

23 May 2008

Capital Markets Intermediaries Department
Monetary Authority of Singapore
10 Shenton Way
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Singapore 079117

Via e-mail to: fairdealing@mas.gov.sg

Re: Consultation on Proposed Guidelines on Fair Dealing – Board and Senior Management Responsibility for Delivering Fair Dealing Outcomes to Consumers

To Whom It May Concern:

The CFA Institute Centre for Financial Market Integrity¹ and CFA Singapore are pleased to comment on the *Proposed Guidelines on Fair Dealing*, put forward by Monetary Authority of Singapore on 31 March 2008. The CFA Institute Centre represents the views of investment professionals to regulators and standard setters worldwide on issues that affect the practice of financial analysis and investment management, as well as the integrity of global financial markets. CFA Singapore represents more than 2,500 investment professionals in Singapore, and is a member society of CFA Institute.

General Comments

We commend MAS for addressing the issue of fair dealing by financial institutions in Singapore, paying particular attention to the retail segment. As the Singaporean economy continues to be strong and create wealth for the population, new investors are coming to the market, including those with limited literacy on the characteristics and risks of the financial products available to them. At the same time, financial institutions catering to retail investors are only expected to grow in number and offer an increasingly diverse portfolio of products, some of which may have structures that are too complex for the average investor. As such, investor protection becomes an even more imperative regulatory consideration, and we believe that the Proposed Guidelines on fair dealing by financial institutions are timely and necessary steps towards safeguarding the interests of retail investors.

¹ The CFA Institute Centre for Financial Market Integrity is a part of CFA Institute. 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 94,500 financial analysts, portfolio managers, and other investment professionals in 136 countries and territories, of which nearly 79,400 are holders of the Chartered Financial Analyst® (CFA®) designation. CFA Institute membership also includes 135 Member Societies and Chapters in 56 countries and territories.

CFA Institute and CFA Singapore have long held that a fundamental principle of ethical investment practice is that the best interests of the investing client must take precedence over the interests of investment professionals and their employers. This responsibility and the need for full disclosure of conflicts of interest are clearly stated in the CFA Institute *Code of Ethics* and *Standards of Professional Conduct* by which CFA Institute requires all of its individual members and candidates to abide. These Codes and Standards form the basis of our response to the Proposed Guidelines.

In light of this Consultation Paper on the Proposed Guidelines on fair dealing, we recognize the authority of MAS as the supervisor and regulator of the financial services sector of Singapore, with prudential oversight over the banking, securities, futures and insurance industries. We therefore take this opportunity to respectfully note that the provisions expressed in this Consultation Paper could potentially overlap with existing legislation relating to fair dealing, such as the Consumer Protection Fair Trading Act, as well as the Financial Advisers Act which the Proposed Guidelines are meant to complement. Such overlaps may create nuances that may result in differing interpretations of the same objectives. In the interest of efficiency, and to ensure that the fair dealing objectives of the Proposed Guidelines and the existing legislation are focused and in agreement, we suggest that a review be done to identify and eliminate or minimize overlapping provisions.

Our Position on the Proposed Guidelines

We address the specific questions in the consultation paper below.

1. Do the five fair dealing outcomes clearly express the key outcomes that our regulatory regime for financial advisory services should seek to achieve? Are there any other outcomes that should be included?

Overall, we support the following five fair-dealing outcomes the MAS proposes for the board and senior management of financial institutions to deliver to consumers:

1. Consumers have confidence that financial institutions put consumers' interests first in the conduct of their business.
2. Financial institutions offer products and services that are suitable for the consumer segments they target.
3. Financial institutions appoint competent representatives who provide consumers with advice that meet their financial objectives and suit their personal circumstances.
4. Consumers receive clear, relevant and timely information to make informed financial decisions.
5. Financial institutions handle consumer complaints promptly and in a consistent manner.

We believe that the outcomes adequately address the issues of main concern to the protection of retail investors. They are also consistent with the five "Duties to Clients" embodied in CFA Institute's *Standards of Professional Conduct* – written for CFA Institute members and

candidates to abide by, but relevant to finance professionals globally – which we outline and paraphrase below in respect of the broader constituency of the MAS².

Standard III: Duties to Clients

A. Loyalty, Prudence, and Care. Investment professionals 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. Investment professionals 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 investment professionals are in an advisory relationship with a client, they must:
 - 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 investment professionals 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, investment professionals must make reasonable efforts to ensure that it is fair, accurate, and complete.

E. Preservation of Confidentiality. Investment professionals must keep information about current, former, and prospective clients confidential unless:

1. The information concerns illegal activities on the part of the client or prospective client,
2. Disclosure is required by law, or
3. The client or prospective client permits disclosure of the information.

² In its original form, the Standards of Professional Conduct address CFA Institute's "Members and Candidates". In respect of the broader constituency of the MAS, we paraphrase this reference to "investment professionals".

We believe that determining the client's needs and always acting in the best interest of that client are fundamental to the adviser-client relationship. Given the increasing level of interest of retail investors in financial products, instruments and securities, we emphasize the importance of making sure that clients receive relevant information that allows them to adequately assess the opportunities and risks of, and to thus set reasonable expectations from, their investments. We have long held the position that those who either lack information or who do not understand the information that is available to them are at a distinct disadvantage in buying or selling securities or any other financial product. Information is the lifeblood of the capital markets; as such, it must be presented to every participant with clarity and in a context that enhances, rather than obscures, its true meaning.

2. Are the illustrations useful? Do you have other suggestions or examples of good or poor practices?

We believe that the illustrations and their accompanying explanations are useful in guiding the board and senior management of financial institutions in delivering the fair dealing outcomes. We feel, however, that some of the illustrations and explanations have certain weaknesses that may potentially dilute the overall effectiveness of the Proposed Guidelines.

Limited illustrations may be construed as best practice endorsed by MAS

We understand that the illustrations provide examples of situations and how they affect the relationship of a financial institution, its representatives, and its clients. In the same breath, the illustrations also provide examples of measures a financial institution may take in response to such situations, in a manner that is consistent with the fair dealing outcomes. We believe, however, that some of the illustrations are too limited that the sample measures provided run the risk of being construed as the best practices endorsed by MAS. This impression, in our view, may then prove to be a disincentive to the financial institution from exploring other appropriate practices that may even be more effective in achieving the fair dealing outcomes.

Illustration 1.2, for example, highlights a financial institution that remunerates its representatives based not only on sales volume, but also on client retention, complaints, compliance records, proportion of full fact-finds conducted, and competency assessments. Illustration 1.5, on the other hand, highlights a financial institution that prepares quarterly management information reports that cover compliance issues, complaint trends, consumer feedback and other relevant indicators, to be reviewed at quarterly management meetings. If construed as best practice, these illustrations may give financial institutions an excuse not to innovate in their organizational practices by exploring other appropriate remuneration factors such as customer-satisfaction metrics, or by preparing crucial management information and convening management meetings on a more frequent basis.

Illustrations could provide more guidance on how to comply with guidelines

As such, we believe that the illustrations could be more useful if they were accompanied not with brief, simple explanations that merely repeat the points already mentioned in the “Rationale” and “Key Components” discussions under each fair dealing outcome, but instead with “Recommended Procedures for Compliance” that enumerate a wider range of possible measures for financial institutions to consider, while encouraging them to seek other appropriate measures that will effectively deliver the same fair dealing outcome.

Fair Dealing Outcome Three, for example, could enhance the illustrations and discussion of “Suitability of Advice” by providing specific pieces of information financial institutions may ask customers, to enable their representatives to offer their customers more suitable financial products.

CFA Institute’s *Standard of Practice Handbook* lists the following “Recommended Procedures for Compliance” to our “Standard of Practice III C (Suitability)”, which CFA Institute members and candidates must take when formulating an investment policy for, or offering an investment advice to, the client. We believe that a full understanding of a client’s financial situation and investment objectives is fundamental to the adviser’s responsibility for making suitability determinations, and that advisers should not make a recommendation unless they reasonably determine that the recommendation is suitable to the client’s financial situation, investment experience, and investment objectives.

- 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) tax considerations, (6) regulatory and legal circumstances, (7) investor preferences, prohibitions, circumstances, and unique needs, and (8) proxy-voting responsibilities and guidance.
- Performance measurement benchmarks.

In the same vein, we believe that Fair Dealing Outcome Four could further enhance the illustrations and discussion of the “Relevant Information” discussion, by providing more specific examples of information financial institutions must disclose to clients in order to give them a better understanding of the characteristics and risks of the financial products being sold to them. In an April 2008 paper on “Customer Suitability in the Retail Sale of Financial Products and Services”³, which looks at the retail sales practices of financial institutions globally, the Basel Committee on Banking Supervision of the Bank for International Settlements asked firms in member countries if they provided the following information to their customers:

³ “Customer Suitability in the Retail Sale of Financial Products and Services”, Bank of International Settlements, April 2008. p. 37.

- product characteristics
- whether the capital is guaranteed or not
- investment risk
- recommended investment duration
- expected performance or kind of events affecting performance
- information on commissions, fees and other costs directly borne by the customer (“direct costs”)
- information on embedded costs indirectly borne by the customer (“indirect costs”)
- amount and structure of other remuneration received by the financial institution for the sale (“other remuneration”)
- any conflicts of interest

We believe that the above pieces of information are relevant, and if used in the context of providing examples to illustrate how financial institutions may provide relevant information to clients as a fair-dealing outcome, these may add to the user-friendliness of the Proposed Guidelines.

3. Are the self-assessment questions relevant and comprehensible? Are there any other questions that should be included?

We agree that self-assessment questions outlined in the Proposed Guidelines are relevant, comprehensible, and useful in guiding the board and senior management of financial institutions in assessing their capabilities to deliver the fair dealing outcomes. However, we believe that in their current phrasing, the questions may be further enhanced by emphasizing the role of policies and procedures in driving financial institutions to achieve the desired fair dealing outcomes. After all, the smooth running of an organization relies on procedural efficiencies, which may be achieved by ensuring appropriate procedures are in place, that the right mechanisms are employed to execute the procedures more effectively, that employees follow these procedures, and that audit reviews are conducted regularly to better guard the organization from operational risks, and consequently, from failing to provide their customers with the products and services they deserve.

We understand the importance of asking the board and senior management of financial institutions *how* they ensure that they are able to deliver the fair dealing outcomes. It is equally important, in our view, to put forward straightforward questions as to *what* procedures and policies they have to enable them to meet such fair dealing outcomes. One fair dealing regulatory paper that, in our view, asks comprehensive self-assessment questions to financial institutions is the UK Financial Services Authority’s “Treating Customers Fairly – Building on Progress”⁴, which touches on a broad range of issues specific to each financial product, from product design, special deals, and bundling of products (for mortgages) to sales and advice, claims handling, and linked sales (for general insurance).

⁴ “Treating Customers Fairly – Building on Progress”, Financial Services Authority, July 2005. pp. 24-27.

To complement the self-assessment questions in the Proposed Guidelines, it may be worth asking:

- What procedures does the financial institution have in place to ensure that it obtains all the relevant information about its clients, in order to offer them only the products that are suitable to their needs, and how effective are these procedures?
- What procedures does the financial institution have in place to ensure that its employees and representatives understand the products they are selling to customers, and how effective are these procedures?
- What pieces of information does the financial institution provide to clients and prospective clients to ensure that they fully understand the characteristics and risks of the products being sold to them, and how relevant are these?
- How often does the financial institution audit its procedures to ensure that they conduct their business in the best interests of the clients?

Besides the proposed initiatives set out in the Guidelines, what other practical initiatives may help the industry deliver fair dealing outcomes to consumers?

One fair dealing outcome we believe is beneficial to retail investors is for financial institutions to provide clients with performance information on products. (We believe this outcome is more practicable than personalized performance information, which the CFA Institute supported when it was put forward by the Ontario Securities Commission in its Fair Dealing Model Concept Paper in May 2004.) We recognize that providing performance information for only one year may encourage investors to focus on short-term results, rather than developing a long-term investment strategy. We therefore recommend that, where available, investment performance be provided for as long a period as reasonably possible.

We acknowledge that there are many practical challenges for financial institutions to overcome in order to provide this kind of reporting, and that the required calculation “may be complex”. We also acknowledge that the utility of performance information is lost when there is no uniformity in its presentation, and thus no basis for comparability among different asset classes. Given the importance of providing investment performance information in a manner that is credible, uniform, and that allows comparability, we strongly suggest consideration of the CFA Institute *Global Investment Performance Standards* (GIPS), which are recognized, relied upon, and accepted around the world.

We are happy to furnish MAS with a copy of our GIPS manual upon request.

Closing Remarks

The CFA Institute Centre for Financial Market Integrity and CFA Singapore appreciate the opportunity to comment on MAS’s *Proposed Guidelines on Fair Dealing – Board and Senior Management Responsibility for Delivering Fair Dealing Outcomes to Consumers*.

If you have questions or seek amplification of our views, and feel that CFA Institute Centre and CFA Singapore may be able to help in the formulation of the final guidelines, please feel free to contact Lee Kha Loon, CFA, at +852-3103-9303 or khaloon.lee@cfainstitute.org, or Th'ng Beng Hooi, CFA, at 6323-6679 or bh.thng@cfasingapore.org.

Respectfully yours,

(Signed)

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