Market Conduct and Securities Market Trading

Market participants, in the Trinidad and Tobago securities industry, are expected to conduct their business activities in a manner that contributes to the maintenance of a fair and orderly securities market. These expected behaviours are referred to as "market conduct" and encompass a number of best practice standards aimed at maximising clients' interests, promoting fair market trading and fostering a culture of efficiency and high standards.

In this article, we will look at some aspects of best practice market conduct for firms as they relate to the execution of trades on the securities market, as well as some unfair and unethical trading practices which can occur in the market. Shareholders should pay particular attention to the following and report any misconduct to the Trinidad and Tobago Securities and Exchange Commission (TTSEC).

MARKET CONDUCT AND BEST PRACTICE

Independence and Integrity

Firms must show integrity and deal with clients' money and assets in good faith. This means reasonable care and judgement should be exercised by firms, in order to maintain independence and impartiality when making investment decisions on behalf of clients; and they should also avoid situations that could cause conflicts of interest. Where conflicts of interest arise, firms should make full disclosure ensuring that such disclosures are factual, complete and presented in a format that communicates the information effectively. Trust is an important part of the relationship between firms and clients, and as such impartiality, honesty and full disclosure help maintain and build this trust.

Client Order Priority

A client order is an investor's instruction to a brokerage firm to buy or sell a security. This instruction usually specifies the type of order being placed, as well as, the quantity and price at which the order should be executed. Firms should give priority to client orders and such orders should be executed fairly with priority over house account orders; particularly in situations where there are orders for the same security at the same price. In instances where the firm is operating as both broker[1] and dealer[2], trading with its clients as the counter party, the firm must not offer trading positions that are unreasonable or disadvantageous to clients.

Timely and Best Execution of Trades

Client orders are received throughout the trading day and firms should affect and execute an order as soon as it is reasonably practicable to do so. Additionally, subject to any instructions provided by the client in relation to placing the order, the firm should use its best endeavours to obtain for the client the best available price at the point in time, given the size and type of transaction concerned. Other factors the firm may take into consideration, when executing orders on the basis of best execution, include the direction of the market for the security, the size of the spread and the liquidity of the security. The spread is the difference between the buying and the selling price of a security while liquidity refers to ease and speed at which a security can be bought or sold. Seeking timely and best execution at the point that the order is received, maximises client portfolio value for all client transactions and eliminates broker discretion that could potentially harm clients.

Notification and Settlement of Client Trades

Once a trade is executed on behalf of a client, the client must be notified immediately, in writing. Such notification should contain all pertinent details of the transaction, including quantity, price, fees/commissions and settlement information. Settlement of trades must be prompt and within the standards established by law or otherwise. The broker must ensure that the client provides evidence of sufficient funds to cover all costs associated with the transaction; in the case of the purchase of securities, and that the client owns/holds sufficient securities in the case of the sale of securities.

Clients' money must also be accounted for properly, thereby ensuring that funds received in settlement of an executed order are promptly allocated to the client's account. Clients' money must not be comingled with the firm's assets, used for another client's transactions or be made available in any circumstance for payment of any debt the firm may incur.

UNFAIR AND UNETHICAL TRADING PRACTICES

FRONT RUNNING

Front running is the unethical practice of brokerage firms trading securities for their own account on the basis of advance knowledge of pending orders from their clients so as to make a profit. Front running generally occurs when a brokerage firm buys or sells securities for its own account ahead of a large order to be executed (of which the firm is aware) which will shift the price of the

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[1] A brokerage acts as a broker when it executes orders on behalf of clients.

[2] A brokerage acts as a dealer when it executes orders on behalf of its own account.

security in the firm’s favour. The profit made on such a transaction is at the direct expense of the firm’s clients, thereby making such transactions unethical.

CHURNING

Churning takes place when trades are excessive in volume and frequency and are not in the best interest of the client. It occurs when brokers use their discretionary authority to misuse client accounts to generate commissions via excessive buying and selling of securities.

To assess if churning is taking place several factors are taken into consideration which include:

- the frequency of trades relative to the clients’ investment objectives;
- commissions, fees and other remuneration paid by clients;
- the clients’ financial situation; and
- the validity of each trading advice.

As such, since the main purpose of churning is to increase commissions, clients can avoid such activities by maintaining full control over their accounts.

INSIDER TRADING

Insider trading (Securities Act, Chapter 83:02, (SA) Section 100) occurs when persons trade on material non-public information. In a general sense, this type of trading occurs where persons who have access to price sensitive information, that has not been made available to the public, buy or sell securities on the basis of that information. It includes situations where not only persons with access to price sensitive information make trades on their own account, but also when these persons disclose insider information to another person or when these persons encourage other persons to act on insider information. As such, insider trading undermines investor confidence in the fairness and integrity of the securities market.

MISREPRESENTATION

Misrepresentation, which is provided for under Sections 60 and 93 of the SA, usually involves a deliberate intention to deceive or mislead clients for profit. Under such circumstances, firms make guarantees and/or assurances in relation to investment products, based on uncertain market factors, to induce clients to make investment decisions. Misrepresentation can occur when a firm fails to disclose all material risks related to an investment; where firms fail to disclose all costs related to a transaction, where unrealistic assumptions have been used in making investment projections and where inaccurate performance calculations have been presented to clients.

MARKET MANIPULATOIN

Market manipulation is a broad term which encompasses any action which distorts security prices artificially. Section 91 of the SA states, 'No person shall do anything, take part, carry out, or cause anything to be done, whether directly or indirectly, in one or more related transactions, with the intention that or being reckless as to whether such transaction has or is likely to have the effect of creating a false or misleading appearance of trading activity on a securities market. Such activities undermine the securities industry and prevent the market from being fair and equitable.

Unfair and unethical trading practices erode public confidence in the market. Therefore, firms should always consider how their actions affect the securities market and always consider market conduct best practices to improve industry standards, while avoiding the pitfalls of unfair and unethical trading practices. Protecting the best interests of clients must always be of utmost priority and not be subject to compromise.

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You may also visit our Investor Education website at **www.investucatett.com** or
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Published Article – Business Express Newspaper
August 18th, 2021