

# Jumping on the gravy train?

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**W**E are all attracted to high returns, more so when they are guaranteed. But what is guaranteed? The total return, or only a portion of the returns, or something else such as capital or the interest strips?

Or perhaps nothing is guaranteed. The latter is likely to be the case – where nothing is guaranteed including capital. Hence, investors must be discerning when presented with marketing and promotional materials.

Finance professionals, on the other hand, must not misrepresent the nature of returns and performance of risk assets, including any misrepresentation relating to investment analysis, recommendations, actions, or other professional activities.

## The Misrepresentation Standard

As a global professional body for investment management professionals, CFA Institute addresses the issues on misrepresentation through the Misrepresentation Standard. The standard states that a misrepresentation is any untrue statement or omission of a fact or any statement that is otherwise false or misleading.

One must not knowingly omit or misrepresent information or give a false impression of a firm, organisation, or security in 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 one either knows or should have known that the misrepresentation was being made or that the omitted information could alter the investment decision-making process.

The standard prohibits finance professionals from guaranteeing clients any specific return on volatile investments. Most investments contain some element of risk that makes their return inherently unpredictable. For such investments, guaranteeing either a particular rate of return or a guaranteed preservation of investment capital (for example: “I can guarantee that you will earn 8 per cent on equities this year”, or “I can guarantee that you will not lose money on this investment”) is misleading to investors.

The standard does not prohibit one from providing clients with information on invest-

ment products that have guarantees built into the structure of the products themselves or for which an institution has agreed to cover any losses.

## Why should misrepresentation be avoided?

Trust is the foundation of the investment profession. Investors must be able to rely on the statements and information provided to them by those in whom the investors have entrusted their financial well-being.

Investment professionals who make false or misleading statements not only harm investors, but also reduce the level of investor confidence in the investment profession and threaten the integrity of capital markets as a whole.

## Social media

The advancement of online discussion forums and communication platforms, commonly referred to as social media, places additional responsibilities on finance professionals. When communicating through social media channels, one should provide only the same information they are allowed to distribute to clients and potential clients through other traditional forms of communication.

The online or interactive aspects of social media do not remove the need to be open and honest about the information being distributed.

## Resolving a dispute

Should a dispute arise from misrepresentation, the national financial education programme, MoneySense, recommends that the first port of call for investors to resolve a dispute is to speak to the financial institution (FI). FIs are expected by the Monetary Authority of Singapore (MAS) to handle consumer issues and complaints promptly.

If the dispute remains unresolved, the next step is to approach an independent and affordable mediator for dispute. The Financial Industry Disputes Resolution Centre (FIDReC) can assist in resolving disputes related to banking, insurance and capital market transactions. If all else fails, legal action remains an option on the table.

## Reporting to MAS

The MoneySense website also gives in-



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vestors guidance on when investors should report a matter to MAS.

It states that MAS is unable to resolve commercial disputes between you and your FI, such as those regarding your FI’s pricing policies or contractual arrangements with you, or order your FI to compensate you.

However, while you must seek to resolve the dispute with your FI, you should report to MAS when you come across the following:

- Inappropriate or misleading advice
- Misrepresentation of products
- A lack of disclosure in the sales and advisory process.

You should also report to MAS when you suspect that an FI has committed offences such as fraud, cheating, criminal breach of trust, forgery, fraudulent accounting or corruption.

## Ethics in action

Here is a case to illustrate how the Misrepresentation Standard works. The case is adapted from material developed by CFA Insti-

tute based on facts from a CFA Institute Professional Conduct enforcement action.

Sri works for a publishing company writing an online financial newsletter that describes her investment philosophy and identifies intriguing investment opportunities. She is paid a salary plus incentive bonuses for every new subscriber.

Sri routinely states that she makes S\$5,000 in investment returns every week, and that if readers followed her advice, they could too. She often includes success stories from readers, including the story of a reader who turned S\$200 into S\$1 million in six months using Sri’s investment techniques. Are Sri’s actions acceptable?

## No clear violation

This case involves potential misrepresentation. The CFA Institute Misrepresentation Standard states that one “must not knowingly make any misrepresentations relating to investment analysis, recommendations, actions, or other professional activities”.

This includes statements relating to past investment performance history.

Did Sri misrepresent her past performance record and the success of her investments? It is not clear. Sri’s statements regarding her weekly investment returns and the success stories of readers who follow her advice may be true. More facts are needed.

Assuming those statements are true, it is irrelevant whether she is making the statements to clients, potential clients, subscribers to her newsletters, or the investing public. The Misrepresentation Standard prohibits any misinformation regardless of the audience.

However, interested persons can enquire more about the performance record to gauge its veracity. Sri would be required to respond truthfully to probing questions, such as “How many readers using your investment techniques have lost money?”

It has also to be noted that because there is no investment advisory relationship between Sri and those who may read her articles, she is not required to conduct a suitability analysis of the investments for anyone reading her newsletter.

However, best practices would dictate that Sri include general cautionary language in her articles recommending that readers ensure any investments they make are suitable to their financial goals, constraints and circumstances.

Finally, the Misrepresentation Standard prohibits one from guaranteeing clients any specific return on investments because most investments contain some element of risk that makes their return inherently unpredictable. Sri did not provide guarantees because she qualifies her statements about expected performance by asserting that readers following her investment philosophy “could” earn regular returns; she does not guarantee that they will.

Hence, from the facts in the case, Sri did not violate the Misrepresentation Standard.

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