. Candidates can also be penalized by revoking the right to sit for CFA examinations, thereby becoming ineligible for membership.

Ethics and the Investment Industry

Efficient markets rely on trust and transparency. Ethical conduct ensures fair markets, fostering investor confidence. While laws and regulations are crucial, they aren't enough. A culture of integrity, where ethical principles like honesty and fairness guide behavior, is essential for sustaining global capital markets. Unethical behavior erodes trust and harms market sustainability. Thus, ethics play a vital role in maintaining robust financial markets and benefiting society as a whole.

Ethics, Society and Markets

CFA Institute's mission includes "for the ultimate benefit of society," emphasizing the importance of stable, efficient global capital markets. These markets allocate resources effectively, fostering innovation, job creation, and improved living standards. Trust is crucial; if investors distrust market fairness, they invest less, demanding higher risk premiums, harming the economy. Universal ethics promote trust and integrity across all regions, supporting the industry's efficiency and values. Global standards should align with fundamental ethical principles to maintain a vibrant investment environment.

Capital Market Sustainability and the Actions of One

Investment professionals and firms should consider the broader impact of their actions on the global investment community. As finance becomes more interconnected, market sustainability is crucial. Isolated decisions can collectively cause crises, so awareness of global effects is essential. Ethical behavior, risk management, and product development should prioritize market health. Compensation strategies must avoid incentivizing unethical conduct. Protecting client interests above all remains a fundamental principle.

The Relationship between Ethics and Regulations

Some equate ethical behavior with legal compliance, but ethics often go beyond the law. Laws guide appropriate behavior but don't cover all unethical acts. Legal behavior is what’s required; ethical behavior is doing what’s morally right. Since regulators may lack resources to enforce all rules, relying solely on legal compliance is insufficient for ensuring ethical conduct in the investment industry. Strong ethical principles at individual and firm levels are crucial to limit abuses and ensure ethical decision-making.

Applying an Ethical Framework

Laws, regulations, and professional standards guide ethical behavior, but individual judgment is crucial for principled choices. Without a solid ethical framework, decisions can lead to fraud and loss of public trust. Investment professionals should use a decision-making framework to balance profit with ethical considerations, ensuring their actions meet high standards. This framework helps analyze decisions in context, supporting ethical conduct and fulfilling professional responsibilities effectively.

Commitment to Ethics by Firms

A firm’s code of ethics must be deeply integrated into its culture to be effective. Investment professionals need a framework that brings ethical principles to life, making them central to the firm's operations. Building a culture of integrity, led by senior management, reinforces the desire to "do the right thing." Regular practice of ethical decision-making helps employees make sound choices despite conflicts of interest. This approach benefits businesses, individuals, firms, the industry, markets, and society by promoting ethical conduct in investment management.

Ethical Commitment of CFA Institute

CFA Institute aims to uphold the highest ethical standards in the investment industry through its Code of Ethics and Standards of Professional Conduct. These guidelines ensure fair and ethical practices for members and candidates. Over 60 years, the Code and Standards have evolved to stay relevant. The Standards of Practice Handbook addresses key ethical principles, covering professionalism, responsibilities, and conflicts of interest. Despite the complexity of modern finance, distinguishing right from wrong remains essential. CFA Institute provides resources to help members and candidates apply these ethical principles effectively.

Code of Ethics

The CFA Institute has outlined six components to its ***Code of Ethics***. Members of the CFA Institute must:

1. 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.

2. Place the integrity of the investment profession and clients' interests above their own personal interests.

3. Use reasonable care and exercise independent professional judgment when conducting investment analysis, making investment recommendations, taking investment actions, and engaging in other professional activities.

4. Practice and encourage others to practice professionally and ethically to reflect credit on themselves and the profession.

5. Promote the integrity of, and uphold the rules governing, capital markets.

6. Maintain and improve their professional competence and strive to maintain and improve the competence of other investment professionals.

Standards of Conduct

With regard to ***Standards of Conduct***, there are seven areas by which one must be held accountable. They are as follows:

1. Professionalism

- Knowledge of the law
- Independence and objectivity
- Misrepresentation
- Misconduct

2. Integrity of Capital Markets

- Material non-public information
- Market manipulation

3. Duties to Clients and Prospective Clients

- Loyalty and prudence
- Fair dealing
- Suitability
- Performance presentation
- Preservation of confidentiality

4. Duties to Employers

- Loyalty
- Additional compensation arrangements
- Responsibilities of supervisors

5. Investment Analysis, Recommendations, and Action

- Diligence and Reasonable Basis
- Communication with clients and prospective clients
- Records retention

6. Conflicts of Interest

- Disclosure of conflicts
- Priority of transactions
- Referral fees

7. Responsibilities as a CFA Institute Member or CFA Candidate

- Conduct as participants in CFA Institute programs
- Reference to CFA Institute, CFA designation, and CFA program

Ethical Responsibilities Required by the Code and Standards

I. Professionalism

Standard I is broad in scope and directed toward competence within a small business environment. This standard makes it clear high ethical standards must apply even when an issue hasn't been identified in writing. In addition, it specifies that investment professionals must have a working knowledge of laws and a framework for resolving ethical dilemmas.

II. Integrity of Capital Markets

Standard II discusses sharing of material information qualified as non-public and the intent to manipulate markets. It prohibits CFA members from acting in a way to distort market value through manipulation.

III. Duties to Clients and Prospective Clients

Standard III addresses client loyalty, discretion, and care; fair dealing; suitability; performance presentation; and maintaining confidentiality. Investment professionals are obligated to put the interests of their clients before that of their organization or their personal interests.

IV. Duties to Employers

Standard IV outlines basic responsibilities by investment professionals for their employers. Language includes the premise of "do no harm" toward an employer, bearing that there can occasionally be a conflict of loyalty between personal and agency interests. There are also specific instances outlined in which an investment professional may be considered in violation of duties to employers, including unfair competition and sharing of confidential information. Whistleblowing, or reporting unethical employers, is also addressed in this section.

V. Investment Analysis, Recommendations, and Action

Standard V outlines the responsibility of investment professionals regarding due diligence before making recommendations to clients. The intent is to prevent conjecture in the form of a "hot tip" but rather provides that recommendations be made based on a firm's independent research or the quantitative research of other reputable sources.

VI. Conflicts of Interest

There are bound to be conflicts of interest and loyalty within any business organization, leading to an ethical dilemma. Standard VI specifies that CFA members and candidates must disclose any potential conflicts between clients and employers, individual interests, and the like. The purpose of this is to protect employers from an unknown clash of concerns that may promote unethical decisions.

VII. Responsibilities as a CFA Institute Member or CFA Candidate

Finally, Standard VII indicates that members and candidates must not risk the integrity of the CFA Institute or the CFA designation through unethical action. This standard also addresses cheating on CFA exams.