

May 31, 2006
Andrew Fawcett
Assistant Director
Regulatory Policy
GPO Box 9827
Melbourne VIC 3001
Australia

Re: ASIC Discussion Paper “Managing Conflicts of Interest”

Dear Mr. Fawcett,

We would like to thank you for allowing us the opportunity to provide feedback and comments on your discussion paper “Managing conflicts of interest in the financial services industry.” High ethical standards are critical to maintaining the public’s trust in financial markets and in the investment profession. CFA Institute and the CFA Centre for Financial Market Integrity (“CFA Centre”)¹ is active in promoting the investment profession globally by setting high standards of education, integrity, and professional excellence.

This submission has been prepared jointly by the CFA Centre and the two Australian societies of the CFA Institute, the CFA Society of Sydney and the CFA Society of Melbourne. Both societies are formally affiliated with CFA Institute and are active in the representation of Australian domiciled members. Recent membership counts are over 850 members in Australia (Sydney: 640 approx. and Melbourne: 210 approx.). Year-over-year membership growth is 16.2% for both societies combined. Nearly 80% of members at each society are CFA charterholders. The total number of CFA candidates writing all three levels of the exam in 2005 was close to 1,900 in Australia and over 108,000 worldwide.

Since their creation in the 1960s, CFA Institute’s Code of Ethics and Standards of Professional Conduct (“Code and Standards”) have promoted the integrity of CFA Institute members and served as a model for measuring the ethics of investment professionals globally. The Code and Standards are prescriptive in nature with various examples and compliance guidelines which make them relevant and applicable to real cases.

The Code and Standards are developed by The Standards of Practice Council (SPC) which is a volunteer committee of CFA Institute, also working in the area of ethics and professional

¹ The CFA Centre for Financial Markets Integrity is part of the CFA Institute with a mission to “be a leading voice on issues of fairness, efficiency, and investor protection in global capital markets and to promote high standards of ethics, integrity, and professional excellence within the investment community”.

With headquarters in Charlottesville, Virginia, USA, and regional offices in London, Hong Kong and New York, CFA Institute is a global, non-profit professional association of more than 82,400 financial analysts, portfolio managers, and other investment professionals in 126 countries and territories of which nearly 68,000 are holders of the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 132 Member Societies and Chapters in 53 countries.

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conduct. The SPC is an advisory committee of the CFA Centre that promotes ethical practice in the investment industry. The purpose of the SPC is to foster the integrity of capital markets through its work in developing and maintaining the Code and Standards and other standards of practice developed by the CFA Centre. The SPC just completed work on the revised Code and Standards and 9th edition of the Standards of Practice Handbook. The revisions to the Code and Standards are undertaken based on current and topical issues on which candidates and members need assistance on.

All CFA Institute members (including holders of the CFA designation) and CFA candidates must abide by the Code and Standards. In cases where the local rules and regulations conflict with those of CFA Institute's Code, members must comply with the stricter law, rule, or regulation. Violations of the Code and Standards may result in disciplinary sanctions by CFA Institute. Sanctions can include revocation of membership, candidacy in the CFA Program, and the right to use the CFA designation.

The Code and Standards² provide specific practical guidelines in the following areas (a descriptive summary is paraphrased and provided in the Appendix).

- I. Professionalism
 - A. Knowledge of the Law
 - B. Independence and Objectivity
 - C. Misrepresentation
 - D. Misconduct

- II. Integrity of Capital Markets
 - A. Material Non-public Information
 - B. Market Manipulation

- III. Duties to Clients
 - A. Loyalty, Prudence and Care
 - B. Fair Dealing
 - C. Suitability
 - D. Performance Presentation
 - E. Preservation of Confidentiality

- IV. Duties to Employers
 - A. Loyalty
 - B. Additional Compensation Arrangements

² Please note that the guidelines and examples provided in the Code are predominantly U.S.-based and may not be entirely applicable to the Australian market.

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- C. Responsibilities of Supervisors

- V. Investment Analysis, Recommendations and Action
 - A. Diligence and Reasonable Basis
 - B. Communication with Clients and Prospective Clients
 - C. Record Retention

- VI. Conflicts of Interest
 - A. Disclosure of Conflicts
 - B. Priority of Transactions
 - C. Referral Fees

- VII. Responsibilities as a CFA Institute Member or CFA Candidate
 - A. Conduct as Members and Candidates in the CFA Program
 - B. Reference to CFA Institute, the CFA Designation and the CFA Program

In addition to our Code and Standards, CFA Institute has developed supplementary guidelines, which are listed as follows with accompanying web links:

- **Code of Ethics and Standards of Professional Conduct**
<https://www.cfainstitute.org/cfacentre/ethics/codeandstandards.html>

- **Standards of Practice Handbook**
(online access to full document available to members only)
http://www.cfainstitute.org/standards/ethics/conduct/complaint_center/standards.html

- **Research Objectivity Standards** (for sell side firms & analysts)
http://www.cfainstitute.org/standards/ethics/sellside_ROS.html
http://www.cfainstitute.org/cfacentre/ethics/pdf/sellside_ROS.pdf

- **Trade Management Guidelines** (for investment management firms & managers)
<http://www.cfainstitute.org/cfacentre/ethics/trademanagement.html>

We have provided two copies of the Handbook which explain in greater detail our principles which we hope will be of help as you frame your regulations relating to managing conflicts of interests. We would in addition to this general framework like to make some specific comments relating to your proposed recommendations and examples.

Against this background, the CFA Institute provides the following specific comments on the case studies provided in the discussion paper *Managing conflicts of interest in the financial services industry* (April 2006). ASIC has specifically asked for responses to the following questions:

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Q1 Are the examples used in the case studies practical and useful? Please refer to specific examples in your answer.

Q2 Are there examples of other practices that could usefully be included?

Q3 Is the commentary following the examples helpful and useful? Are the solutions discussed reasonable? Please refer to specific examples in your answer.

Q4 Should we include cross-references in the case studies to relevant parts of [PS 181] and/or *Managing conflicts of interest—An ASIC guide for research report providers*?

Section A: Financial advisers (wholesale) and research report providers

A1 Lead manager/ house broker and conflicted research

Standard I B (Professionalism – Independence and Objectivity) and Research Objectivity Standards provide guidelines to achieve and maintain independence and objectivity in the professional activities. Specifically in the example of investment banking relationships (pages 16-17 of our Handbook), where sell-side firms exert pressure on their analysts to issue favourable research on current or prospective investment banking clients, we recommend the firm to:

- Provide an environment where analysts are neither coerced nor enticed into issuing research that does not reflect their true opinions.
- Require public disclosure of actual and perceived conflicts of interest to investors. (*Note: we do not recommend disclosure of actual fee amounts*).
- Establish “firewalls” between the research and investment banking functions and to ensure separate reporting structures for personnel within the two functions.

Recommended procedures for compliance are as follow:

- Establish policies stating that every research report on issues by a corporate client reflects the unbiased opinion of the analyst.
- Design compensation systems that protect the integrity of the investment decision process by minimizing the pressures and rewarding objectivity and accuracy.
- If the firm is unwilling to permit dissemination of adverse opinions about a corporate client, involved persons should encourage the firm to remove the controversial company from the research universe and put it on a restricted list so that the firm disseminates only factual information about the company.

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Example: Susan Dillon, an analyst in the corporate finance department of an investment services firm, is making a presentation to a potential new business client that includes the promise that her firm will provide full research coverage of the potential client.

Comment: Dillon may agree to provide research coverage, but she must not commit her firm's research department to providing a favorable recommendation. The firm's recommendation (favorable, neutral, or unfavorable) must be based on an independent and objective investigation and analysis of the company and its securities.
For additional examples on applications of this Standard, please see pages 20-24 in our Handbook.

A2 Selective publication of changed recommendation

Standard III B (Duties to Clients – Fair Dealing) requires fair treatment for all clients when disseminating investment recommendations or material changes to prior investment advice or when taking investment action with regard to general purchases, new issues, or secondary offerings. This standard covers the conduct relating to two broadly defined categories of conduct – investment recommendations and investment action – which are as follows:

- Ensure that information is disseminated in such a manner that all clients have a fair opportunity to act on every recommendation.
- Treat all clients fairly in light of their investment objectives and circumstances. For example, a bank may hold many positions for a manager, such as corporate trustee, pension fund manager, manager of funds for individuals employed by the customer, loan originator, or creditor. In this case, the manager must exercise care to treat clients fairly, including those with whom multiple relationships do not exist.
- Disclose to clients and prospects the written allocation procedures they or their firms have in place and how the procedures would affect the client or prospect.

Recommended procedures for compliance are as follow:

- Limit the number of people who are privy to the fact that a recommendation is going to be disseminated.
- Make reasonable efforts to limit the amount of time that elapses between the decision to make an investment recommendation and the time the actual recommendation is disseminated.

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- 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.
- Maintain a list of all clients and the securities or other investments each client holds in order to facilitate notification of customers or clients of a change in an investment recommendation.
- Develop written allocation procedures, with particular attention to procedures for block trades and new issues.
- 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.
- Review each account on a regular basis to ensure that no client or customer is being given preferential treatment and that the investment actions taken for each account are suitable for the account’s objectives.
- Disclose to all clients whether or not the organization offers different levels of service to clients for the same fee or different fees.

Example: Saunders Industrial Waste Management (SIWM) publicly indicates to analysts that it is comfortable with the somewhat disappointing earnings per share projection of \$1.15 for the quarter. Bernard Roberts, an analyst at Coffey Investments, is confident that SIWM management has understated the forecasted earnings so that the real announcement would cause an “upside surprise” and boost the price of SIWM stock. The “whisper number” estimate based on extensive research and discussed among knowledgeable analysts is higher than \$1.16. Saunders repeats the \$1.16 figure in his research report to all Coffey clients but informally tells his larger clients that he expects the earnings per share to be higher, making SIWM a good buy.

Comment: By not sharing his opinion regarding the potential for a significant upside earnings surprise with all clients, Roberts is not treating all clients fairly and has violated Standard III(B).

Note: This example (quarterly earnings) is specific to U.S. companies. Australian listed companies are not required to publish quarterly earnings. For additional examples on applications of this Standard, please see pages 66-68 in our Handbook.

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A3 Conflicted buy recommendations

In addition to Standard I B (Professionalism – Independence and Objectivity) discussed above, Standard VI A (Conflicts of Interest – Disclosure of Conflicts) also apply to this example. Standard VI A recommends:

- Full disclose to clients, potential clients, and employers all actual and potential conflicts of interest.
- Maintain objectivity when rendering investment advice or taking investment action.
- Disclose any personal ownership of stocks analysed or recommended, participation in outside boards, and financial and other pressures that create potential conflicts of interest.
- Disclosures must be prominent and must be made in plain language and in a manner designed to effectively communicate the information to clients and prospective clients.
- The most obvious conflicts of interest, which should always be disclosed, are relationships between the investment professional or their firm and an issuer (such as a directorship or consultancy), investment banking, underwriting and financial relationships, broker/dealer market-making activities, and material beneficial ownership of stock.

Recommended procedures for compliance are as follow:

- Disclose special compensation arrangements with the employer that might conflict with client interests, such as bonuses based on short-term performance criteria, commissions, incentive fees, performance fees, and referral fees.
- Include information on compensation packages in firms' promotional literature.

Example: The investment management firm of Dover & Roe sells a 25 percent interest in its partnership to a multinational bank holding company, First of New York. Immediately thereafter, Margaret Hobbs, president of Dover & Roe, changes her recommendation of First of New York's common stock from "sell" to "buy" and adds First of New York's commercial paper to Dover & Roe's approved list for purchase.

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Comment: Hobbs must disclose the new relationship with First of New York to all Dover & Roe clients. This relationship must also be disclosed to clients by the firm's portfolio managers when they make specific investment recommendations or take investment actions with respect to First of New York's securities.

For additional examples on applications of this Standard, please see pages 116-119 in our Handbook.

A4 Pressure to make favourable recommendations

The following standards discussed above apply to this example:

- Standard I B (Professionalism – Independence and Objectivity)
- Standard VI A (Conflicts of Interest – Disclosure of Conflicts)
- Research Objectivity Standards

A5 Poor disclosure of interests

The following standard discussed above applies to this example:

- Standard VI A (Conflicts of Interest – Disclosure of Conflicts)

A6 Tender consultants and paid research

The following standards discussed above apply to this example:

- Standard I B (Professionalism – Independence and Objectivity)
- Standard VI A (Conflicts of Interest – Disclosure of Conflicts)

In addition, Standard VI C (Conflicts of Interest – Referral Fees) also applies. Standard VI C recommends advising the client or prospective client, before entry into any formal agreement for services, of any benefit given or received for the recommendation of any services provided by the member or candidate. Consideration includes all fees, whether paid in cash, in soft dollars, or in kind. Four examples are given on pages 127-129 in our Handbook which illustrate how this Standard is applied.

Standard III C (Duties to Clients – Suitability) applies to Wombat's investment advisers recommending the product to all investors. Standard III C requires persons who are in an investment advisory relationship with clients consider carefully the needs, circumstances, and objectives of the clients when determining the appropriateness and suitability of a given

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investment or course of investment action. When an advisory relationship exists, the investment professional must gather client information at the inception of the relationship.

Recommended procedures for compliance are as follow:

- Put the needs and circumstances of each client and the client's investment objectives into a written investment policy statement (IPS) for each client. In formulating an investment policy for the client, the following should be considered:
- Client identification:
 - (1) type and nature of clients
 - (2) the existence of separate beneficiaries
 - (3) approximate portion of total client assets
- Investor objectives:
 - (1) return objectives (income, growth in principal, maintenance of purchasing power)
 - (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) tax considerations
 - (6) regulatory and legal circumstances
 - (7) investor preferences, prohibitions, circumstances, and unique needs
 - (8) proxy-voting responsibilities and guidance.
- Performance measurement benchmarks.

Example: Caleb Smith, an investment advisor, has two clients: Larry Robertson, 60 years old, and Gabriel Lanai, 40 years old. Both clients earn roughly the same salary, but Robertson has a much higher risk tolerance because he has a large asset base. Robertson is willing to invest part of his assets very aggressively; Lanai wants only to achieve a steady rate of return with low volatility to pay for his children's education. Smith recommends investing 20 percent of both portfolios in zero-yield small-cap high-technology issues.

Comment: In Robertson's case, the investment may be appropriate given his financial circumstances and aggressive investment position but, this investment would not be suitable for Lanai. Smith would violate Standard III(C) by applying Robertson's investment strategy to Lanai because Lanai's financial circumstances and objectives are different.

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For additional examples on applications of this Standard, please see pages 72-74 in our Handbook.

A7 Product issuer with interest in research house

The following standards discussed above apply to this example:

- Standard I B (Professionalism – Independence and Objectivity)
- Standard VI A (Conflicts of Interest – Disclosure of Conflicts)

In addition, Standard V A (Investment Analysis, Recommendations, and Actions – Diligence and Reasonable Basis) also applies. Standard V A requires:

1. Exercise diligence, independence, and thoroughness in analysing investments, making investment recommendations, and taking investment actions.
2. Have a reasonable and adequate basis, supported by appropriate research and investigation, for any investment analysis, recommendation, or action.

Recommended procedures for compliance are as follow:

- Establish a policy requiring that research reports and recommendations have a basis that can be substantiated as reasonable and adequate.
- Develop detailed, written guidance for research analysts, supervisory analysts, and review committees that establish due-diligence procedures for judging whether a particular recommendation has a reasonable and adequate basis.
- Develop measurable criteria for assessing the quality of research, including the reasonableness and adequacy of the basis for any recommendation and the accuracy of recommendations over time, and implement compensation arrangements that depend on these measurable criteria and that are applied consistently to all research analysts.

Example: Gary McDermott runs a small, 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 based on these reports.

Comment: 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.

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For additional examples on applications of this Standard, please see pages 101-103 in our Handbook.

A8 Agreement to issue positive research on a client

A9 Research staff crossing information barriers

The following standards discussed above apply to these examples:

- Standard I B (Professionalism – Independence and Objectivity)
- Standard VI A (Conflicts of Interest – Disclosure of Conflicts)

A10 Proprietary Trading

The following standard discussed above applies to this example:

- Standard III B (Duties to Clients – Fair Dealing)

Section B: Licensees/ financial advisers (retail)

B1 Commission only remuneration

The following standard discussed above applies to this example:

- Standard VI A (Disclosure of Conflicts – Referral Fees)

In addition, Standard III A (Duties to Clients – Loyalty, Prudence and Care) also applies. Standard III A clarifies that client interests are paramount. An investment professional's responsibility to a client includes a duty of loyalty and a duty to exercise reasonable care. Investment actions must be carried out for the sole benefit of the client and in a manner the manager believes to be in the best interest of the client, given the known facts and circumstances. The investment professional should endeavour to avoid all real or potential conflicts of interest and forgo using opportunities for their own benefit at the expense of those to whom their duty of loyalty is owed.

An investment manager often has discretion over the selection of brokers executing transactions. Conflicts arise when an investment manager uses client brokerage to purchase research services that benefit the investment manager, a practice commonly called "soft dollars" or "soft commissions." A manager who pays a higher commission than he or she would normally pay to purchase goods or services, without corresponding benefit to the client, violates the duty of loyalty to the client.

Recommended procedures for compliance are as follow:

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- Review investments periodically to ensure compliance with the terms of the governing documents.
- Establish policies and procedures with respect to proxy voting and the use of client brokerage, including soft dollars.

Example: Charlotte Everett, a struggling independent investment advisor, serves as investment manager for the pension plans of several companies. One of her brokers, Scott Company, is close to consummating management agreements with prospective new clients whereby Everett would manage the new client accounts and trade the accounts exclusively through Scott. One of Everett's existing clients, Crayton Corporation, has directed Everett to place securities transactions for Crayton's account exclusively through Scott. But to induce Scott to exert efforts to land more new accounts for her, Everett also directs transactions to Scott from other clients without their knowledge.

Comment: Everett has an obligation at all times to seek best price and execution on all trades. Everett may direct new client trades exclusively through Scott Company as long as Everett receives best price and execution on the trades or receives a written statement from new clients that she is not to seek best price and execution and that they are aware of the consequence for their accounts. Everett may trade other accounts through Scott as a reward for directing clients to Everett only if the accounts receive best price and execution and the practice is disclosed to the accounts. Because Everett did not disclose the directed trading, Everett has violated Standard III(A).

For additional examples on applications of this Standard, please see pages 57-59 in our Handbook.

B2 Product Pipeline

The following standards discussed above apply to this example:

- Standard III A (Duties to Clients – Loyalty, Prudence and Care)
- Standard III C (Duties to Clients – Suitability)

B3 Buyer of last resort

The following standards discussed above apply to this example:

- Standard III A (Duties to Clients – Loyalty, Prudence and Care)
- Standard III C (Duties to Clients – Suitability)

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- Standard VI C (Conflicts of Interest – Referral Fees)

B4 Relationship between product issuer and adviser

The following standards discussed above apply to this example:

- Standard III C (Duties to Clients – Suitability)
- Standard V A (Investment Analysis, Recommendations, and Actions – Diligence and Reasonable Basis)
- Standard VI A (Conflicts of Interest – Disclosure of Conflicts)

B5 Advice on platforms

B6 Dial-up/ dial-down fees

B7 Shelf fees

B8 Payments for switching funds

B9 Insurance brokers and cluster groups

B11 Super funds that don't pay commissions

The following standards discussed above apply to these examples:

- Standard III C (Duties to Clients – Suitability)
- Standard V A (Investment Analysis, Recommendations, and Actions – Diligence and Reasonable Basis)
- Standard VI A (Conflicts of Interest – Disclosure of Conflicts)
- Standard VI C (Conflicts of Interest – Referral Fees)

B10 Bulky statement of advice

Standard VI A (Conflicts of Interest – Disclosure of Conflicts) applies to this example. Specifically, disclosures must be prominent and must be made in plain language and in a manner designed to effectively communicate the information to clients and prospective clients.

Section C: Product issuers/ fund managers

C1 Directed brokerage

C2 Asset management advice

C3 Related entities

C4 Embedded termination benefit for responsible entity

The following standards discussed above apply to these examples:

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- Standard VI A (Conflicts of Interest – Disclosure of Conflicts)
- Standard VI C (Conflicts of Interest – Referral Fees)

In addition, CFA Institute Soft Dollar Standards provide investment professionals guidance on how to use client brokerage ethically and in a manner that benefits clients. (Please visit: http://www.cfainstitute.org/standards/ethics/soft_dollar/). The CFA Institute Soft Dollar Standards are based on the following concepts:

- Soft dollars belong to the client.
- Investment managers may only purchase research with client brokerage if the primary use of the research, whether a product or a service, directly assists managers in their investment decision-making process and not in the management of the investment firm.
- Investment managers are fiduciaries and, therefore, must disclose all relevant benefits they receive through client brokerage.

Additional topic – Personal trading by investment professionals

One area which was not addressed in your discussion paper is personal trading by investment professionals. Specifically, Standard VI B (Conflicts of Interest – Priority of Transactions) reinforces the responsibility of investment professionals to give the interests of their clients and employers priority over their personal financial interests. This standard is designed to prevent any potential conflict of interest or the appearance of a conflict of interest with respect to personal transactions. Client interests have priority.

Conflicts between the client's interest and an investment professional's personal interest may occur. Although conflicts of interest exist, there is nothing inherently unethical about individual managers, advisors, or managed fund employees making money from personal investments as long as (1) the client is not disadvantaged by the trade, (2) the investment professional does not benefit personally from trades undertaken for clients, and (3) the investment professional complies with applicable regulatory requirements.

Personal transactions include those made for the individual's own account, for family (including spouse, children, and other immediate family members) accounts, and for accounts in which the individual has a direct or indirect pecuniary interest, such as a trust or retirement account.

Recommended procedures for compliance are as follow:

- Limit participation in equity IPOs since there may be an appearance of potential conflict of interests.

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- Place strict limits on investment personnel acquiring securities in private placements.
- Establish appropriate supervisory and review procedures to prevent non-compliance.
- Establish black-out periods for investment personnel involved in the decision making process so that they cannot take advantage of their knowledge of client activity by “front-running” client trades.
- Establish reporting procedures for investment personnel, including duplicate confirmations, disclosure of personal holdings/ beneficial ownerships, and pre-clearance procedures.

Example: A 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.

Comment: Long violated Standard VI (B) by taking advantage of his knowledge of the stock’s value before allowing his employer to benefit from that information.

Example: Erin Toffler, a portfolio manager at Esposito Investments, manages the retirement account established with the firm by her parents. Whenever IPOs become available, she first allocates shares to all her other clients for whom the investment is appropriate; only then does she place any remaining portion in her parents’ account, if the issue is appropriate for them. She has adopted this procedure so that no one can accuse her of favoring her parents.

Comment: Toffler has breached her duty to her parents by treating them differently from her other accounts simply because of the family relationship. As fee-paying clients of Esposito Investments, Toffler’s parents are entitled to the same treatment as any other client of the firm. If Toffler has beneficial ownership in the account, however, and Esposito Investments has preclearance and reporting requirements for personal transactions, she may have to preclear the trades and report the transactions to Esposito.

For additional examples on applications of this Standard, please see pages 124-129 in our Handbook.

While there are some overlaps in our recommendations compared with your discussion paper, we would ask that you review our Code and Standards, which are detailed in the Handbook. Our project manager is Ernestine Chan, CFA, Policy Analyst, CFA Centre for Financial Market Integrity. Should you need further questions or clarification, please contact myself at khaloon.lee@cfainstitute.org or telephone 852.3103.9303 or Ernestine at

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ernestine.chan@cfainstitute.org or telephone 852.3103.9323. Our local representatives would also be willing to meet with you to discuss this submission.

Sincerely,

Lee Kha Loon, CFA
Head, Asia Pacific
CFA Centre for Financial Market Integrity

Philip Graham, CFA
Secretary, Melbourne CFA Society

Bruce Tomlinson, CFA
Advocacy Chair, Sydney CFA Society

Enclosures: 2 copies of Standards of Practice Handbook, 9th edition 2005

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APPENDIX – STANDARDS OF PROFESSIONAL CONDUCT

I. PROFESSIONALISM

- A. Knowledge of the Law.** Members and Candidates must understand and comply with all applicable laws, rules, and regulations (including the CFA Institute Code of Ethics and Standards of Professional Conduct) of any government, regulatory organization, licensing agency, or professional association governing their professional activities. In the event of conflict, Members and Candidates must comply with the more strict law, rule, or regulation. Members and Candidates must not knowingly participate or assist in and must dissociate from any violation of such laws, rules, or regulations.
- B. Independence and Objectivity.** Members and Candidates must use reasonable care and judgment to achieve and maintain independence and objectivity in their professional activities. Members and Candidates must not offer, solicit, or accept any gift, benefit, compensation, or consideration that reasonably could be expected to compromise their own or another's independence and objectivity.
- C. Misrepresentation.** Members and Candidates must not knowingly make any misrepresentations relating to investment analysis, recommendations, actions, or other professional activities.
- D. Misconduct.** Members and Candidates must not engage in any professional conduct involving dishonesty, fraud, or deceit or commit any act that reflects adversely on their professional reputation, integrity, or competence.

II. INTEGRITY OF CAPITAL MARKETS

- A. Material Nonpublic Information.** Members and Candidates who possess material nonpublic information that could affect the value of an investment must not act or cause others to act on the information.
- B. Market Manipulation.** Members and Candidates must not engage in practices that distort prices or artificially inflate trading volume with the intent to mislead market participants.

III. DUTIES TO CLIENTS

- A. Loyalty, Prudence, and Care.** Members and Candidates have a duty of loyalty to their clients and must act with reasonable care and exercise prudent judgment. Members and Candidates must act for the benefit of their clients and place their clients' interests before their employer's or their own interests. In relationships with clients, Members and Candidates must determine applicable fiduciary duty and must comply with such duty to persons and interests to whom it is owed.
- B. Fair Dealing.** Members and Candidates must deal fairly and objectively with all clients when providing investment analysis, making investment recommendations, taking investment action, or engaging in other professional activities.
- C. Suitability.**
1. When Members and Candidates are in an advisory relationship with a client, they must:

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- a. Make a reasonable inquiry into a client's or prospective clients' investment experience, risk and return objectives, and financial constraints prior to making any investment recommendation or taking investment action and must reassess and update this information regularly.
 - b. Determine that an investment is suitable to the client's financial situation and consistent with the client's written objectives, mandates, and constraints before making an investment recommendation or taking investment action.
 - c. Judge the suitability of investments in the context of the client's total portfolio.
2. When Members and Candidates are responsible for managing a portfolio to a specific mandate, strategy, or style, they must only make investment recommendations or take investment actions that are consistent with the stated objectives and constraints of the portfolio.
- D. Performance Presentation.** When communicating investment performance information, Members or Candidates must make reasonable efforts to ensure that it is fair, accurate, and complete.
- E. Preservation of Confidentiality.** Members and Candidates must keep information about current, former, and prospective clients confidential unless:
1. The information concerns illegal activities on the part of the client or prospective client.
 2. Disclosure is required by law.
 3. The client or prospective client permits disclosure of the information.

IV. DUTIES TO EMPLOYERS

- A. Loyalty.** In matters related to their employment, Members and Candidates must act for the benefit of their employer and not deprive their employer of the advantage of their skills and abilities, divulge confidential information, or otherwise cause harm to their employer.
- B. Additional Compensation Arrangements.** Members and Candidates must not accept gifts, benefits, compensation, or consideration that competes with, or might reasonably be expected to create a conflict of interest with, their employer's interest unless they obtain written consent from all parties involved.

- C. Responsibilities of Supervisors.** Members and Candidates must make reasonable efforts to detect and prevent violations of applicable laws, rules, regulations, and the Code and Standards by anyone subject to their supervision or authority.

V. INVESTMENT ANALYSIS, RECOMMENDATIONS, AND ACTION

- A. Diligence and Reasonable Basis.** Members and Candidates
1. Exercise diligence, independence, and thoroughness in analyzing investments, making investment recommendations, and taking investment actions.
 2. Have a reasonable and adequate basis, supported by appropriate research and investigation, for any investment analysis, recommendation, or action.

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- B. Communication with Clients and Prospective Clients.** Members and Candidates must:
1. Disclose to clients and prospective clients the basic format and general principles of the investment processes used to analyze investments, select securities, and construct portfolios and must promptly disclose any changes that might materially affect those processes.
 2. Use reasonable judgment in identifying which factors are important to their investment analyses, recommendations, or actions and include those factors in communications with clients and prospective clients.
 3. Distinguish between fact and opinion in the presentation of investment analysis and recommendations.
- C. Record Retention.** Members and Candidates must develop and maintain appropriate records to support their investment analysis, recommendations, actions, and other investment-related communications with clients and prospective clients.

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VI. CONFLICTS OF INTEREST

- A. Disclosure of Conflicts.** Members and Candidates must make full and fair disclosure of all matters that could reasonably be expected to impair their independence and objectivity or interfere with respective duties to their clients, prospective clients, and employer. Members and Candidates must ensure that such disclosures are prominent, are delivered in plain language, and communicate the relevant information effectively.
- B. Priority of Transactions.** Investment transactions for clients and employers must have priority over investment transactions in which a Member or Candidate is the beneficial owner.
- C. Referral Fees.** Members and Candidates must disclose to their employer, clients, and prospective clients, as appropriate, any compensation, consideration, or benefit received from, or paid to, others for the recommendation of products or services.

VII. RESPONSIBILITIES AS A CFA INSTITUTE MEMBER OR CFA CANDIDATE

- A. Conduct as Members and Candidates in the CFA Program. Members and Candidates** must not engage in any conduct that compromises the reputation or integrity of CFA Institute or the CFA designation or the integrity, validity, or security of the CFA examinations.
- B. Reference to CFA Institute, the CFA designation, and the CFA Program.** When referring to CFA Institute, CFA Institute membership, the CFA designation, or candidacy in the CFA Program, Members and Candidates must not misrepresent or exaggerate the meaning or implications of membership in CFA Institute, holding the CFA designation, or candidacy in the CFA Program.