CAIA Ethical Principles

Professionalism and Fiduciary Responsibilities

The Investment Industry

Match the industry purpose to the correct definition:

- **Core purpose**
- **Collateral purpose**
- **Intrinsic purpose**
- **Fundamental purpose**

- Matching those with excess capital with those that have a need for capital
- Increasing wealth and managing risk
- Increase societal wealth and well-being
- Provide employment and growth opportunities for investment firms

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The Investment Industry

- **True or false?** Recent IPO/buyback activity suggests the investment industry is not adding value with respect to either its core or intrinsic goals.
- **Define** the following keywords and briefly describe how they are related in the text:
  - Triple bottom line
  - Social-license compact

The Investment Industry

- ***True or false?*** *Recent IPO/buyback activity suggests the investment industry is not adding value with respect to either its core or intrinsic goals.* **False.** Declines in IPO activity and increases in share buybacks suggest that the investment industry is not adding value with respect to its intrinsic goal; however, core purpose functions such as wealth and risk management remain valuable.

The Investment Industry

- ***Define*** *the following keywords and briefly describe how they are related in the text:*
  - *Triple bottom line:* A corporate focus on economic, environmental and social value generation.
  - *Social-license compact:* The implied granting of privileges to an industry by society in return for the industry conducting its business in a responsible manner.

Fiduciary Duty/Professional Mindset

- **State** two challenges to carrying out fiduciary duty in practice
- **State** two values which drive a professional and fiduciary mindset
- Briefly **describe** the virtuous cycle of positive forces from the client-first mindset

Fiduciary Duty/Professional Mindset

- ***State** two challenges to carrying out fiduciary duty in practice*
  - Any two of:
    - Interpretation may vary by context
    - Interpretation changes over time
    - No globally consistent interpretation of obligations or scope
    - The prioritization of financial performance over ESG factors

Fiduciary Duty/Professional Mindset

- ***State** two ways a professional and fiduciary mindset delivers value to clients*
  - Any two of:

  1. *Ethical and professional behavior* embraced by the firm's culture
  2. *Partnership* with the client
  3. *Client first:* knowing the client and making suitable decisions
  4. *Transparency, integrity and accountability*
  5. *Public responsibility* (clean 'license to operate')

- *Briefly* ***describe*** *the virtuous cycle of positive forces from the client-first mindset*
  - Good portfolio performance benefits clients and builds trust, which benefits the growth of the asset manager's business and the future performance of portfolios

The Investment Industry

- **True or false?**
  - Public responsibility is a key definitional component of a profession
  - An investment professional's skill set should include soft-skills and T-shaped skills
  - When adopting a 'client first mindset' in practice it is important to treat all clients equally

- **State** *two* reasons why firms fall short in meeting the target of being professional

The Investment Industry

- ***True or false?***
  - Public responsibility is a key definitional component of a profession. **True.**
  - An investment professional's skill set should include soft-skills and T-shaped skills. **True.**
  - When adopting a 'client first mindset' in practice it is important to treat all clients equally. **False** – a client first mindset has the concept of treating clients *fairly* at its heart in practice. Different clients can and should be treated differently dependent on their circumstances and level of service.
- ***State*** *two reasons why firms fall short in meeting the target of being professional*
  - Any two of: Unjustified fees, misaligned values or poor communication

The Investment Industry

Match the type of industry with the correct definition:

- **Absent**
- **Misaligned**
- **Professional**
- **Unnecessary**

Good For Industry?	Good for Society?
✓	✓
Partially good	✗
✗	Partially good
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Ethics

The Value Creation Equation

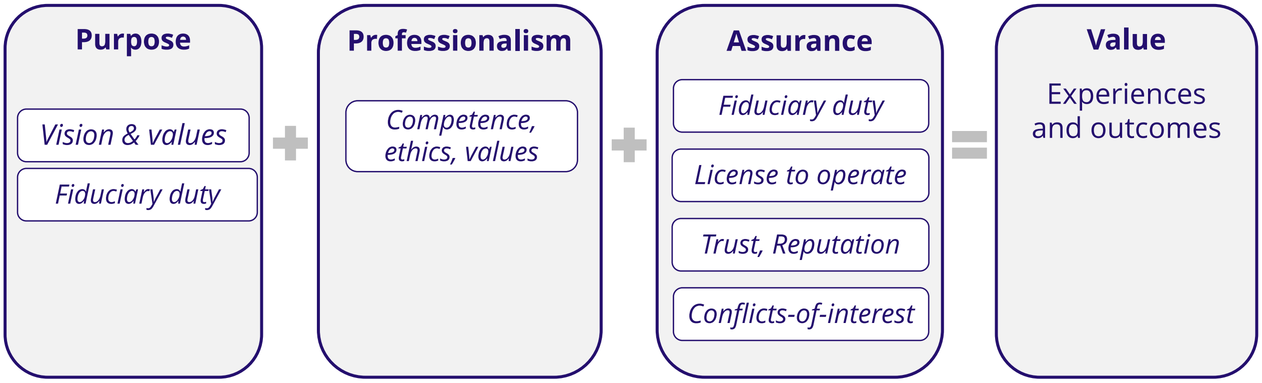
Place the following elements in their correct place in the **value creation equation:**

Vision & values | *Fiduciary duty* | *License to operate*

Competence, ethics, values | *Conflicts-of-interest* | *Trust, Reputation*

Purpose		Professionalism		Assurance		Value
	+		+		=	Experiences and outcomes

The Value Creation Equation



Foundations for the CAIA Ethical Principles

Which of the following statements is/are inaccurate?

I. An advantage of principles-based ethical systems over rules-based systems is that principles-based systems encourage critical thinking and professional judgment

II. Trustworthiness is always enhanced by a firm's brand

III. A firm should never engage in a business activity that leads to conflicts of interest

IV. Continued learning is a key feature of professionalism

A) I and III
B) II and III
C) II and IV
D) III and IV

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The CAIA Ethical Principles 1 – 4: Doing The Right Things

Map the following behavior to the *most relevant* Principle:

Behavior
Speak the truth. Pass on important information
Moral courage, integrity, encourage others to act ethically, responsibility to all stakeholders
Strong governance/oversight. Place client's interests before self-interest
Know your client, communicate in a manner that builds trust

Principle
1. Ethical and Professional Behavior
2. Partnership
3. Client First Mindset
4. High Standards of Conduct: Transparency, Integrity, Accountability

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The CAIA Ethical Principles 5 – 8: Doing Things Right

Map the following behavior to the *most relevant* Principle:

Behavior
Establishing adequate ethical framework, appropriate reward systems
Value diversity, work with regulators, mentor and volunteer
Be humble and curious, apply a growth mindset
Comply with laws, act ethically under duress, manage risk, perform proper due diligence,

Principle
5. High Standards of Practice
6. Professional Work
7. Continued Learning
8. Collaboration

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The CAIA Ethical Principles Case Studies

Which of the following statements is most accurate?

I. All five of the CAIA Case Studies involved a breach of Principle 1: Ethical and Professional Behavior

II. The only case study to not exhibit behavior which breached Principle 3: Client-First Mindset was Archegos Capital Management

III. Principle 4: High Standards of Conduct was breached by behavior of management at Bear Stearns Hedge Funds

IV. Principle 8: Collaboration was breached by behavior at MF Global

A) I and II B) II and III

C) I, II, and III D) III and IV

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A) I and II

B) II and III

C) I, II, and III

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The CAIA Ethical Principles: Case Studies

MF Global

- Unlawfully used client funds to cover margin calls for losses on proprietary positions, eventually filing for bankruptcy with shortfalls in client funds
- Key **breaches** of ethical principles:
  - Lack of adequate risk governance (P3: Client-First Mindset)
  - Employees not voicing concerns (P1: Ethical and Professional Behavior)
  - Failure in transparency and accountability (P4: High Standards of Conduct)
  - Not adhering to CFTC segregation rules (P6: Professional Work)

The CAIA Ethical Principles: Case Studies

Archegos Capital Management

- Took highly levered positions in derivatives whilst concealing overall exposure to counterparties. Eventual losses to counterparties estimated to be $10 billion.
- **Breaches** of ethical principles:
  - Manipulation of stock market prices (P1: Ethical and Professional Behavior)
  - Lack of transparency in exposure with counterparties (P4: High Standards of Conduct)
  - Lack of ethical framework (P5: High Standards of Practice)
  - Lack of effective risk management (P6: Professional Work)

The CAIA Ethical Principles: Case Studies

Bear Stearns Hedge Funds

- Two structured credit hedge funds collapsed, with clients suffering losses whilst portfolio managers concealed losses and redeemed their own personal investments (whilst lying about adding assets to the fund)
- **Breaches** of ethical principles:
  - Misleading clients about prospects for the funds (P1: Ethical and Professional Behavior)
  - Transferring assets out of the fund ahead of clients (P3: Client-First Mindset)
  - Failing to disclose extent of issue to clients (P4: High Standards of Conduct)

The CAIA Ethical Principles: Case Studies

NY State Common Retirement Fund

- New York State comptroller and adviser guilty of receiving gifts and donations from financial firms to which they had allocated capital
- **Breaches** of ethical principles:
  - Disregard for pension plan participants (P1: Ethical and Professional Behavior)
  - Placing their own interest above plan participants (P3: Client-First Mindset)
  - Lack of effective investment decision making (P6: Professional Work)

The CAIA Ethical Principles: Case Studies

CalPERS

- CEO took bribes from adviser in return for allocations to adviser's funds whilst falsifying documents claiming to show approval for investment decisions
- **Breaches** of ethical principles:
  - Taking bribes (P1: Ethical and Professional Behavior)
  - Lack of adequate governance (P3: Client-First Mindset)
  - Inappropriate reward system (P5: High Standards of Practice)