Role of “Duty of Care” in Successful Capital Markets

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The financial market consists of supply and demand sides, wholesale, retail and intermediaries. In this mix the retail, i.e. ordinary investor is at a considerable disadvantage in comparison to the better trained supply side market professional. When investing in listed securities, mutual funds, or buying insurance the ordinary investor must rely on the expertise of the financial market professional (market professional). Because of this reliance, the market professionals owe a duty of care to the person relying on their expertise and advice.

What is duty of care?

Legal dictionary defines duty of care as:

*“**A requirement that a person act toward others and the public with watchfulness, attention, caution and prudence that a reasonable person in the circumstances would; If a person's actions do not meet this standard of care, then the acts are considered negligent, and any damages resulting may be claimed in a lawsuit for negligence**”*

It is important to note that the world’s most successful capital markets share the following two essential characteristics:

1. Investors are protected because market professionals trading securities treat all investors fairly and honestly.
2. The regulatory framework and compliance by market professionals and others, whether directly or indirectly involved, ensures that markets are fair, efficient and transparent.

In order for these markets to have these essential characteristics it is important that market professionals and others, who are held in a position of trust, practice ” duty of care” when providing their services.

As a financial professional, how do you cultivate this habit of “duty of care” owed to the recipient of your services? You can accomplish this by observing the five internationally recognized fundamental principles of professional ethics that are a pre-requisite for practicing “duty of care”. They are: integrity, objectivity, professional competence, confidentiality, and professional behavior respectively. Here is a brief description of what is required by each one of these principles.

1. Integrity: You need to know your ethical values, and then do your utmost to model them in your behavior. Accordingly, you must be straightforward and honest in your professional and business dealings.
2. Objectivity: You must not allow conflict of interest, bias, or undue influence of others to prevail over your professional and business decisions.

3. Professional competence: You have a duty to maintain professional knowledge and skill in your profession that is based on current practice, regulation and technique.
4. Confidentiality: You must respect the confidentiality of information acquired through your professional and business relationships, and must not disclose such information to third parties without specific authority, unless there is a legal or professional obligation to do so. In addition, confidential information must never be used for personal advantage.
5. Professional behavior: you must comply with relevant laws and regulations applicable to your profession, and must avoid any action that discredits your profession.

It is important that all financial professionals in their respective professional capacity should identify, evaluate, and address threats to the fundamental principles of ethics and take appropriate measures to ensure that the principles are not compromised. This will help create a market environment where duty of care will evolve and services provided will be of the highest quality. This in turn, will help develop a market place that is not only fair, efficient and transparent, but that also protects the rights of all investors. Over time such markets develop a reputation for fair play and become the destination of choice for market related activities.

As financial professionals we not only owe a duty of care to our clients but also to the market place that provides us with our livelihood. We must take pride in our work, and practice "duty of care "by always doing what is right in compliance with rules and regulations.

How does duty of care apply to the various professionals involved in the financial market?

Brokers, investment advisors and fund managers: Duty of care requires that you always place your client's interest before your own. You must understand the product that you are selling, and fully explain the various positive and negative features to the investor. Further, when giving advice or investing on behalf of a client, you must keep in view the client's risk profile and the appropriateness of your recommendations. It is important to educate the client about the costs involved, the importance of their time horizon and the possible risk of loss due to forced sale during market volatility.

Research entities and analysts: A duty of care is owed to the users of buy, sell and hold recommendations. Benchmarks and data used in making predictions must be identified together with appropriate disclaimers that clearly explain to the user that predictions are guided by objectivity, based on estimates, and that investors must exercise caution.

Auditors: A duty of care is owed to the shareholders, investors, creditors and other users of financial statements who must rely on them for decision making and analysis. Auditors must exercise duty of care in the conduct of their audit, by ensuring that information provided in the financial statements is free from material misstatement, is complete, and includes all required disclosures. In Pakistan ICAP has adopted the internationally recognized fundamental principles of professional ethics of Integrity; Objectivity; Professional competence; Confidentiality; and Professional behavior. All chartered accountants should identify threats to the fundamental principles, and apply safeguards to ensure that the principles are not compromised.

Directors: An important fiduciary duty of care is owed to listed company shareholders. As representatives of shareholders the directors must act in a prudent manner that helps promote the company's best interest and protects the rights of all shareholders including minorities. Directors must ensure that all business decisions are free from conflict of interest. It is important that directors comply with the code of corporate governance 2012, which is part of the listing regulations of the Pakistan Stock Exchange.

In the backdrop of Pakistan's inclusion in the MSCI Emerging Market Index (MSCI-EM) in June 2016, and the anticipated inflow of foreign portfolio investment, the role of duty of care in improving the performance of our market cannot be ignored.

The ultimate responsibility for developing a culture of duty of care, by always doing what is right in compliance with rules and regulations, rests squarely on the shoulders of professionals and intermediaries who participate either directly or indirectly in the day to day operations of the market. In today's interconnected world, investors from around the world will flock to markets where they are assured that:

- investment professionals will place the investor' interest before their own ;
- their hard earned money will be safe and they can earn a reasonable return;
- fees charged will be reasonable ; and
- they can get their money back when they need it.

It is important to realize that developing a culture of duty of care will not happen overnight, and it will take time. But we must make a start now. Market professionals must show zero tolerance for fellow professionals who are breaking the rules by reporting them to enforcement authorities of their respective professions. They must take pride in their work, and all their work should be guided by a dedication to fair play and excellence.

In conclusion, by developing a culture of duty of care there is no reason why Pakistan's capital market cannot become a regional hub of choice for raising new capital and for listing securities. In addition, this will not only provide employment for our hardworking professionals but also help bring in new investors.

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