

## R57 Code of Ethics and Standards of Professional Conduct

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## Introduction

The Code of Ethics and Standards of Professional Conduct (Code and Standards) stipulate rules and guidelines for CFA Institute members and candidates on how to conduct themselves in a professional and ethical manner, with integrity, under all circumstances for the benefit of society.

## 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 Professional Conduct Program (PCP), 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 form the basic structure for enforcing the Code and Standards.

Professional Conduct **inquiries** can be prompted by several reasons:

- Self-disclosure: On the annual Professional Conduct Statement, members disclose if they have been a subject of civil litigation or criminal investigation.
- Written complaints: The PCP staff may receive written complaints.
- Evidence of misconduct: The PCP staff may come across violations through media or any public source.
- Report by a CFA exam proctor: If a candidate violated any rules on exam day and is reported by the proctor.
- CFA Institute may conduct analysis of scores and exam materials after the exam, as well as monitor online and social media to detect disclosure of confidential exam information. For instance, if a friend sits for the exam in Australia and discusses specific questions online after the exam while you are in the United States where the exam hasn't started, it can be considered a violation of the Code and Standards.

After an inquiry is initiated, the professional conduct team conducts an **investigation**. If the professional conduct staff believes a violation of the Code and Standards has occurred, they propose sanctions which can include: public censure, suspension of membership and use of the CFA designation, and revocation of the CFA charter. Candidates may be suspended or prohibited from further participation in the CFA program.

The member or candidate has the opportunity to accept or reject any charges and the proposed sanctions. If the member/candidate accepts the violation, then the sanctions will be imposed. If the member/candidate does not accept the charges or the proposed sanctions, the matter is referred to the **DRC**, which reviews 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 has occurred and, if so, what sanction should be imposed.

## Code of Ethics

Members of the CFA Institute (including CFA charterholders) and candidates for the CFA designation (“Members and candidates”) must:

1. 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.
2. Place the integrity of the investment profession and 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 in a professional and ethical manner that will reflect credit on themselves and the profession.
5. Promote the integrity and viability of the global capital markets for the ultimate benefit of society.
6. Maintain and improve their professional competence and strive to maintain and improve the competence of other investment professionals.

### **Instructor’s Note:**

The six components of Code of Ethics, outlined above, are important and should be memorized.

## Standards of Professional Conduct

There are seven Standards of Professional Conduct. Each standard has sub-sections. The standards are covered in detail in the next reading.

- I. Professionalism
- II. Integrity of Capital Markets
- III. Duties to Clients
- IV. Duties to Employers
- V. Investment analysis, Recommendations, and Actions
- VI. Conflicts of Interest
- VII. Responsibilities as a CFA Institute Member, or CFA Candidate

### **I. Professionalism**

#### **A. Knowledge of the Law**

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 stricter law, rule, or regulation. Members and Candidates must not knowingly participate or assist in and must dissociate from any violation of such laws, rules, or regulations.

**B. Independence and Objectivity**

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.

**C. Misrepresentation**

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

**D. Misconduct**

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.

**II. Integrity of Capital Markets**

**A. Material Nonpublic Information**

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.

**B. Market Manipulation**

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

**III. Duties to Clients**

**A. Loyalty, prudence, and care**

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.

**B. Fair Dealing**

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.

**C. Suitability**

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.
- D. Performance Presentation  
When communicating investment performance information, Members and Candidates must make reasonable efforts to ensure that it is fair, accurate, and complete.
- E. Preservation of Confidentiality  
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 or prospective client,
  2. Disclosure is required by law, or
  3. The client or prospective client permits disclosure of the information.

#### **IV. Duties to Employers**

- A. Loyalty  
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.
- B. Additional Compensation Arrangements  
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.
- C. Responsibilities of Supervisors  
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.

**V. Investment Analysis, Recommendations, and Actions****A. Diligence and Reasonable Basis**

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.

**B. Communication with Clients and Prospective Clients**

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 analysis and recommendations.

**C. Record Retention**

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.

**VI. Conflicts of Interest****A. Disclosure of Conflicts**

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.

**B. Priority of Transactions**

Investment transactions for clients and employers must have priority over investment transactions in which a Member or Candidate is the beneficial owner.

**C. Referral Fees**

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.

## **VII. Responsibilities as a CFA Institute Member or CFA Candidate**

### **A. Conduct as participants in CFA Institute Programs**

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.

### **B. Reference to CFA Institute, the CFA designation, and the CFA program**

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.

## Summary

### **LO.a: Describe the structure of the CFA Institute Professional Conduct Program and the process for the enforcement of the Code and Standards.**

The Professional Conduct Program (PCP), in conjunction with the Disciplinary Review Committee (DRC), is responsible for enforcement of the Code and Standards. The CFA Institute Bylaws and Rules of Procedure for Professional Conduct form the basic structure for enforcing the Code and Standards. Professional Conduct inquiries can be prompted by: self-disclosure, written complaints and evidence of misconduct, and report by a CFA exam proctor.

If the professional conduct staff believes a violation of the Code and Standards has occurred, sanctions are proposed. If the member/candidate does not accept the charges or the sanctions, the matter is referred to the DRC, which reviews materials and presentations from professional conduct staff and from the member or candidate. The DRC makes a final decision on whether there was a violation and if so what sanctions must be imposed.

### **LO.b: Identify the six components of the Code of Ethics and the seven Standards of Professional Conduct.**

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

1. 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.
2. Place the integrity of the investment profession and 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 in a professional and ethical manner that will reflect credit on themselves and the profession.
5. Promote the integrity and viability of the global capital markets for the ultimate benefit of society.
6. Maintain and improve their professional competence and strive to maintain and improve the competence of other investment professionals.

### **LO.c: Explain the ethical responsibilities required by the Code and Standards, including the sub-sections of each Standard.**

Covered in the next reading.



## Practice Questions

1. Which of the following is a Standard of Professional Conduct?
  - A. Responsibilities as an Investment Manager.
  - B. Professionalism.
  - C. Duties to regulators.
  
2. Which of the following is *most likely* the result of a sanction imposed by CFA Institute?
  - A. Seven years sentence.
  - B. Revocation of the CFA charter.
  - C. Termination of employment if the firm claims compliance with the Code and Standards.
  
3. Which of the following is *most likely* correct about Disciplinary Review Committee (DRC)?
  - A. DRC is responsible to maintain oversight and responsibility for the Professional Conduct Program.
  - B. DRC is responsible to review conduct and partner with Professional Conduct staff to establish and review professional conduct policies.
  - C. Both A and B.

**Solutions**

1. B is correct. The seven Standards of Professional Conduct are as follows:
  - I. Professionalism
  - II. Integrity of Capital Markets
  - III. Duties to Clients
  - IV. Duties to Employers
  - V. Investment analysis, Recommendations, and Actions
  - VI. Conflicts of Interest
  - VII. Responsibilities as a CFA Institute Member, or CFA Candidate
2. B is correct. Sanctions include public censure, suspension of membership, use of the CFA designation, and revocation of the CFA charter. Candidates may be suspended or prohibited from further participation in the CFA program.
3. B is correct. 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 Board of Governors maintains oversight and responsibility for the Professional Conduct Program, which, in conjunction with the Disciplinary Review Committee (DRC), is responsible for enforcement of the Code and Standards.