Learning Module 1: Ethics and Trust in the Investment Profession

LOS 1a: Ethics and Trust in the Investment Profession

Ethics Defined

Many professions define a code of ethics aimed at outlining cultural values within that profession. For the investment industry, ethics are defined as a standard of conduct valued by the financial sector. These can be expressed via concrete rules of behavior as defined by law, or through abstract concepts meant to define the spirit of organizational conduct. The Chartered Financial Analyst (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 the interests of clients 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 in a way that will reflect credit on themselves and the profession.

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

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

Describe the Role of a Code of Ethics in Defining a Profession

The role of ethics within the investment profession is to promote the integrity and viability of global capital markets for the ultimate benefit of society. By learning and committing to that code of ethics, each professional contributes to a universal protocol of acceptable behavior. Within the financial sector, there are both Global Investment Practice Standards (GIPS), as well as CFA Institute Standards of Practice.

Ethics and Profession

A profession can be defined as the occupational group that is based on the unique education, specialist knowledge, and framework of practice and behavior that establishes community trust, respect, and recognition. A large proportion of professions outlines the importance of ethics, excellent service, and empathy when dealing with clients.

Diverse professions have developed over the years due to:

- Rise of new specialist areas of expertise which requires licensing and technical standards
- Pressure from the governments and regulators. These entities encourage the formation of strong ethical standards between professionals and society at large.
- Demand for a certain profession by the parties who see the merit of working as a professional and desire to work with professionals in specific fields.

Establishment of Trust by Professions

A credible profession is characterized by a strong trust from both the clients and the society at large. Profession builds through the following ways:

1. Provision of Community Service

The provision of community services creates confidence and professional pride and professional acceptance. Consequently, a trustworthy professional is substantially flexible and is independent of the government regulatory bodies when carrying its operations.

2. Making a Profession Client-based

The trust of a profession is built if it puts its integrity and the interest of clients above their interests. A client-focused profession is one that its actions portray a high level of care, skill, and diligence while making the interests of the clients' priority. In summary, a profession gains trust if it shows **fiduciary duty** a commitment to high-quality care when acting for the benefit of another party.

3. Normalizing of the Practitioner Behavior

A profession is trusted if it is grounded on codes and standards recognized by regulators and the government, under which the profession is established. The regulatory bodies should understand the profession’s codes and standards and their enforcement.

4. Developing High Entry Standards for a Profession

A profession should develop an elaborate entry requirement into a profession since membership in a profession is a sign to the consumers that the professional will deliver high-quality service. Such requirements include expertise, knowledge, technical skills, and ethics.

5. Possessing Body of Expert Knowledge

Experienced and skilled practitioners should make available useful knowledge to their members to work resourcefully and ethically, based on best practice.

6. Continuous Education

Having qualified into a profession, there is a need for ongoing education to its members to accommodate the ever-changing knowledge and technical skills, technology, standards of ethical behavior, legal and business environment where professional services are needed. Most of the professional regulatory bodies make it mandatory for the members to undergo **continuing**

professional development -undergoing specified new learning each year.

7. Monitoring Professional Misconduct

Each professional found liable for professional misconduct should be held accountable. This is necessary to maintain the integrity and the reputation of the profession and hence trust.

8. Making a profession Collegial

Despite that members of a profession do compete, they should respect each other rights, autonomy, and dignity.

9. Establishing Profession Oversight Authorities

Although it is the responsibility of each professional to maintain a high level of professional standards and competency, an oversight body is established to make this happen. Moreover, the oversight body is mandated to provide continuous educational resources and information on professional changes as time goes by.

10. Engagement of the Professional Members

Professional members may help to protect the future of professional values by acting as educators to peers. They achieve this by volunteering to mentor and inspire other young professionals or even those who wish to join a certain profession to develop expertise and ethics. In the long term, the future trust of a profession is protected.

The Need for High Ethical Standards in the Investment Industry

In 2014 the investment industry accounted for more than $64 trillion in assets. Additionally, it is growing at eight percent a year. It can be theorized that with trillions in assets and billions of financial transactions each year, even a small percentage of unethical exchanges amount to a significant overall number.

A market collapse is devastating to faith and confidence in the investment industry. With each significant downfall, there is an increase in unemployment and a slump in the economy. The well-being of capital markets depends largely on consumer trust. Trust is earned through ethical conduct.

Professionalism in Investment Management

Investment management is an upcoming profession. This is evidenced by the following:

- The public understanding of its practice and codes are still growing.
- There is a lack of recognition by the regulators and the employers, which prevents the establishment of a profession in investment management.
- Not all participants in the investment management are professionals since the participants have not engaged in specified training or are members of any recognized authority. This makes it hard for investment management to gain trust.

However, some critical elements of investment management have developed over the years. Investment management, just like any other profession, meets a large proportion of the profession's expectations. Moreover, in most of the countries, some form of certification has been established, with no requirements to join a professional body. The investment management profession is trying to move with time. That is, it tries to cope with ever-changing demands.

Investment management is becoming global due to the increased opening of the capital markets internationally. Therefore, investment managers can offer their services in different countries or freely moving within the offices of multinational asset management firms. Several established bodies, such as actuarial societies, have investment management professionals as members.

Building Trust in Investment Management

The investment management profession has established itself to the level of other professions such as law and medicine, such that it is trusted to draw knowledge and utilize it with care and judgment. To maintain this trust, professionals should possess technical and financial expertise and understand the laws and regulations.

Investment management professionals should describe to the clients the charges, uncertainties, and conflicts that may arise in providing their investment services.

Investment management professionals should always adhere to codes of ethics and professional standards while their practices should be guided by care, transparency, and integrity.

Ethical Dilemmas

An ethical dilemma occurs whenever there are two or more choices. In this given circumstance there will always be the best choice, even when each option appears to have negative consequences.

Although the CFA Institute Code of Ethics aspires to drive behavior through high-level, moral principles, a dilemma can occur when two or more standards of conduct compete for primary preference. Major areas in which ethical dilemmas occur are (1) Misrepresentation, (2) Misconduct, (3) Fairness, (4) Loyalty prudence and care. Each will be discussed within a future LOS.

The Difference Between Ethical and Legal Standards

Often people equate ethical behavior with legal choices. However, there are numerous choices that may be legal but have no moral standing. It is important to remember that all laws stem from a place in which moral covenant has broken down. The means by which control is maintained in these circumstances is to set laws and stipulate punishment. Therefore, the law is reactive. By contrast, ethical conduct is proactive and the means by which standards of practice maintain a high level of morality beyond legality.

One may adhere to the letter of the law but ignore the spirit of the law. For example, IRS regulations repeatedly single out actions with “no legitimate business purpose.” If an investment professional makes choices with no legitimate business purpose in order to avoid short-term loss (i.e. taxation, fees) then you may be staying within parameters of what is legal, but with no purpose other than to get around the law.

Framework for Ethical Decision-Making

A framework for ethical decision-making is defined as a set of principles established to aid investment professionals in conducting business with integrity. The CFA Institute has outlined six tenets of ethical behavior as outlined in LOS 1a.

Beyond understanding the six ethical considerations established by CFA, one must apply these principles through ethical analysis. It is important to recognize that ethical dilemmas are a normal and predictable part of most jobs. This realization will help increase the likelihood that you will notice and act on ethical issues before they become destructive.

Question 1

The credibility of a profession is deeply dependent on the trust of both the clients and the community at large. Which of the following is *least likely* to be a way of building trust by professions?

A. *Members' engagement to nurture future professionalism*
B. *Antagonistic competition among the members of a profession*
C. *Continuous provision of educational resources to the members of a profession*

Solution

The correct answer is **B.**

Competition is healthy in any other industry, but members of a profession do compete; they should respect each other rights, autonomy, and dignity. By doing this, the reputation of a profession is maintained.