Importance of Ethics in the Securities Industry

Ethics is crucial to the viability of capital markets. Without it, exists the potential to incapacitate the growth and development of the securities industry.

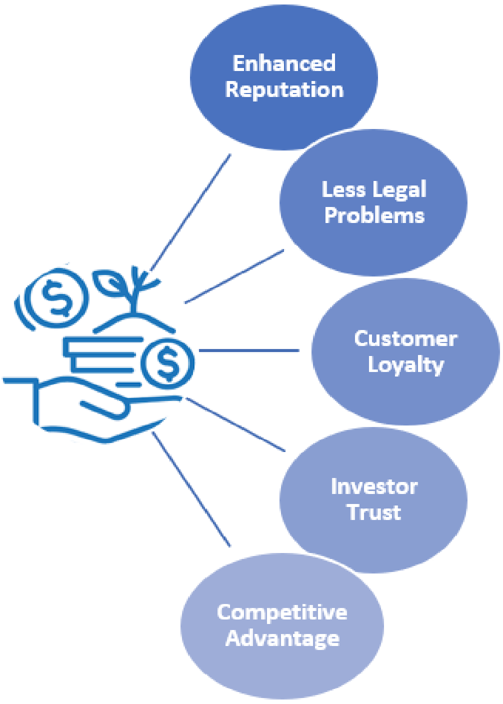
Over the years, securities markets around the world have been plagued with a myriad of cases of professionals utilising wrongful business practices to defraud clients, employers and their peers for personal gain. Following the global financial crisis of 2007-2009, the Financial Crisis Inquiry Commission (FCIC) was established. The FCIC, in its 2011 report, concluded that one of the main reasons for the crisis was due to a "systemic breakdown in accountability and ethics." Since then, regulators have reformed their regulatory regime to deter such unethical practices. Notwithstanding this, ethical violations persist as individuals or entities continue to take advantage of loopholes in the legislative system. In this regard, regulators encourage professionals in the industry to develop a strong ethical culture in their operations to help maintain the integrity and confidence of capital markets.

The Trinidad and Tobago Securities and Exchange Commission (TTSEC), as the regulator of the local securities industry, has an important role in fostering investor confidence by providing protection to investors from unfair, improper or fraudulent practices and nurturing fair, efficient and transparent securities markets to reduce systemic risks and other related matters. The securities industry of Trinidad and Tobago is governed by the Securities Act, 2012 (SA 2012), the Securities (General) By-Laws, 2015 (the By-Laws) and other regulatory requirements of the TTSEC. Registrants registered under Section 51(1) of the SA 2012 (Broker-Dealers, Investment Advisers and Underwriters) have a fiduciary duty to their clients to act in their best interest. **When acting in the best interest of clients, Registrants should be aware of the trust investors repose in them to act with prudence, care and due diligence**.

Prudence requires the investment professional to act with sound and responsible judgment in utilising securities that are suitable to an investor's goals and objectives. Due diligence requires thorough research and investigation into potential investments before investing funds. Registrants who implement appropriate ethical practices tend to build the trust of investors to invest on their behalf and encourages greater overall participation in the securities industry.

Ethical versus unethical behaviour

The words 'ethical' and 'unethical' are derived from the word 'ethics', in which, the Oxford Dictionary defines it as the moral principles that govern a person's behaviour or the conduct of an activity. Ethical behaviour involves the demonstration of key moral principles that include honesty, fairness, integrity and understanding. This type of behaviour is essential to the success of a business. On the other hand, unethical behaviour is an action that falls outside of what is considered to be morally right and can lead to consequences in the future due to misconduct.



Unethical practices in the securities industry

Investors should be aware of professionals recommending investments which seem unsuitable for their investment profile and strategies. Investors who may feel pressured to invest, or unwillingly invest, in risky trades may be victims of fraud and/or unethical practices. Examples of unethical practices in the securities industry include:

- **Insider Trading –** This involves trading of a public company's security utilising material non-public information. According to the SA 2012, material non-public information refers to any material fact or material change in relation to the securities of a Reporting Issuer that has not been published or disclosed to the public. Information is said to be 'material' where the disclosure of such information is likely to have an impact on the price of a security or affect the decision of a reasonable investor, in relation to the security. Persons are not allowed to act on material non-public information.
- **Front-running –** This involves trading ahead of orders so as to profit from market price changes which can result from large customer orders.
- **Churning** – This involves the Broker-Dealer intentionally buying and selling securities at an excessive rate in an investor's account in order to increase the Broker-Dealer's commission. Since Broker-Dealers are generally paid on a commission basis, this can be an incentive to make as many trades as possible.
- **Market Manipulation** – This involves the attempt to artificially distort the price of a security or a market movement with the intent to make a profit.

In the event that a Registrant is involved in unethical practices and found liable, the TTSEC will bring action against the Registrant. In accordance with Sections 156(1) and 165(2) of the SA 2012, the Registrant can be subject to a fine of five hundred thousand dollars (TT$500,000.00) and possible imprisonment for two (2) years. It should be noted that the TTSEC can only administer civil liabilities and criminal action is forwarded to the Director of Public Prosecutions (DPP).

Benefits of ethical behaviour

Registrants are encouraged to practise ethical behaviour as it benefits the entity in a number of ways. Practising ethical behaviours in business:

- **Enhances the Registrant's Reputation –** Ethical behaviour is crucial to success as it creates a positive image of the Registrant. However, a Registrant that engages in unethical practices will create a negative image for the company, and by extension the industry, resulting in the loss of customers.

- **Avoids Legal Problems –** Registrants who maintain a high ethical standard in their operations are very unlikely to find themselves in legal situations that involve ethical violations. As such, the company will avoid penalties, fines or other regulatory action related to unethical practices.
- **Builds Customer Loyalty** – Investors trust Registrants who practise ethical behaviours in their operations and tend to maintain a long-standing relationship with the Registrant. In light of this, the Registrant may pay less marketing fees in acquiring new customers to keep the business profitable.
- **Builds Investor Trust** – Transparent and ethical operations encourage confidence in the Registrant's investment abilities. Hence, investors may be more willing to have the Registrant act on their behalf.
- **Gives the Registrant a Competitive Advantage** – Registrants with business operations founded on ethical principles are more likely to be more attractive to investors and thus result in a competitive advantage within the industry.

In next week's article, the TTSEC will continue our discussion on the topic of ethics in the securities industry.

For more information, please visit our corporate website, www.ttsec.org.tt.
You may also visit our Investor Education website at www.investucatett.com or
connect with us via any of our social media handles:

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