



# Bangko Sentral ng Pilipinas

## OFFICE OF THE DEPUTY GOVERNOR SUPERVISION AND EXAMINATION SECTOR

### CIRCULAR LETTER NO. CL-2010-013

To : All Banks and Non-Bank Financial Institutions

Subject : **Code of Ethics Governing Financial Market Activities in the Philippines**

Towards the end of improving financial market integrity, the Bangko Sentral ng Pilipinas (BSP) hereby informs all banks, their subsidiaries and affiliates, and other financial institutions supervised by BSP the development of "The Code of Ethics Governing Financial Market Activities in the Philippines" (Code) by the Money Market Association of the Philippines (MART). A copy of the Code is attached as Annex A for your reference.

The Code provides a set of principles and standards for market conduct of financial market participants, such as banks, brokerage firms and other financial institutions. It aims to guide market participants in determining the nature of their responsibilities to one another, clients and the market and in decision-making when faced with ethical situations. The observance of these principles and guidelines seek to promote greater professionalism in the market. The Code is anchored on the belief that high ethical standards are critical in maintaining the public's trust in the fairness of financial markets, and allowing markets to function efficiently.

The Code is generally principles-based which can be applied as a minimum standard in trading across financial product markets. The Code covers the following topics: Professionalism, Integrity of Capital Markets, Duties to Clients, Conflicts of Interest, and Duties to Market Counterparties. The BSP believes that the Code may be a basis or part of the binding market conventions governing orderly conduct / operations of the market, which is one of the components in order to recognize an over-the-counter market as an organized market.

For information and guidance.

  
NESTOR A. ESPENILLA, JR.  
Deputy Governor

24 February 2010

PANANALAPING MATATAG, BANSANG PANATAG

**Code of Ethics**  
**Governing Financial Market Activities**  
**In the Philippines**

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## INTRODUCTION

The Money Market Association of the Philippines (MART) has compiled this set of guidelines for the "Code of Ethics Governing Financial Market Activities in the Philippines" to provide a reference for banks, brokerage firms and other financial institutions in setting high ethical standards and professional excellence for market practitioners. This is anchored on the belief that high ethical standards are critical in maintaining the public's trust in the fairness of financial markets, and allowing markets to function efficiently.

The Code was designed to be generally principles-based which can be applied as a minimum standard in trading across financial product markets. It is aimed to guide members in decision-making when faced with ethical situations; and determining the nature of their responsibilities to one another, to clients and the market.

The Code of Ethics of the following associations were used to sieve the common thread of trading and selling principles: ACI Philippines, Bankers Association of the Philippines (BAP), Investment House Association of the Phils (IHAP) and MART. We also used as a reference the CFA Institute (Chartered Financial Analysts) Code of Ethics and Standards of Professional Conduct. The Appendices provide copies of the abovementioned codes used as a reference.

It is to be made clear, however, that the Code does not include trading conventions, and hence would not supercede the Trading Conventions of the different associations pertinent to their specific product markets.

It is important then that all market practitioners observe the guiding principles embodied in this Code to continue to promote greater professionalism in our treasury markets.

### NOTE:

For the purpose of the Code, the term "financial institutions" is used to represent banks, quasi-banks, thrift banks, investment houses, and brokerage firms which are members of the abovementioned associations. The term "members" is used to represent employees of the financial institutions engaged in the following banking activities, namely, money market, foreign exchange, fixed-income securities, derivatives and underwriting.

CODE OF ETHICS GOVERNING FINANCIAL MARKET ACTIVITIES  
IN THE PHILIPPINES

I. Professionalism

A. Knowledge of the Law

Financial institutions should employ the resources and procedures needed for the proper performance of its business activities. It is therefore essential that financial institutions employ or appoint persons who are qualified to conduct business with its clients and counterparties. As they are responsible for the actions and conduct of its dealers and related personnel, the financial institutions should ensure that its members have the authority, as well as the knowledge of and training on the laws governing the products and markets they are dealing with.

Members must understand and comply with all applicable laws, rules and regulations of any government, regulatory organization, or professional association governing their activities. Members must not knowingly participate nor assist in any violation of such laws, rules, or regulations.

More specifically, members should comply with the regulatory requirements issued by the Bangko Sentral ng Pilipinas (BSP) and the Securities and Exchange Commission (SEC), among others, which are relevant to the banks' trading activities in the money markets, foreign exchange, fixed income securities and derivatives, as well as in the underwriting business.

To acquire and maintain knowledge and understanding of the applicable laws, rules, and regulations, members should:

1. Stay informed. The financial institutions should establish a procedure by which members are regularly informed about the changes in the relevant laws, rules and regulations. In many instances, the banks' compliance department can provide such information in the form of memoranda distributed to the members. The members should also be abreast of current issues and developments in the products and markets they are trading. One way of keeping current is participating in in-house as well as external training courses, such as attending industry fora.

2. Review procedures. The financial institutions should review written compliance procedures on a regular basis to ensure that the procedures reflect current law and provide guidance to members what is permissible conduct under the law.
3. Maintain current files. The financial institutions should maintain readily accessible current reference copies of relevant rules and regulations.

B. Independence and Objectivity

Members must use reasonable care and judgment to achieve and maintain independence and objectivity in their professional activities. Although gifts or entertainment can be offered in the normal course of business, members must not offer, solicit, nor accept any gift, entertainment, benefit or compensation that reasonably could be expected to compromise their own independence and objectivity.

It is therefore important that the members disclose to management the gifts or benefits received. Financial institutions should establish clear policies and guidelines on when and how entertainment and gifts are to be used, supervised and monitored. At the minimum, the policies should require disclosure of details of the gifts and entertainment, with said disclosure to be submitted, preferably on a monthly basis, to the Compliance Officer and to the Board of Directors or its equivalent committee, of the member's financial institution.

The financial institution's corporate culture should fully support independence and objectivity. Given the symbiotic relationship between different business functions, say research and investment banking, one method of protecting objectivity is building a "firewall" or "Chinese wall" between these two functions. A key element of an enhanced firewall is separate reporting structures for personnel within two different business functions. This topic of "Chinese wall" will be discussed in more detail under Section II. Integrity of Capital Markets, Part A. Use of Insider Information/Material Non-Public Information.

C. Misrepresentation

A misrepresentation is any untrue statement or omission of a fact or any statement that is otherwise false or misleading.

Members must not knowingly make any misrepresentations relating to investment analysis, recommendations, actions and other professional activities. Members must not knowingly misrepresent nor give a false

impression in oral representations, advertising (whether in the press or through brochures), electronic communications, or written materials (whether publicly disseminated or not) and should not issue misleading statements about the performance of the financial institution. In this context, "knowingly" means representatives of the financial institution either know or should have known that the misrepresentation was being made.

Financial Institutions should ensure that communications with the public be done only by members with requisite authority to make public statements, or to make analysis, or provide recommendation to the general public. Communications should not contain promises of specific results, exaggerated or unwarranted claims, or unwarranted superlatives, unfounded opinions for which there is no basis or forecasts of future events which are unwarranted, or which are not clearly labeled as forecasts. Communication to the public includes disclosure or presentation of the financial institution's performance.

Members should consider several factors when determining whether communications contain misleading information such as:

1. Overall context in which the statement/s is/are made. A statement made in one context may be misleading even though such a statement could be perfectly appropriate in another context. An essential test in this regard is the balance of treatment of risks and potential benefits.
2. The audience to which the communication is directed. Different levels of explanation or detail may be necessary depending on the audience to which a communication is directed and the ability of the financial institution given the nature of the media used, to restrict the audience appropriately. If the statements made in a communication would be applicable only to a limited audience, or if additional information might be necessary for other audiences, it should be kept in mind that it is not always possible to restrict the readership of a particular communication.
3. The clarity of the communication. A statement or disclosure made in an unclear manner can result in a failure to understand the statement, or in a serious misunderstanding. A complex or overly technical explanation may cause even greater misunderstanding than too scant an information. Likewise material disclosure relegated to legends or footnotes may not generally enhance the reader's understanding of the communication.

The term communication includes, but is not limited to

1. Written material such as research reports, market letters, newspaper columns, and books.
2. Electronic communications such as Internet communications, Web pages, chat rooms, and e-mail.
3. Verbal communication such as presentations and telephone conversations.

Members must not misrepresent any aspect of its practice, including but not limited to the qualifications or credentials of its employees, the qualifications or services provided by the financial institutions, and employees' performance records as well as that of the financial institution.

In avoiding misstating or providing misleading statements, members are encouraged to fully disclose its investment performance data and must make reasonable efforts to make sure that it is fair, accurate and complete. It is important that financial institutions provide credible performance information to clients/public. If presentations made to clients are brief, the financial institution must ensure that detailed information shall be made available upon request.

In complying with the provision against misrepresentation, members should have adequate policies and procedures regarding disclosure of performance presentation and performance measurement that are consistent with regulatory requirements and the principles of fairness, accuracy and consistency. Procedures should prevent possible misrepresentations of past performance or reasonably expected performance. Historical data related to individual accounts and composite or group of accounts should be complete, fair, and accurate. In presenting past performance, the following may be considered to avoid misrepresentation:

1. Knowledge and sophistication of the audience to whom a performance presentation is addressed;
2. Including disclosures that would fully explain the performance results being reported (for example, stating, when appropriate, that results are simulated when model results are used, or disclosing whether the performance is gross of fees, net of fees, or after tax);
3. Maintaining the data and records used to calculate the performance being presented;



4. Where performance of a different type of investment product is included, stating any material difference.

Where the presentation material contains past performance information and is intended for use over a period of time, disclosures should make clear that the information may not be current and an explanation on where up-to-date past performance information may be obtained

Members must avoid spreading misinformation and rumors. Financial markets are generally responsive to news on related developments. It is not surprising therefore that gossip and misinformation emanating from various sources is often relayed through the market telephone lines and screens. These rumors can be quoted, or even originate in the financial media.

Members should not relay any information which they know to be false and should take great care when discussing unsubstantiated information, which they suspect to be inaccurate and could be damaging to a third party, be it a corporation or an individual.

#### D. Misconduct

Members must not engage in any act involving dishonesty, fraud, or deceit or commit any act that reflects adversely on their professional reputation, integrity or competence. Members must also ensure that their overall conduct and demeanor are appropriate with respect to the highest standard of professionalism as adhered to by their institution, and by the banking industry as a whole.

Professional misconduct can damage the trustworthiness or competence of an investment professional and can adversely affect a financial institution's reputation. This includes behavior that may not be illegal but could negatively affect the employee's ability to perform his or her responsibilities. For example, abusing alcohol during business hours can be considered professional misconduct because it could have a detrimental effect on the employee's ability to fulfill his or her professional responsibilities.

Members should adopt policies and procedures to prevent general misconduct:

1. Develop and/or adopt a code of ethics to which every employee must subscribe and make clear that any personal behavior that reflects poorly on the individual involved, the institution as a whole, or the investment industry will not be tolerated

2. Disseminate to all employees a list of potential violations and associated disciplinary sanctions, up to and including dismissal from the institution.
3. Check references of potential employees to ensure that they are of good character and not ineligible to work in the financial industry because of past infractions of the law.

In addition, members should have specific policies on the following:

a. Fraud

Attempts at fraud do occur and can be meticulously planned. As there are several ways in which an institution can be defrauded, great vigilance is required by management and staff, particularly so when calls are received on an ordinary telephone line (usually in principal to principal transactions).

As a preventive measure, the details of all telephone deals which do not include pre-agreed standard settlement instructions should be confirmed by email or similar means by the recipient seeking an answerback to ensure the deal is genuine.

Particular care should be taken in checking authenticity where the beneficiary is a third party or other than the transaction counterparty.

In the event of any suspicious circumstances staff must notify management without delay.

b. Gambling

Making or arranging of bets among market participants is expressly forbidden. There should be no gambling within the dealing room of a financial institution.

It is strongly recommended that management have a clearly defined written policy on the control of this activity.

c. Use of Drugs and Abused Substances

Management should take all reasonable steps to educate themselves and their staff about possible signs and effects of the use of drugs including alcohol and other abused substances. Policies should be developed and clearly announced for dealing with individuals who are found to be substances abusers, as judgment of any member dependent on such

substances may be impaired and his ability to function satisfactorily seriously diminished. A member is also likely to be vulnerable to outside inducement to conduct business not necessarily in the best interest of the firm or the market in general.

Thus, drugs and abused substances are in no way permitted inside the dealing room and, as such, users are also not allowed to enter the trading room under such influence.

## II. Integrity of Capital Markets

The orderly operation of financial markets depends greatly on the overall level of trust among all market participants. Ethical practices instill a public trust in the fairness and integrity of capital markets, enhancing their liquidity and efficiency. Financial institutions should therefore practice ethical standards that promote and maintain a high level of confidence in market integrity. The principles of transparency, disclosure, and fairness promote market integrity.

### A. Insider Information/Material Nonpublic Information

Members should not, with intent or through negligence, profit or seek to profit from insider information and material non-public information that could affect the value of an investment. Members should likewise not assist anyone with such information to make a profit for themselves, their firm or their clients.

Disclosure of material non-public information to unrelated parties and, in some cases, to related parties without consent before it becomes public is unethical and a breach of confidentiality. Dealing in financial instruments based on material non-public information about the issuer of such instruments or the instruments themselves constitutes 'insider dealing'. "Insider" is hereby defined as any individual in possession of material non-public information.

This requires that financial institutions must have in place policies and procedures to manage material non-public information. This should include, where appropriate, 'Chinese walls' to restrict the internal distribution of confidential information to those who need to know in order to be able to execute orders for customers or for compliance purposes. Material nonpublic information is not always clearly identifiable., thus, employees must be given sufficient training to either make an informed decision or consult a supervisor or compliance officer before engaging in questionable transactions.

Information is considered to be material non-public if it satisfies any of the following:

1. It has not been generally disclosed to the public and would likely affect the market price of a security or any financial instrument after being disseminated to the public and the lapse of a reasonable time for the market to absorb the information;
2. It would be considered by a reasonable person important under the circumstances in determining his course of action whether to buy, sell or hold a security or any financial instrument.

Material non-public information may include, but is not limited to, information on the following:

- Financial results of the company;
  - Mergers, acquisitions, tender offers, or joint ventures;
  - Changes in assets and/or capital structure
  - Innovative products, processes, or discoveries;
  - New licenses, patents, registered trademarks, or regulatory approval/rejection of a product;
  - Developments regarding customers or suppliers (e.g., the acquisition or loss of a contract);
  - Changes in management;
  - Change in auditor notification or the fact that the issuer may no longer rely on an auditor's report or qualified opinion;
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- Events regarding the issuer's securities (e.g., defaults on senior securities, calls of securities for redemption, repurchase plans, stock splits, changes in dividends, changes to the rights of security holders, public or private sales of additional securities, and changes in credit ratings);
  - Bankruptcies;
  - Significant legal disputes;
  - Government reports of economic trends (inflation, GDP, monetary policy, fiscal policy, currency information, etc.);
  - Issue of shares by way of public offering, rights, bonus, etc;
  - Orders for large trades before they are executed.

In addition to the substance and specificity of the information, the source or relative reliability of the information also determines materiality. The less reliable a source, the less likely the information provided would be considered material. For example, factual information from a corporate insider regarding a significant new contract for a company would likely be

material, while an assumption based on speculation by a competitor about the same contract might be less reliable and, therefore, not material.

Members must not act on and disclose insider information to make a profit for themselves, their institution or their clients. The term "insider" may include, but is not limited to, the following:

- the issuer
- a director or officer (or person performing similar functions) of, or a person controlling the issuer
- a person whose relationship or former relationship to the issuer gives or gave him access to material information about the issuer or the security that is not generally available to the public
- a government employee, or director, or officer of an exchange, clearing agency and/or self-regulatory organization who has access to material information about an issuer or a security that is not generally available to the public
- a person who learns such information by a communication from any of the foregoing insiders.

Members must be particularly aware of information that is selectively disclosed by corporations to a small group of investors, analysts, or other market participants. Information that is made available to analysts remains nonpublic until it is made available to investors in general. Corporations that disclose information on a limited basis create the potential for insider trading violations. However, under the "mosaic theory," members are free to act on the collection of material public and non-material non-public information without risking violation.

Information is "non-public" until it has been disseminated or is available to the marketplace in general (as opposed to a select group of investors). Dissemination can be defined as "made known to." For example, a company report of profits that is posted on the Internet and distributed widely through a press release or accompanied by a filing has been effectively disseminated to the marketplace.

An information barrier is the minimum procedure a financial institution should have in place to protect itself from liability. It should also consider restrictions or prohibitions on personal trading by employees and should carefully monitor both proprietary trading and personal trading by employees. It should require employees to make periodic reports (to the extent that such reporting is not already required by securities laws) of their own transactions and transactions made for the benefit of family members. Securities should be placed on a restricted list when an institution has or

may have material nonpublic information. The broad distribution of a restricted list often triggers the sort of trading the list was developed to avoid. Therefore, a watch list shown to only the few people responsible for compliance should be used to monitor transactions in specified securities. The use of a watch list in combination with a restricted list is an increasingly common means of ensuring an effective procedure.

Financial institutions should adopt policies and procedures designed to prevent the inappropriate flow of material, nonpublic information and to aid in the detection of illegal trading based on such information. An information barrier commonly referred to as a "Chinese Wall" is the most widely used approach to prevent the communication of material nonpublic information within institutions and avoid the illegal use of insider information. It restricts the flow of confidential information to those who need to know the information to perform their jobs effectively. The minimum elements of such a system include, but are not limited to, the following:

- Substantial control of relevant interdepartmental communications, preferably through a clearance area within the institution in either the compliance or legal department;
- Review of employee trading through the maintenance of "watch," "restricted," and "rumor" lists;
- Documentation of the procedures designed to limit the flow of information between departments and of the enforcement actions taken pursuant to those procedures;
- Heightened review or restriction of proprietary trading while an institution is in possession of material nonpublic information.

Any financial institution which assumes more than one function whether as dealer, broker, adviser or underwriter, or which engages in market making transactions, shall maintain proper segregation of those functions within the firm to prevent the flow of non-public material information among different parts of its organization, which perform each function. For instance, the unit/department arranging securities origination may receive inside information, i.e. the knowledge of the new issue and its likely impact on existing securities of the issuer or information provided by the issuer. Inside information gathered by the origination/deal team should not be disclosed to the other business units such as sales, trading and research.

In particular, if a member shall become aware of a potential tender offer before the tender offer has been publicly announced, such member shall not buy or sell, directly or indirectly, the securities of the target issuer until the tender offer shall have been publicly announced. Such buying or selling shall constitute insider trading.

To the extent possible, financial institutions should consider physical separation of departments and files to prevent the communication of sensitive information. For example, the investment-banking and corporate finance areas of a brokerage firm should be separated from the sales and research departments, and a bank's commercial lending department should be segregated from its trust and research departments. Other significant areas include sales, execution, research and back office settlement.

One of the primary objectives of an effective Chinese Wall procedure is to establish a reporting system in which authorized people review and approve communications between departments. The financial institution should have policies and procedures on sharing information with an end-view of maintaining the integrity of said information.

Written compliance policies and guidelines should be circulated to all employees of a financial institution. Policies and guidelines should be used in conjunction with training programs aimed at enabling employees to recognize material nonpublic information. Material nonpublic information is not always clearly identifiable. Employees must therefore be given sufficient training to either make an informed decision or consult a supervisor or compliance officer before engaging in questionable transactions.

#### B. Market Manipulation

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

This standard requires that financial institutions uphold market integrity by prohibiting market manipulation. Market manipulation includes practices that distort security prices or trading volume with the intent to deceive people or entities that rely on information in the market. Market manipulation harms the integrity of, and thereby undermines public confidence in capital markets and adversely affects interests of all investors, by disrupting the smooth functioning of the markets, distorting prices, harming the hedging functions of these markets, and creating an artificial appearance of market activity.

Market manipulation can be related to the following:

1. Transactions that deceive market participants by distorting the price-setting mechanism of financial instruments. Transaction-based manipulation includes but is not limited to:

- Transactions that artificially distort prices or volume to give the impression of activity or price movement in a financial instrument in order to induce a purchase or sale of the said instrument.
- Pegs, fixes or stabilize the price of such security unless otherwise allowed
- Effecting any transaction in such security which involves no change in the beneficial ownership thereof;

2. The dissemination of false or misleading information.

Information-based manipulation includes, but is not limited to spreading false rumors to induce trading by others. The standard prohibits the circulation and dissemination of information that the price of any security will or is likely to rise or fall because of manipulative market operations conducted for the purpose of raising or depressing the price of the security for the purpose of inducing the purchase or sale of such security. In addition, any person shall be prohibited from making false or misleading statement with respect to any material fact, which he knew or had reasonable ground to believe was false or misleading, for the purpose of inducing the purchase or sale of any security.

For example, dealers must refrain from "pumping up" the price of a security by issuing misleading positive information or overly optimistic projections of a security's worth only to later "dump" ownership in the security once the price of the security, fueled by the misleading information's effect on other market participants, reaches an artificially high level.

### III. Duties to Clients

#### A. Integrity, Prudence and Care

Financial institutions must act with reasonable care and exercise prudent judgment in their dealings with their clients. Investment advisors must act for the benefit of their clients and place the interests of the latter above their own.



Prudence requires caution and discretion. In the context of advising a client, prudence requires following the investment parameters set forth in the client's suitability profile.

The first step for financial institutions in fulfilling their duty to clients is to determine the identity of the "client" to whom the duty of loyalty is owed. In the context of an investment manager managing the personal assets of an individual, the client is easily identified. However, when the member is responsible for the portfolios of pension plans or trusts, for example, the client is not the person or entity who hires the member but, rather, the beneficiaries of the said plan or trust.

Financial institutions should be conscious of its duty of prudence and care when developing (i.e. asset and security selection) and implementing (i.e. buying and selling of securities) a client's investment strategy. If the FI has control or discretion over a customer's account, it should not "churn" the account, i.e. enter into transactions with unnecessary frequency having regard to the customer's agreed investment strategy. An FI should also not switch a customer between products unnecessarily, considering what is suitable for the client.

In fulfilling its duty to clients, a member has the duty to seek Best Execution for every trade. In determining prudence and best execution, a member should examine whether securities/investments/assets were exposed to extraordinary hazards. Prudence addresses the appropriateness of holding certain securities, while Best Execution addresses the appropriateness of the methods by which securities are acquired or disposed. Security selection seeks to add value to client portfolios by evaluating future prospects; Best Execution seeks to add value by reducing frictional trading costs.

To provide best execution, an FI must take reasonable care to ascertain the price which is best available for the customer in the market at the time of the transaction of the kind and size concerned. It should execute a customer order at a price no less advantageous to the customer. Although best execution may mean best available price to the customer, its concept may be applied in a broader context. Best execution may refer to the trading process financial institutions apply that seeks to maximize the value of a client's portfolio within the client's stated investment objectives and constraints. Value may be maximized by reducing trading costs including price of security (when purchasing), brokerage fees, and commissions, and other trade-related fees and charges. This alternative definition does not necessarily conflict with existing regulatory definitions. What is emphasized is the principle behind best execution and the importance of setting policies

and procedures to enhance a financial institution's ability to maximize the value of a client's portfolio.

B. Fair Dealing

Financial institutions must deal fairly and objectively with all clients. A member should act honestly, fairly and in the best interest of his client and for the integrity of the market. Where a member advises or acts on behalf of a client, it shall ensure at all times that any representations or other communications made and information provided to the client are accurate and not misleading.

When a financial institution has multiple clients, the potential exists for it to favor one client over another. This favoritism may take various forms, from the quality and timing of services provided to the allocation of investment opportunities. The term "fair dealing" implies that the member must take care not to discriminate against any clients. Each client has unique needs, investment criteria, and investment objective so that not all investment opportunities are suitable for all clients.

When establishing fair-dealing compliance procedures, financial institutions should consider the following points, particularly when giving investment recommendations:

- Limit the number of people involved who are privy to the fact that investment recommendation is going to be disseminated.
- Shorten the time frame between decision and dissemination, and make reasonable effort to limit the amount of time that elapses between the decision to make investment recommendations and the time the actual recommendation is disseminated.
- Publish personnel guidelines for pre-dissemination, and establish guidelines that prohibit personnel who have prior knowledge of an investment recommendation from discussing or taking any action on the pending recommendation.
- Establish procedures for dissemination of investment recommendations so that all clients are treated fairly - that is, with the goal of informing them at approximately the same time.
- Develop a set of guiding principles that ensure (1) fairness to advisory clients, both in priority of execution of orders and in the allocation of the price obtained in execution on block orders or trades and (2) timeliness and efficiency in the execution of orders. With these

principles, a financial institution may consider the following procedures:

- Requiring orders and modifications or cancellations of orders to be in writing and time stamped;
  - Processing and executing orders on a first-in, first-out basis;
  - Developing a policy to address such issues as calculating execution prices and “partial fills” when trades are grouped, or blocked, for efficiency purposes;
  - Giving all client accounts participating in a block trade the same execution price and charging the same commission;
  - When allocating trades for new issues, obtaining advance indications of interest, allocating securities by client (rather than portfolio manager), and providing for a method for calculating allocations.
- Disclose trade allocation procedures. Financial institutions should disclose to clients and prospective clients how they select accounts to participate in an order and how they determine the amount of securities each account will buy or sell.

#### C. Client Suitability

Members must consider the needs, circumstances and objectives of the clients when determining the appropriateness and suitability of a given investment or course of investment action.

The responsibilities conferred upon members to gather information and make a suitability analysis prior to making a recommendation or taking investment action falls on those members who provide investment advice in the course of an advisory relationship with a client. Other members often are simply executing specific instructions for retail clients when buying or selling securities, such as shares in mutual funds. These members may not have the opportunity to judge the suitability of the particular investment for the person or entity. In cases of unsolicited trade requests that a member knows are unsuitable for the client, the member should make an effort to explain to the client why such trade is unsuitable.

When an advisory relationship exists, members must gather client information at the inception of the relationship. Such information includes the client’s financial circumstances, personal data (such as age and occupation) that are relevant to investment decisions, attitudes toward risk, and objectives in investing. This information should be incorporated into a written client suitability form that addresses the client’s risk tolerance,

return requirements, and all investment constraints (such as time horizon, liquidity needs and other unique factors and circumstances).

The effort to determine the needs and circumstances of each client is not a one-time occurrence. Investment recommendations or decisions are usually part of an ongoing process that takes into account the diversity and changing nature of portfolio and client characteristics. The passage of time is bound to produce changes that are important with respect to investment objectives. It is suggested that the client suitability review be updated on an annual basis.

Suitability review can be done effectively only if the client fully discloses his complete financial portfolio or condition including those portions not managed by the member. If clients withhold such information, the suitability analysis conducted by members cannot be expected to be complete but must be done based on the information provided.

A member should put the needs and circumstances of each client and the client's investment objectives into the client suitability form. The member should take the following into consideration:

- Client identification—(1) type and nature of clients, (2) the existence of separate beneficiaries, and (3) approximate portion of total client assets.
- Investor objectives—(1) return objectives (income, growth in principal, maintenance of purchasing power) and (2) risk tolerance (suitability, stability of values).
- Investor constraints—(1) liquidity needs, (2) expected cash flows (patterns of additions and/or withdrawals), (3) investable funds (assets and liabilities or other commitments), (4) time horizon, (5) investor preferences, prohibitions, circumstances, and unique needs.

#### D. Diligence and Reasonable Basis

In fulfilling its duties to clients, a financial institution should exercise due skill, care and diligence in its dealings with existing and potential clients. In particular, when providing advice to a client, he shall act diligently and ensure that his advice and recommendations in relation to clients are based on thorough analysis and take into account available alternatives.

The concept of due diligence can apply to different areas, most notably on the duty of the financial institution to provide investment recommendations or take investment actions based on reasonable research, investigation or analysis of investment alternatives, including suitability of investments to clients. Part of this due diligence process includes the

diligence to obtain client information that will aid the financial institution determine suitability and the diligence in the implementation of its policies and procedures.

Where the FI holds itself out as giving product recommendation, it must not give any such recommendation unless it has carried out a reasonable analysis of a sufficiently large number of products which are generally available from the market or conducts the analysis on the basis of criteria which reflect adequate knowledge of the products generally available from the market.

The duty of due diligence is intertwined with the duty to maintain independence and objectivity in providing investment recommendations or taking investment actions. Financial institutions should exercise diligence, independence, objectivity and thoroughness in analyzing investments, making investment recommendations, and taking investment actions. To achieve this, financial institutions must have a reasonable and adequate basis, supported by appropriate research and investigation, for any investment analysis, recommendation or action.

Where the FI relies on persons/entities when providing the financial research, the FI should be able to show that it was reasonable for the FI to rely on the information provided to it in writing. It should take steps to establish to that the said entity is competent to provide the information. For instance, if a financial institution relies on third-party research, it should make reasonable and diligent efforts to determine whether such research is sound.

#### E. Disclosure of Information and Communication to Clients/Public

In addition to obtaining information from clients under its suitability review process, among others, financial institutions are required to make adequate disclosure of material information in its dealings with clients. Members should provide clients with adequate information about the firm particularly the financial condition of the business upon request. Furthermore, a financial institution should make adequate disclosure of relevant material information in its dealings with its clients, including information about risks, needed by the client to make informed decisions.

The financial institution should pay due regard to the information needs of its clients and communicate the information to them in a way that is clear, fair and not misleading. It should take reasonable steps to ensure that the client understands the nature of the risks inherent in their transactions.

## F. Preservation of Confidentiality

Financial institutions must keep information about former, current, and prospective clients confidential unless:

- The information concerns illegal activities on the part of the client;
- Disclosure is required by law; and
- The client permits disclosure of the information.

Confidentiality is paramount especially when a member receives information on the basis of its special ability to conduct a portion of the client's business or personal affairs and the member receives information that arises from or is relevant to that portion of the client's business that is the subject of the special, fiduciary, or confidential relationship. If disclosure of the information is required by law (e.g. disclosure of conflicts) or if the information concerns illegal activities by the client, however, the FI may have the obligation to report the activities to the appropriate authorities.

A financial institution should have appropriate policies and procedures to maintain confidentiality of information received from clients. When in doubt, an employee should consult with the financial institution's compliance unit or legal department before disclosing confidential information about clients.

## IV. Conflicts of Interest

### A. Disclosure of Conflicts

Members should avoid conflicts of interest and when they cannot be avoided 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 their employer.

Members must ensure that such disclosures are prominent, are delivered in plain language, and communicate the relevant information effectively.

#### Disclosure to Clients

Members must prudently maintain their objectivity when rendering investment advice or taking investment action. They must take reasonable steps to determine whether a conflict of interest exists and disclose to clients any conflicts when known.

It is the rightful duty of the member to disclose market-making activities of the institution. Such disclosure would alert clients that a purchase or sale might be made from or to the institution's principal account.

When members providing investment services/transactions also serve as directors, they should be isolated from those making investment decisions by the use of Chinese walls or similar restrictions.

Members should disclose any materially beneficial ownership/interest in a security or other investment that the member is recommending.

B. Dealing for Personal Account

Management should ensure that adequate safeguards are established with regards to dealing for personal account, to prevent conflict of interest or insider dealing in any form. These safeguards should also reflect the need to preserve confidentiality with respect to non-public price sensitive information and to ensure that no action is taken by a member, which might adversely affect the interests of the institution's clients.

Management should have a clearly defined written policy for dealing for personal account, which should include full disclosure of said transactions

Managers should be aware that a conflict of interest may arise if traders are permitted to deal for themselves in those commodities, instruments or products closely related to the ones in which they deal for their institution and should stipulate clearly which ones, if any, the members can trade in for their own account.

C. Priority of Transactions

Investment transactions for clients and employers must have priority over investment transactions in which a member is the beneficial owner. Furthermore, a member shall handle orders of clients fairly and in the order in which they are received.

It is the responsibility of members to give the interests of their clients and employers priority over their personal financial interests or the appearance of a conflict of interest with respect to personal transactions. Client transactions must take precedence over transactions made on behalf of the member's institution or personal transactions.

Establish Blackout/Restricted Periods

Investment personnel involved in the investment decision-making process should establish blackout periods prior to trades for clients so that members cannot take advantage of their knowledge of client activity by “front-running” client trades.

Individual institutions must decide who within the firm should be required to comply with the trading restrictions. At a minimum, all members who are involved in the investment decision-making process should be subject to the same restricted period.

#### Reporting Requirements

The best method for monitoring and enforcing procedures established to eliminate conflicts of interest relating to personal trading is through reporting requirements, including the following:

- Pre-clearance procedures. Investment personnel should clear all personal investments to identify possible conflicts prior to the execution of personal trades. Pre-clearance procedures are designed to identify possible conflicts before a problem arises.
- Disclosure of holdings in which the employee has a beneficial interest.
- Disclosure by investment personnel to the firm should be made upon commencement of the employment relationship and at least annually thereafter.

To address privacy considerations, disclosure of personal holdings should be handled in a confidential manner by the institution.

#### V. Duties to Market Counterparties

##### A. Knowledge of Trading Conventions

Financial institutions must ensure that only qualified members are allowed to trade. Members should be trained and knowledgeable on the standard trading conventions of the products they are trading, which they are expected to adhere to at all times.

##### B. Firmness of Price Quotation and Deals

Members should be guided by the principle of “Dictum Meum Pactum” translated as “My Word is My Bond”. Prices which are quoted by members



should be taken as firm unless otherwise qualified (e.g. under reference).  
Members should also honor all their closed or "done" transactions.