

When investors are plentiful and allocations fall short

By CFA Society Singapore
Advocacy Team

YIELD hungry Singapore-based investors are constantly on the lookout for investment grade Singapore bonds and perpetual offerings, especially in a turbulent and a low interest rate environment. Investors are also keen on technology unicorn initial public offerings (IPOs).

When a hot fixed income or equity new issuance is underway, investors plough in funds, hoping to snag a piece of the action. When demand is greater than supply, there is inevitably a shortfall in allocation. Unmet expectations may trigger unhappiness among investors. Access to opportunities may also be perceived to favour the wealthy and connected.

Hence, finance professionals must deal fairly and objectively with all clients with regard to investment processes and other professional activities, including the allocation of bond and equity new offerings to avert adverse consequences in the long term.

The Fair Dealing Standard

As a global professional body for investment management professionals, CFA Institute addresses the fairness issue through the Fair Dealing Standard.

Finance professionals have to treat all clients fairly when disseminating investment recommendations or making material changes to prior investment recommendations; or when taking investment action relating to general purchases, new issues or secondary offerings.

Only through the fair treatment of all parties can the investment management profession maintain the confidence of the investing public.

When an investment adviser has multiple clients, the potential exists for the adviser to favour one client over another. This favouritism may take various forms – from the quality and timing of services provided to the allocation of investment opportunities.

The term “fairly” implies that one must take care not to discriminate against any clients when disseminating investment recommendations or taking investment action.

The Fair Dealing Standard does not state “equally” because finance professionals could not possibly reach all clients at exactly the same time – whether by printed mail, telephone (including text messaging), computer (including Internet updates and e-mail distribution), facsimile (fax), or wire.

Each client has unique needs, investment criteria and investment objectives – so not all investment opportunities are suitable for all clients.



When a hot fixed income or equity new issuance is underway, yield hungry investors plough in funds, hoping to snag a piece of the action. ILLUSTRATION: PIXABAY

Differentiated services

In addition, one may provide more personal, specialised or in-depth service to clients who are willing to pay for premium services through higher management fees or higher levels of brokerage.

Finance professionals may differentiate their services to clients, but different levels of service must not disadvantage or negatively affect clients.

In addition, the different service levels should be disclosed to existing and prospective clients; and should be available to everyone (that is – different service levels should not be offered selectively).

Recommended procedures

■ **Develop firm policies:** Although the Fair Dealing Standard refers to a finance professional’s responsibility to deal fairly and objectively with clients, one should also encourage their firms to establish compliance procedures requiring all employees who disseminate investment recommendations or

take investment actions to treat customers and clients fairly.

At the very least, the finance professional should recommend appropriate procedures to management if none are in place. And one should make management aware of possible violations of fair dealing practices within the firm when they come to the attention of the finance professional.

The extent of the formality and complexity of such compliance procedures depends on the nature and size of the organisation and the type of securities involved. An investment adviser who is a sole proprietor and handles only discretionary accounts might not disseminate recommendations to the public, but that adviser should have formal written procedures to ensure that all clients receive fair investment action.

Good business practice dictates that initial recommendations be made available to all customers who indicate an interest. Although the finance professional need not communicate a recommendation to all cus-

tomers, the selection process by which customers receive information should be based on suitability and known interest, not on any preferred or favoured status.

A common practice to assure fair dealing is to communicate recommendations simultaneously within the firm and to customers.

■ **Disclose trade allocation procedures:** Finance professionals 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.

Trade allocation procedures must be fair and equitable, and disclosure of inequitable allocation methods does not relieve finance professionals of this obligation.

In addition, for public subscription tranches, the SGX Mainboard Rules 233 states that: where an invitation involves a public subscription tranche, the following rules apply to allocation and allotment of securities in this tranche:

■ The basis of allocation and allotment to investors must be fair and equitable.

■ The balloting procedures must be clearly spelt out and strictly adhered to. Unsuccessful applicants must be notified, and the application money must be returned within 24 hours of the balloting.

■ In respect of applications which have been balloted but subsequently rejected, the reasons for rejection must be clearly stated.

■ In respect of applications which have been partially successful, the balance of the application money must be refunded in the shortest possible time.

Ethics in action

Here is a case to illustrate how the Fair Dealing Standard works. The case is adapted from material developed by CFA Institute.

Case: Minimum lot allocations

Chantrea is a well-respected private wealth manager in her community with a diversified client base. She determines that a new 10-year bond being offered by Glove and Pharmaceuticals is appropriate for five of her clients.

Three clients request to purchase S\$10,000 each, and the other two request S\$50,000 each. The minimum lot size is established at S\$5,000, and the issue is oversubscribed at the time of placement.

Her firm’s policy is that odd-lot allocations, especially those below the minimum, should be avoided because they may affect the liquidity of the security at the time of sale.

Chantrea is informed she will receive only S\$55,000 of the offering for all accounts. She distributes the bond investments as follows: The three accounts that requested S\$10,000 are allocated S\$5,000 each, and the two accounts that requested S\$50,000 are allocated S\$20,000 each.

Chantrea has not violated the Fair Dealing Standard, even though the distribution is not on a completely pro rata basis because of the required minimum lot size.

With the total allocation being significantly below the amount requested, she ensured that each client received at least the minimum lot size of the issue. This approach allowed the clients to efficiently sell the bond later if necessary.

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