MTA Ethics Program

A Short Overview

Today’s Presentation

- Recent program improvements
  - Why changes were needed
  - What changes were made
  - Impact of changes on members
- Quick review of each principle

Why changes were needed

- Membership has grown and includes professionals in different positions
- Original Code did not fully consider expanded diversity of membership
  - Standards were not always clear on precedence of rules (for example, insider trading could be permissible for some members)
  - Some standards conflicted with fiduciary responsibilities

Fiduciary role becoming more important in industry

- But original Standard 7 says:
  - "When a Member or Affiliate recommends that a security ought to be bought, sold or held, adequate opportunity to act on such a recommendation shall be given to the Member's or Affiliate's clients, employer, and the employer's clients <u>before acting on behalf of either the Member's or Affiliate's own account or the accounts of immediate family members.</u>"

Original Code needed revision

- Considered completing internal review
  - Would not quickly expand study material for CMT program
  - Risk of error was greater than minimal despite best efforts
- Completed licensing agreement with CFA Institute
  - Obtained decades of experience and ample study material for CMT program

No significant disruptions to members

- Members with CMTs were already held to high standards in original Code
- CFAI Code of Ethics & Standards of Professional Conduct is similar to the original Code
  - Includes handbook that includes best practices

Provides study material for CMT program

- Includes a large number of case studies and sample questions
  - Articles and videos expand on information
- Eliminates lack of clarity associated with ethics test questions in the past

Purpose of Code of Ethics

- The Code of Ethics maintains that you must:
  - Place the integrity of the profession and the interests of clients above your own interests
  - Act with integrity, competence, and respect
  - Maintain and develop your professional competence

Purpose of Standards of Professional Conduct

- The Standards of Professional Conduct cover:
  - Professionalism and integrity of the capital markets
  - Duties to clients and employers
  - Investment analysis and recommendations
  - Conflicts of interest and your responsibilities

Code of Ethics: 6 points

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.**

Code of Ethics: 6 points

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.

Code of Ethics: 6 points

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 Professional Conduct Expand on the Code

- Professionalism
- Integrity of capital markets
- Duties to clients
- Duties to employers
- Investment analysis, recommendations and actions
- Conflicts of interest

Examples are clear

- CMT candidates can be confident they understand ethics prior to testing
- Members can consult reference material to ensure they comply with industry best practices
- Members can find answers to any questions or concerns they encounter

Standard I - Professionalism

Washington's firm advertises past performance by showing a 10-year return of a composite of client accounts. She discovers the composite omits performance of accounts that left the firm during that time, but the description of the composite indicates the inclusion of all firm accounts. This omission has led to an inflated performance figure. Washington is asked to use promotional material that includes the erroneous performance number when soliciting business for the firm.

Standard I - Professionalism

Misrepresenting performance is a violation of the Code and Standards. Although she did not calculate the performance herself, Washington would be assisting in violating the Standard by using the inflated performance number when soliciting clients. She must dissociate herself from the activity. If discussing the misleading number with the person responsible is not an option, she can bring the situation to the attention of her supervisor or the compliance department at her firm. If her firm is unwilling to recalculate performance, she must refrain from using the misleading promotional material and should notify the firm of her reasons. If the firm insists that she use the material, she should consider seeking other employment.

MTA-centric example

A backtest showing MACD alone identifies winning trades 93% of the time is being used to advertise the effectiveness of technical analysis for your RIA. You review the results and find the test was done incorrectly. Can you use the ad in client presentations?

Standard II – Integrity of capital markets

In an effort to pump up the price of his holdings in Moosehead & Belfast Railroad Company, Steve Weinberg logs on to several investor chat rooms on the internet to start rumors that the company is about to expand its rail network in anticipation of receiving a large contract for shipping lumber.

Standard II – Integrity of capital markets

Weinberg has violated the Standard by disseminating false information about Moosehead & Belfast with the intent to mislead market participants.

MTA-centric example

Your newsletter is issued every Monday to your firm’s clients. Based on you analysis of accumulation indicators, you believe a takeover is likely to be announced over the weekend so you buy stock in the company on Friday morning and release the newsletter that afternoon with your opinion that a takeover is likely to be announced.

Standard III – Duties to clients

Adam Dill recently joined New Investments Asset Managers. To assist Dill in building a book of clients, both his father and brother opened new fee-paying accounts. Dill followed all the firm's procedures in noting his relationships with these clients and in developing their investment policy statements. An IPO is coming to market that is a suitable investment for many of his clients, including his brother. Dill does not receive the amount of stock he requested, so to avoid any appearance of a conflict of interest, he does not allocate any shares to his brother's account.

Standard III – Duties to clients

Dill has violated the Standard because he is not acting for the benefit of his brother’s account as well as his other accounts. The brother’s account is a regular fee-paying account comparable to the accounts of his other clients. By not allocating the shares proportionately across all accounts for which he thought the IPO was suitable, Dill is disadvantaging specific clients. Dill would have been correct in not allocating shares to his brother’s account if that account was being managed outside the normal fee structure of the firm.

MTA-centric example

This example applies to anyone working as a stockbroker, RIA, financial adviser or any other position where trade allocation decisions are made.

Standard IV – Duties to employers

James Hightower has been employed by Jason Investment Management for 15 years…and is now a senior portfolio manager and a member of the firm's investment policy committee. Hightower has decided to leave and start his own investment management business. He has been careful not to tell any of Jason's clients that he is leaving; he does not want to be accused of breaching his duty to Jason by soliciting Jason's clients before his departure. Hightower is planning to copy and take with him the following documents and information he developed or worked on while at Jason:

Standard IV – Duties to employers

1) *the client list, with addresses, telephone numbers, and other pertinent client information;*
2) *client account statements;*
3) *sample marketing presentations to prospective clients containing Jason's performance record;*
4) *Jason's recommended list of securities*
5) *computer models to determine asset allocations for accounts with various objectives;*
6) *computer models for stock selection;*
7) *personal computer spreadsheets for Hightower's major corporate recommendations, which he developed when he was an analyst*.

Standard IV – Duties to employers

- Except with the consent of their employer, departing members and candidates may not take employer property, which includes books, records, reports, and other materials, because taking such materials may interfere with their employer's business opportunities.
- Taking any employer records, even those the member or candidate prepared, violates the Standard.
  - Employer records include items stored in hard copy or any other medium (e.g., home computers, portable storage devices, cell phones).

MTA-centric example

You developed a model based on relative strength at a previous employer. Can you take the model with you to a new employer?

Answer: You can with permission. Without permission, if there are no copyright or non-compete issues, you can recreate the model.

Standard V—Investment Analysis, Recommendations, and Actions

Gary McDermott runs a two- person investment management firm. McDermott's firm subscribes to a service from a large investment research firm that provides research reports. McDermott's firm makes investment recommendations on the basis of these reports.

Standard V—Investment Analysis, Recommendations, and Actions

Members and candidates can rely on third- party research but must make reasonable and diligent efforts to determine that such research is sound. If McDermott undertakes due diligence efforts on a regular basis to ensure that the research produced by the large firm is objective and reasonably based, McDermott can rely on that research when making investment recommendations to clients.

MTA-centric example

Your firm subscribes to outside research that provides proprietary supply and demand indicators that have been available since the 1950s and are validated with research. You rely on these indicators for general market trends and supplement the research with specific trades to benefit from the trend. Is your reliance on outside sources acceptable?

Standard VI—Conflicts of Interest

Research analyst Marlon Long does not recommend purchase of a common stock for his employer's account because he wants to purchase the stock personally and does not want to wait until the recommendation is approved and the stock purchased by his employer.

Standard VI—Conflicts of Interest

Long has violated the Standard by taking advantage of his knowledge of the stock's value before allowing his employer to benefit from that information.

MTA-centric example

You scan for potential buys based on momentum every Thursday morning. You then buy the top ten stocks. You continue researching the top ten candidates based on their Wave structure and release a buy list of the best five stocks after the close on Thursday. Is this allowable?

Comparison to original Code

- Same general principles apply under both the original Code and the new material
  - Be professional
  - Be honest
  - Have a basis for your opinion
  - Follow the law
  - Respect privacy of clients & employers
  - Place clients first

Ethics

- Partly based in ideas learned in pre-school
  - Do the right thing, even when no one’s watching
- Cornerstone of any profession
  - Doctors and lawyers also adhere to professional codes
- In trading terms, following the Code & Standards offer great returns (strong professional reputation) and low risk (very little cost or effort to adhere to standards)
  - Ignoring the standards is equivalent to a high risk/low reward trade

Partial list of resources

Code of Ethics and Standards of Professional Conduct

http://www.cfapubs.org/toc/ccb/2014/2014/6

Standards of Practice Handbook

http://www.cfapubs.org/doi/suppl/10.2469/ccb.v2014.n4.1

Study guide

http://www.cfapubs.org/doi/pdf/10.2469/cpb.v2013.n1.1?src=recsys

Webinars

http://www.cfainstitute.org/ethics/integrity/training/Pages/index.aspx