CFA Institute

CONSULTATION PAPER ON

CFA INSTITUTE CODE OF ETHICS AND STANDARDS OF PROFESSIONAL CONDUCT

May 2022

CFA Institute

CONSULTATION PAPER ON

CFA INSTITUTE CODE OF ETHICS AND STANDARDS OF PROFESSIONAL CONDUCT

May 2022

The Standards of Practice Council (SPC) is considering recommending to the CFA Institute Board of Governors a number of changes to the CFA Institute Code of Ethics and Standards of Professional Conduct. These potential changes—and the committee's views about why these changes may be necessary—are set out in this consultation paper. The goal for the consultation paper is to elicit feedback on the potential revisions under consideration. Your input on these ideas and issues will help the SPC shape its final recommendations to the Board of Governors on revisions to the CFA Institute Code and Standards. **All comments must be received by 8 July 2022 to be considered.**

Providing Feedback

Public commentary on this consultation paper will help shape an exposure draft that will include the changes to the Code and Standards proposed by the CFA Institute Board of Governors, which is expected to be issued later this year. Comments should be provided in the designated response form and submitted to standards@cfainstitute.org. You may address as few or as many of the consultation paper's questions as you wish. The consultation paper and the designated response form are available on the CFA Institute website at https://www.cfainstitute.org/en/ethics-standards/codes/esg-standards.

The deadline for providing feedback is 8 July 2022. **Comments received after 8 July 2022 will not be considered**.

A summary of the comments will be made publicly available at the conclusion of the comment period. But identifying information or attribution of the specific comments made by those responding to the consultation paper will **not** be made public.

Guidelines for Submission

Comments are most useful when they

- directly address a specific issue or question,
- provide a rationale and support for the opinions expressed, and
- suggest alternative solutions in the event of disagreement.

Positive comments in support of a proposal are equally helpful as those that provide constructive suggestions for improvement.

Requirements for Submission

In order for comments to be considered, please adhere to the following requirements:

- Insert responses to numbered questions in the designated areas of the response form.
- Assign a unique file name to your response form before submitting.
- Provide all comments in English.
- Submit the response form as a Microsoft Word document.
- Submit the response form to standards@cfainstitute.org by 5:00 p.m. E.S.T. on 8 July 2022.

CONSULTATION PAPER ON CFA INSTITUTE CODE OF ETHICS AND STANDARDS OF PROFESSIONAL CONDUCT

Introduction

The CFA Institute Code of Ethics and Standards of Professional Conduct (Code and Standards) are fundamental to the values of CFA Institute and essential to achieving its mission to lead the investment professional globally by promoting the highest standards of ethics, education, and professional excellence for the ultimate benefit of society. All CFA Institute members, including holders of the Chartered Financial Analyst® designation (as well as candidates for the designation) and holders of the CIPM designation, must comply with the provisions of the Code and Standards. Members must attest annually to their compliance with the Code and Standards and are subject to discipline for any violations.

For over 40 years, CFA Institute has charged a volunteer committee of charterholders with periodically reviewing the Code and Standards to ensure that it remains robust and relevant and represents the vanguard of ethical conduct applicable to investment professionals. The purpose of this committee, the Standards of Practice Council (the SPC or the committee), is to foster the integrity of the capital markets through its work in developing and maintaining the CFA Institute Code and Standards. To achieve this purpose, the SPC identifies and receives input from members and candidates on ethical issues not covered by existing standards and recommends revising or amending existing standards or developing new standards, as required. The SPC, with support from CFA Institute staff, periodically recommends revisions to the Code and Standards to be considered and approved by the CFA Institute Board of Governors that the SPC believes are necessary to maintain the relevance and rigor of the Code and Standards. In the past, revisions have included adding or consolidating standards, updating the language of the Code and Standards to reflect the growing global membership of CFA Institute, and clarifying the language of a number of Standards. CFA Institute leadership publishes the proposed revisions for comment by CFA Institute members and the public. The organization reviews public comments and makes adjustments to reflect input, as appropriate. The Board of Governors reviews and provides final approval of any revisions to the Code and Standards because they directly affect membership obligations.

Revisions to the Code and Standards under Consideration

The SPC is considering recommending to the Board of Governors a number of changes to the Code and Standards. These potential changes—and the committee's views on why these changes may be necessary—are set forth below. The committee is seeking public comment on these potential recommended changes. The goals for this consultation paper are to share the SPC's thinking on important potential changes and to elicit your feedback. Your input on these ideas and issues will help shape the CFA Institute Code and Standards Exposure Draft that will include the final recommendations of the SPC to the Board of Governors on any changes to the Code and Standards. We expect to publish the Exposure Draft later in 2022 for a 60-day comment period.

In addition to the specific comments solicited for each potential change, the committee is soliciting general comments for other ways, if any, in which the Code and Standards should be revised that are not reflected in these potential changes. Please provide your comments on this consultation paper **by 8 July 2022**. Comments can be sent to standards@cfainstitute.org.

1. Adding a General Transparency Standard.

Currently, the Standards of Professional Conduct touch on communication and transparency in several standards addressing disclosure in specific areas: Standard V(B) addresses what information members must disclose to clients about the investment management process. Standard VI(A) addresses when and how disclosures should be made about conflicts of interest. Standard VI(C) addresses disclosures regarding referral fees. Standard II(C) addresses disclosures regarding performance history.

The SPC is considering recommending to the Board a new, broad transparency standard that would require members to take reasonable care to ensure that communications related to their professional activities are fair, accurate, complete, timely, and understandable, are delivered in plain language, and communicate the relevant information effectively. Such communications can relate to a wide variety of information and not only are directed to clients and potential clients but also are made in many other contexts in academia and to employers, regulators, professional associations, and other parties.

Potential language of a new standard could include the following: "Members and Candidates must make reasonable efforts to provide communications related to their professional activities in a fair, accurate, timely, prominent, complete, and understandable manner and use plain language."

The committee recognizes that a requirement of transparency, outside the limited scope of the client relationship, potentially significantly broadens the applicability of the Code and Standards.

The committee is soliciting comments on whether a broad new transparency standard would be too onerous and would set a bar that is too high for professional conduct. Should investment professionals be expected to be transparent with parties other than their clients? Would this new standard be too vague or aspirational in nature, making it difficult to comply with or enforce? Is the conduct addressed by a broad transparency standard primarily undertaken by investment professionals in an individual capacity, or does a conflict-of-interest standard more directly apply to firm-level conduct? Can individual members be expected to influence their employers on these matters? What other comments do you have on this potential change?

2. *Revising the Conflict-of-Interest Standard to Address Avoiding Conflicts of Interest.*

CFA Institute Standard of Professional Conduct VI(A) Conflicts of Interest states:

> "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."

The guidance for this standard in the Standards of Practice Handbook states, "Best practice is to avoid actual conflicts or the appearance of conflicts of interest when possible." However, this directive to avoid conflicts when possible is not part of the requirements of the standard.

The SPC is considering recommending that the conflict-of-interest standard be supplemented. The committee believes that Standard VI(A)'s "disclosure only" language does not go far enough in requiring members to avoid likely conflicts of interest and should explicitly require members and candidates to avoid conflicts of interest when feasible. Proposed new language to the standard might state that "when feasible, Members must *avoid* conflicts that could impair their independence and objectivity and interfere with their duties to clients and their employer." Where conflicts are unavoidable, members would continue to be required to mitigate their impact and make full and fair disclosure to relevant parties. CFA Institute, through guidance to a revised standard, would explain how members should determine when it is feasible to avoid conflicts of interest.

Several codes of conduct of other financial professional organizations have language that goes beyond disclosing conflicts and requires avoiding conflicts of interest or obtaining explicit acknowledgement or consent of the conflict by the client. For instance, the American Institute of Certified Public Accountants (AICPA) has several standards addressing conflicts, including that a member should "maintain objectivity and *be free of conflicts of interest* in discharging professional responsibilities" (0.300.050.01). Another AICPA standard states, "[A member in public practice] who provides auditing and other attestation services should be *independent in fact and appearance*. In providing all other services, a member should maintain objectivity and *avoid conflicts of interest*" (0.300.050.04). And the AICPA standards require that "in the performance of any professional service, a member shall maintain objectivity and integrity, *shall be free of conflicts of interest*, and shall not knowingly misrepresent facts or subordinate his or her judgment to others" (1.100.001.01). The Association of Certified International Investment Analysts (ACIIA) states that "investment analysts shall take all necessary steps to *avoid conflicts of interest* that could reasonably be expected to impair their independence and objectivity" (Key Principle 4). The European Federation of Financial Analysts Societies (EFFAS) states that "investment professionals shall take all necessary steps to *resolve conflicts of interest* that could reasonably appear to impair their independence and objectivity, and otherwise disclose any apparent conflict."

The committee is soliciting comments on whether a revised conflict-of-interest standard would be too onerous and set a bar that is too high for professional conduct. Or, does the revision not go far enough in requiring the expected ethical conduct of investment professionals with respect to conflicts of interest? Is the potential change too vague or aspirational in nature, making it difficult to comply with or enforce? Is the language of the new/revised standard clear in establishing the conduct that is required? Is the phrase "when feasible" straightforward, or is there better terminology for this concept? Is the conduct addressed by a potential revised standard primarily undertaken by investment professionals in an individual capacity, or does a conflict-of-interest standard more directly apply to firm-level conduct? Can individual members be expected to influence employers on these matters? What other comments do you have on this potential change?

3. *Adding a Standard Requiring Disclosures Relating to Nature of Services and Fees, Costs, or Compensation.*

Currently, Standard V(B) Communications with Clients and Prospective Clients requires members to disclose the basic format and general principles of the investment processes they use to analyze investments, select securities, and construct portfolios and to promptly disclose any changes. However, neither the CFA Institute Code of Ethics nor the Standards of Professional Conduct require specific disclosure of the fees or costs assessed to clients or compensation paid to members and candidates.

The SPC is considering recommending a new standard requiring disclosures relating to the nature of services and fees, costs, or compensation. The new standard could include such language as "Members and Candidates must provide effective disclosures to clients and potential clients about the nature of the services provided, along with costs and fees associated with those services."

The SPC believes that members should provide clients with a comprehensive description of the services provided to their clients that is specific to the actions and activities the client can expect from the investment professional. This information would include a description of the nature and amount of fees that clients will pay for the services provided. The combination of these disclosures will permit clients to make informed decisions as to whether to engage with the member or candidate and the firm. The SPC believes this new standard will strengthen the expectation on how clients are informed of these arrangements and the associated fees across the investment management industry.

A number of codes of conduct, particularly those from financial planning associations, address disclosures of costs, fees, or compensation. These include Certified Financial Planner Board of Standards (CFP Board), whose Standard A (Section 10) states that "a CFP professional must provide the following information to the Client, prior to or at the time of the Engagement, and document that the information has been provided to the Client: . . . a description of the services and products to be provided" (10.a.i); "how the Client pays for the products and services, and a description of the additional types of costs that the Client may incur" (10.a.ii); "how the CFP professional, the CFP Professional's Firm, and any Related Party are compensated for providing the products and services" (10.a.iii); and "any other information about the CFP professional or the CFP

Professional's Firm that is Material to a Client's decision to engage or continue to engage the CFP professional or the CFP Professional's Firm" (10.a.viii).

FP Canada has several provisions addressing fees, costs, and compensation, including the following: "A Certificant shall disclose . . . an accurate and understandable description of the known costs of the services to the client; . . . when the services include financial planning or elements of the financial planning process, an accurate and understandable description of how the Certificant [or] the Certificant's firm are compensated for providing the products and services; . . . [and a description of] the specific financial planning services the Certificant will perform for the client" (Rule of Conduct 7). In addition, FP Canada's Rule of Conduct 20 states that "a Certificant shall provide prospective clients with . . . a description of the services the Certificant will provide to the client" and "an accurate and understandable description of (i) any costs payable by the client; (ii) how the client will pay for the services provided; and (iii) how the Certificant and the Certificant's firm are compensated for providing the services and associated products."

The committee is soliciting comments on whether a new standard requiring disclosure of the nature of services, fees, costs, and compensation is appropriate for individual investment professionals or if such a disclosure would be more directly applicable to firm-level conduct. Would this new disclosure standard be too onerous and set a bar that is too high for individual professional conduct? Or would the new standard not go far enough in requiring the expected ethical conduct of investment professionals with respect to disclosure on these topics? Can individual members be expected to influence employers on these matters? Would such a disclosure standard be too narrow, such that it would apply to only a small portion of the membership? What other comments do you have on this potential change?

4. *Supplementing the Supervisory Standard to Require Senior Leaders to Promote Ethical Culture.*

Currently, Standard IV(C) Responsibilities of Supervisors requires members to make reasonable efforts to ensure that anyone subject to their supervision or authority complies with the law, regulations, and the Code and Standards.

The SPC is considering a recommendation to supplement this standard with language that requires senior leaders of the firm to establish and promote a culture of ethical conduct and integrity within their firm.

A fundamental element to ensuring ethical behavior by investment professionals is the implementation of and commitment to a culture of ethics by their employers. Senior leaders of firms who have the authority and power to develop and nurture that ethical culture are critical to the process. CFA Institute has long advocated for and encouraged its members to commit to an ethical firm culture. A new standard would make explicit this requirement of its members.

Potential new language for Standard IV(C) could include the following: "Members who are supervisors or senior leaders within the firm must make reasonable efforts to establish and promote a culture of ethical conduct and integrity within their firm." A senior leader is someone who has decision-making responsibility and authority regarding the policies, procedures, and direction of the firm. Establishing and promoting ethical culture could include such initiatives as holding regular ethics training, adopting a code of ethics, implementing thorough compliance policies and procedures, and establishing an incentive system that recognizes and rewards ethical behavior.

The committee is soliciting comments on whether the potential change to the supervisory responsibility standard would fill a gap in the current Code and Standards or whether the change is redundant. Is the concept of "a culture of ethical conduct" straightforward, or is it too vague or aspirational in nature, making it difficult to comply with or enforce? Is the concept of "senior leader" straightforward, or is it too vague? Would this change be too onerous and set a bar that is too high for individual professional conduct? Is establishing an ethical culture primarily undertaken by investment professionals in an individual capacity, or would such a requirement more directly apply to firm-level conduct? What other comments do you have on this potential change?

5. Establishing an Exception to the Confidentiality Standard Relating to Impaired Clients.

Standard III(E) Preservation of Confidentiality states:

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.

The SPC is considering recommending adding a fourth exception to the confidentiality standard that would allow members to divulge confidential information to protect the interests of clients who demonstrate diminished mental or cognitive capacity that prevents informed decisions. The revised standard could include such language as "Members and Candidates must keep information . . . confidential unless . . . 4. Disclosure protects the interest of the clients who demonstrate diminished mental or cognitive capacity that prevents making informed decisions."

Investment professionals on occasion must deal with clients who exhibit an inability or a decreasing ability to make informed decisions about their financial circumstances. Investment professionals exercising their duty of loyalty to their clients who would like to protect them from negative outcomes arising from their diminished cognitive faculties can feel hampered from seeking assistance from outside parties, such as family and health care professionals, by the requirement to maintain client confidentiality. The SPC would like to add a "safe harbor" for potentially disclosing client matters for the limited purpose of protecting client interests when these situations arise. The SPC believes that such disclosure would protect the interest of clients in these circumstances.

The committee is soliciting comments on whether a new exception to the confidentiality standard is appropriate. Is the potential language clear in establishing the conduct that is required?

Is the concept of "diminished mental or cognitive capacity" straightforward, or is it too vague? Can investment professionals be expected to evaluate the mental and cognitive capacity of their clients? What other comments do you have on this potential change?

6. New Standard Specifically Requiring Competency.

Currently, the Code of Ethics requires members to "act with integrity, *competence*, and diligence" and to "maintain and improve their professional competence and strive to improve the competence of other investment professionals." The current version of Standard of Professional Conduct V(A) Diligence and Reasonable Basis requires members to "exercise diligence, independence, and thoroughness" and "have a reasonable and adequate basis, supported by appropriate research and investigation, for any investment analysis, recommendation, or action."

The SPC is considering recommending a new standard that would reinforce the Code of Ethics to require a baseline level of competency for all members. Proposed language could include the following: "Members and Candidates must act with and maintain the competence necessary to fulfill their professional responsibilities."

The skills and abilities necessary for members to successfully fulfill their role vary according to the nature and complexity of their professional duties. Members will develop and refine their skills and abilities throughout their professional careers as their professional responsibilities expand or evolve. A competency standard would require members to engage in appropriate ongoing training and learning to develop the skills and abilities required of their changing professional responsibilities. Activities to improve and demonstrate competency include, but are not limited to, participation in credentialing or training programs; attending educational events or professional conferences; writing, researching, or reviewing academic papers; and participating on industry panels.

The SPC believes that such a new standard would

- make the requirement of the Code of Ethics more explicit,
- broaden the requirements of Standard V(A), which apply to only "investment analysis, recommendation, or action," and
- emphasize the need for members to continuously maintain or improve the competence required of their professional position.

Under the new standard, all CFA Institute members would be required to demonstrate competency in any professional activity, even those not related specifically to investment action. Given the diverse range of professional services engaged in by members, the skills and abilities necessary to successfully fulfill their role will vary according to the nature and complexity of their professional duties. Over time, a member's role may expand, requiring new or different knowledge, skills, and abilities. Members will develop and refine their skills and abilities throughout their professional careers. The SPC believes that a professional standard requiring members to act with and maintain appropriate levels of competence will help ensure they provide a high standard of professional service to their clients.

Many professional organizations explicitly require their members to practice with, maintain, or continually improve competence in exercising their professional responsibilities. For instance, the AICPA states that "a member should strive to *continually improve competence*" (Principle 0.300.060.01). CFP Board states that "a CFP professional must provide professional services with *competence, which means with relevant knowledge and skill* to apply that knowledge" (Standard of Conduct A.3). The Association of Chartered Certified Accountants (ACCA) and the Chartered Institute of Management Accountants (CIMA) state that members must "*attain and maintain professional knowledge* and skill at the level required to ensure that the client . . . receives competent professional service" (R1131.1). ACIIA states that "investment analysts *shall continuously strive to maintain and improve their professional competence*" (General Principle 5). EFFAS states that "investment professionals *shall take concrete steps to continuously strive to maintain and improve* their professional competence" (Key Principle 4).

The committee is soliciting comments on whether a competency standard would fill a gap in the current Code and Standards or whether the change is redundant to existing requirements. Is the concept of "competency" straightforward, or would a competency standard be too vague or aspirational in nature? Is the potential language of the new standard clear in establishing the conduct that is required? What other comments do you have on this potential change?

7. Consolidating and Combining Certain Standards.

The SPC is considering removing Standard III(D) Performance Presentation from the Code and Standards and incorporating the substance and guidance of this standard into the misrepresentation standard and new transparency standards. The SPC believes that the requirements of a general standard on misrepresentation and transparency would cover many areas of communication, including the presentation of investment performance. The SPC believes that a specific standard on investment performance is not necessary and would emphasize that topic in the Standards over other equally important areas of communication. There would be no substantive effect on CFA Institute members' duty to make reasonable efforts to ensure that investment performance is fair, accurate, and complete.

The SPC is considering removing Standard IV(B) Additional Compensation Arrangements and Standard VI(C) Referral Fees and incorporating the substance and guidance of these standards into the revised conflict-of-interest standard. The SPC believes that the member obligations regarding referral fees and additional compensation arrangements would be covered in the revised conflict-of-interest standard, and there is no need to highlight these topics over other equally important areas where conflicts may occur.

The committee is soliciting comments on whether the performance presentation standard, the additional compensation arrangement standard, and the referral fee standard should be subsumed into other standards or remain as separate standards. What other comments do you have for these potential changes?

