

WEALTH & INVESTING

INSIGHTS FROM CFA SOCIETY SINGAPORE

By CFA Society Singapore Advocacy Team

Conducting due diligence amid Covid-19 restrictions

Analysts need to adapt the investment decision-making process as the worldwide travel ban has yet to be lifted

WHILE Singapore, and many other countries, have begun easing off circuit breaker measures domestically, the same cannot be said for cross-border movement. Many countries have closed their borders to non-citizens and non-residents, while imposing a mandatory 14-day quarantine for residents returning home.

This unprecedented worldwide travel ban poses a major stumbling block for analysts who need to travel abroad to conduct due diligence on companies. What can they now do? And what have they got to bear in mind in taking remedial actions?

To engage with covered companies, analysts may want to consider exploring or increasing the usage of secured call or video conferencing platforms approved by their organisations. At the same time, covered companies may need to consider how to showcase their facilities and operations virtually, or even conduct "live" webcast tours for analysts.

These digital platforms may not be a perfect substitute for in-person visits or meetings but they need to be developed as serious alternatives, as it is unclear when international travel would resume to pre-pandemic conditions.

Digital platforms come with risks of hacking, data breaches, cyberattacks and viruses (the virtual kind), and gatecrashing which may result in fraud or illicit activities. In the wake of these breaches, digital platforms have been fortifying their security with measures such as encryption, passwords and participant monitoring features such as waiting rooms. Cyber security personnel have also advised users of these platforms to use the latest versions of digital tools, and paid versions which are likely to come with more security features to minimise the risks associated with digital platforms.

Diligence and reasonable basis

Even when working from home due to government measures, investment professionals have a duty to exercise diligence, independence, and thoroughness in analysing investments, making investment recommendations, and taking investment actions. There must also be a reasonable and adequate basis, supported by appropriate research and investigation, for any investment analysis, recommendation, or action.

Advisers are expected to have more information and knowledge than clients do. At the most basic level, clients want assurances that their advisers are making the necessary effort to support the recommendations they are making.

Communication with clients and prospective clients

Advisers are also required to observe strict standards when communicating with current and prospective clients, including:

- Disclose to clients and prospective clients the basic format and general principles of the invest-

ment processes they use to analyse investments, select securities, and construct portfolios and must promptly disclose any changes that might materially affect those processes.

- Disclose to clients and prospective clients significant limitations and risks associated with the investment process.
- 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.
- Distinguish between fact and opinion in the presentation of investment analyses and recommendations.

Developing and maintaining clear, frequent, and thorough communication practices is critical to providing high-quality financial services to clients. When clients understand the information communicated to them, they can also understand exactly

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how their advisers are acting on their behalf. This allows clients to make well-informed decisions about their investments.

As well, the manner in which advisers conduct the investment decision-making process must be adequately described to clients and prospective clients. Such disclosure should address factors that have positive and negative influences on the recommendations, including significant risks and limitations of the investment process used. Clients and other interested parties must be kept informed on an ongoing basis about changes to the investment process, especially newly identified significant risks and limitations.

Case study

In the past, Yoon, a research analyst covering the global travel and lodging industry, has routinely met the management of companies that she covers and visited their facilities prior to drafting and updating her research reports. Yoon considers it critical to her work to gain first-hand knowledge of the management and facilities and obtain feedback from employees and guests of the properties.

Because of restrictions on travel and in-person gatherings brought on by a global pandemic, she is not able to conduct the type of thorough research she has conducted in the past.

Nevertheless, Yoon's employer is demanding

constant updates on her research given the swiftly changing environment for this industry. Yoon should:

A: provide only factual information about the companies and refrain from any analysis until she can resume her normal research practices and form a detailed and well-researched opinion.

B: conduct her research as best she can given the restrictions and disclose any issues in her report.

C: provide no information on how she conducts her research because that information is proprietary information of the firm.

D: continue to provide research but make no mention of how the research process has been affected by the travel restrictions.

Analysis

Yoon's well-established routine and procedures for conducting analysis of the global travel and lodging industry have been disrupted by the global pandemic. Steps she normally takes to thoroughly analyse her investment recommendations are now prohibited.

Although she could refrain from undertaking any analysis until her high standards of investigation can be resumed (Choice A), that is likely not practical given the uncertainty of when the restrictions will be lifted and the demands of her employer.

Although Yoon does not have to provide the minute detail of her research process that would give away confidential or proprietary information, she must disclose the basic process for conducting her research. Therefore, the course of conduct in Choice C would not be an option.

If she continues to provide research and recommendations without any mention about the change in process for conducting that research and that her in-person capabilities have diminished (Choice D), that would violate the communication standard, which requires CFA Institute members to disclose any changes that may materially affect the investment process they use to analyse investments and disclose any limitations and risks associated with the process.

Given the facts, Yoon's best course of action is Choice B, which is to conduct her research as best she can given the restrictions and disclose any issues in her report.

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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 advocacy@cfasingapore.org