CFA SINGAPORE INSIGHTS

By CFA Singapore Advocacy Team

# Misrepresenting financial products

Misrepresentation – an untrue statement or omission of a fact or any statement that is otherwise false or misleading – can erode trust in the financial services industry

AS INVESTORS, we have been pitched various financial products for different needs. Have you ever been led to believe that an endowment insurance policy is in fact a savings account? Or been told by a charming salesperson that an investment-linked insurance product is no different from a unit trust?

Did the relationship manager brush off the risk associated with structured products, even though the prospectus indicated otherwise? Did your private banker imply guaranteed returns when capital loss was plausible?

The Monetary Authority of Singapore (MAS) has been investigating various types of financial services misconduct including cases of misrepresentation. In its inaugural enforcement report published in March 2019, MAS flagged that as of the 18 months ending Dec 31, 2018, there were 20 outstanding cases under review and investigation for mis-selling, which included misrepresentation and inappropriate advice.

The 20 cases form 53 per cent of all outstanding financial services misconduct cases being investigated by MAS.

Misrepresentation – which generally refers to the making of a false or misleading statement when one does not care whether the statement is true or false or when one knows or ought reasonably to have known that the statement is false or misleading – is a problem. It erodes trust in the financial services industry.

When trust is low, the public may not be willing to invest as much. If they do invest, they would first need to spend more resources ascertaining the accuracy of what has been disclosed about the product or service. Furthermore, the public may end up with investment products that do not suit their needs or risk profile, based on misrepresented information and advice.

### CFA Institute's stand on misrepresentation

As a premier global association for investment professionals, CFA Institute, under its Code of Ethics and Standards of Professional Conduct, prohibits its members from knowingly making any misrepresentations relating to investment analysis, recommendations, actions, or any other professional activities.

This requirement is captured under the Misrepresentation Standard of Professional Conduct. The standard specifies that a misrepresentation is any untrue statement or omission of a fact or any statement that is otherwise false or misleading.

A member of the institute must not knowingly omit or misrepresent information or give a false impression of a firm, organisation, or security in the member's oral representations, advertising (whether in the press or through brochures), electronic communications, or written materials (whether publicly disseminated or not).

In this context, "knowingly" means that the member either knows or should have known that the misrepresentation was being made or that omitted information could alter the investment decision-making process.

Written materials include, but are not limited to, research reports, underwriting documents, company financial reports, market letters, newspaper columns, and books. Electronic communications include, but are not limited to, Internet communications, webpages, mobile applications, and e-mails. Members who use webpages should regularly monitor materials posted on these sites to ensure that they contain current information.

CFA members should also ensure that all reasonable precautions have been taken to protect the site's integrity and security and that the site does not misrepresent any information and does provide full disclosure.

### Ethics in action: practise, practise, practise

Today's case is based on a US Securities and Exchange Commission enforcement action from September 2019. As a guide, the desired ethical behaviour required is based on the CFA Institute Code of Ethics and Standards of Professional Conduct.

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### Case Study: Joint Venture Investments

Henry is an investment adviser and a leader in his religious organisation. He visits a developing country regularly for missionary work. During these visits, he befriends a leader of the local religious group.

The local religious leader convinces Henry to form a joint venture for people in his home country to invest in local securities that fund infrastructure development projects in the developing country. He assures Henry that the securities have the backing of the local government.

Henry agrees to form the joint venture with the local religious leader and offers his own clients the opportunity to invest in the developing country's securities through purchasing shares in the joint venture. His solicitation targets his clients, members of religious organisations with which Henry is associated, and alumni of the religious university that he attended.

Henry states that he had "been led by the Force" to form this joint venture and claims that the investment opportunity will "stir up the disciples, leaders, and followers to lead the way in the religious organisation and in the world". He refers to his local partner in the joint venture as a "follower" and a "leader disciple in his country". He states that the projects funded by the "government-backed" securities purchased by the joint venture will "help light the Path to non-followers".

Henry's actions are:

a) unethical because he appeals to the religious beliefs of individuals to solicit investments;
b) ethical as long as the investments are suitable for his clients;
c) unethical because his claims about the securities are misleading;
d) ethical if he diligently investigates the investment opportunity and has a reasonable basis for the recommendation; or
e) none of the above.

### Analysis

This case is related to misrepresentation. CFA Institute Standard of Professional Conduct – Misrepresentation – prohibits CFA Institute members from making any misrepresentations relating to investments. Although the underlying securities purchased by the joint venture may be guaranteed by the local government, clients are buying shares of the joint venture, which are not "government-backed" investments.

Also, the claim that the securities are "government-backed" does not specify the government involved, potentially implying that it is Henry's home government (which is very likely more creditworthy than the local government). It is not necessarily unethical to market investments as having subjective and tangential religious benefits to potential investors who have a particular interest in achieving those goals.

For instance, promoting and selling socially responsible investments to those seeking to invest in assets that advance social or environmental goals is a valid and established investment practice.

In this case, although Henry has diligently investigated the investments and the securities themselves may be suitable for clients, these facts would not remedy or supersede the misrepresentations about the shares of the joint venture being "government-backed" that mislead investors about the characteristics or merits of the investment. Choice C is the best response.

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**The writers are CFA charterholders who volunteer with the Singapore society on advocacy issues with a view towards promoting financial literacy among retail investors and improving overall standards and integrity in the industry. Should you have comments and feedback, do write to the CFA Society Singapore Advocacy Committee: advocacy@cfasingapore.org**