Proficiency requirements 2012

ANNUAL KNOWLEDGE UPDATE

SW. ÅRLIG KUNSKAPSUPPDATERING (ÅKU)

FINANSIELL LICENSIERING SWEDSEC

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Introduction

The function served by the proficiency requirements

This document defines the proficiency, in the form of an annual knowledge update, which is required as a complement to the licensing examination for SwedSec's licence holders. As in the licensing examination proficiency requirements, the proficiency requirements here are divided into sections (subject areas), subsections and checkpoints. A checkpoint specifies what the licence holder is expected to master within a limited field of knowledge.

The proficiency requirements are intended to function as a support when developing relevant syllabuses and also to serve as a basis when setting examination questions. They are designed to give an overview of what is expected of a licence holder. It is the task of each professional training provider to interpret the proficiency requirements and develop a relevant and instructive course based on such interpretation.

The table below describes various *cognitive levels*.

Level	Definition
Recall (R)	A candidate is required to recognise and remember concepts, definitions, and facts.
Comprehend (C)	A candidate is required to understand and be able to explain various connections and contexts.
Apply (P)	A candidate is required to be able to apply, for instance, formulae, rules, laws/acts, and methods
Analyse (A)	The licence holder is required to be able to interpret, evaluate, relate to, and draw conclusions from, the relevant knowledge.

For each checkpoint, there is a mark defining the cognitive level that the candidate must achieve regarding the knowledge in question. The level is denoted by the initial letter in the name of the level: *R, C, P, A*. The cognitive levels are interrelated and closely connected. If, for instance, a checkpoint refers to the cognitive level *Analyse*, there will be marks in the columns for *Recall*, *Comprehend*, *Apply* and *Analyse*. It is thus assumed that if a licence holder is able to analyse a certain piece of knowledge, he or she is also be able to apply it, understand it, and is familiar with it.

Section 1 -Savings and investments

Exchange traded funds (ETF) and other exchange traded products (ETP)

Investment funds are traditionally traded in such a way that, in the case of purchase, the investor (the fond unit holder) buys fund units from the fund management company, which issues new fund units in conjunction with the transaction. When the investor wishes to sell (redeem) his or her fund units, this takes place in a corresponding manner directly vis-à-vis the fund management company. In other words, trading takes place on a primary market.

There are, though, certain funds which also traded on a secondary market. These funds are referred to as exchange traded funds –or ETFs – and, as the name indicates, they are essentially traded in the same way as listed shares. The ETFs which are issued by undertakings within the EU are usually structured as UCITS funds.

Exchange traded funds are no new phenomenon; they have been around for a long time, especially in the US. In recent years, these products have become increasingly popular also in Europe. In 1997, there were in total 21 exchange traded funds worldwide; by January 2011, the figure had risen to over 2,500. According to BIS (Bank for International Settlement), at the end of 2010 they were traded on more than 40 exchanges and other marketplaces throughout the world and offered by approximately 130 so-called sponsors.

Exchange traded funds are usually pure tracker funds, with or without leverage. Most ETFs track broad equity indices, but there are also funds that track fixed income indices or commodities indices. With respect to exchange traded products (ETPs), the value of which is determined by the performance of a commodity, these are usually not issued as funds but, instead, as exchange traded certificates (ETCs, sometimes also called ETNs – Exchange Traded Notes). The reason for this is that, due to the need for diversification, these cannot be issued as a fund and are therefore packaged instead as certificates.

Usually, exchange traded funds have themselves invested in a portfolio of, e.g. shares which reflects the fund's benchmark index. In recent times, it has become increasingly common for such funds to create synthetic holdings by entering into a share swap (Total Return Swap)

with, e.g. a bank. The idea behind this is to enhance efficiency in the management of the fund and to reduce any tracking error[1] between the fund's NAV[2] the index's value.

The licence holder must be familiar with the information which must be provided to a client before a transaction is carried out on the client's behalf; see the section on UCITS IV. The licence holder must also be familiar with the differences between exchange traded funds which themselves hold the underlying assets, and funds which create a synthetic exposure with respect to the portfolio, and how these differences affect the risk for an investor. In addition, the licence holder must be familiar with the essential differences between an exchange traded fund and other similar exchange traded products (primarily ETCs and ETNs).

Certain information about ETFs is available through the following links:
http://www.esma.europa.eu/data/document/2011_220.pdf
http://www.bis.org/publ/work343.pdf
http://www.financialstabilityboard.org/publications/r_110412b.pdf

	Cognitive level			
Other funds (fixed income funds, mixed funds, hedge funds, exchange traded funds (ETF), etc.)	R	C		

Investment savings accounts (ISA) *Sw. Investeringssparkonto (ISK)*

[*Note that this section is currently based on a legislative proposal and may be changed.*]

On 1 January 2012, a new type of savings scheme subject to a default tax rate was introduced: the investment savings account. The assets on an investment savings account are taxed at a default rate, i.e. capital gains within the scope of the account are not taxed, and capital losses may not be deducted. The account holder is not required to report every capital gain or capital loss in his or her tax return.

The default rate taxation is based on a return being calculated for each year. An asset base is calculated first: one quarter of the value on the account at the beginning of each quarter,

[1] Tracking error (active risk) is a measurement of risk which describes how a fund's performance follows the performance of its benchmark index.

[2] NAV is the total value of the fund divided by the number of units in the fund.

together with deposits/withdrawals of cash and transfers of financial instruments which have been carried out each quarter. The asset base is multiplied by the government borrowing rate (at the end of November of the year prior to the tax year). The result of this calculation is a return which is reported in the category ‘income from capital’.

An investment savings account may include only the following:

- financial instruments which are admitted to trading on a regulated market (or on an equivalent market outside the EEA), or on a trading platform (MTF);
- units in an investment fund; or
- cash.

What are referred to as “qualified shares”, e.g. shares in closely held companies, etc. (see Chapter 57, sections 4-7b of the Income Tax Act) do not constitute permitted assets. If the holder directly or indirectly holds participating interests in a company which correspond to at least 10% of the voting capital or share capital, such interests also do not constitute permitted assets.

All other assets are impermissible assets.

A licence holder must be familiar with the way in which investment savings accounts are taxed and which assets are permitted.

At present, information regarding the investment savings account is available in a consultation response issued by the Council on Legislation:
http://www.regeringen.se/content/1/c6/16/85/68/706079eb.pdf
In addition, information is provided in the Government Offices of Sweden’s questions and answers:
http://www.sweden.gov.se/sb/d/14802

	Cognitive level			
Investment savings accounts - taxation and permitted assets	R			

Tax rules for investment funds and their unit holders

[*Note that this section is currently based on a legislative proposal and may be changed.*]

The tax rules for holders of units in investment funds, and for investment funds, changed on 1 January 2012, which affects everyone who holds or has held a fund during 2012.

Investment funds are no longer liable to taxation in respect of income from assets held by the fund. The changes mean that funds registered in Sweden which previously issued dividends in order to avoid double taxation for the fund unit holders now not need issue any dividends. As a consequence of the changed rules, from a tax perspective there are no differences between investing in a Swedish fund and a foreign-registered fund.

Instead, the party which holds units in an investment fund (Swedish or foreign) must report a default income (*Sw. schablonintäkt*) which is calculated based on the value of the unit holder's fund units at the beginning of the calendar year, increased by the value at the time of acquisition of the units purchased during the year. The default income is thereafter calculated by multiplying this value by 0.4 per cent.

Default income of less than SEK 200 (the threshold for state income tax) will not need to be taxed, and consequently the majority of people below the age of 18 will neither be obliged to file a tax return nor to pay tax in respect of any default income. Dividends to unit holders, as well as capital gains when the units are sold, will be taxed in the same manner as previously. The foregoing applies correspondingly to deductions in the case of losses. The foregoing also applies as regards the tax rate for both natural persons and legal entities.

The licence holder must be able to explain and calculate the tax base in respect of the unit holder's holdings, and understand the changes that have taken place as regards taxation of Swedish investment funds.

For information regarding the tax rules governing investment funds and their unit holders, see: http://data.riksdagen.se/fil/16916c70-0c4b-4749-a76a-8242f0222bdd

	Cognitive level			
Taxation of Swedish shares and funds	R	C		
Taxation of foreign shares and funds	R			
Capital taxation	R	C	P	
Private finances in light of the tax system	R	C	P	

Section 3 -Financial economics

Establishing an appropriate risk level for the client

Prior to the provision of financial advice/ management services, a thorough analysis must be conducted as regards the appropriate risk level. As professional investors, the Swedish National Pension Funds (*Sw. AP fonder*) and other major players possess significant resources and know-how in order to conduct this risk evaluation independently. They evaluate the risk-taking applying an ALM (asset liability modelling) method, entailing that the longer the investor's investment horizon, the higher the normally permissible risk level. As regards private individuals and smaller institutional investors, the responsibility for carrying out this evaluation lies with the adviser/management company.

In order to be able to carry out this analysis, detailed information must be compiled regarding the asset owner/client, for example, the amount of the wealth, in order to assess the scope of the service from an overall perspective in terms of investment horizon, risk preferences and objectives, in order to assess an appropriate risk level. This constitutes a prerequisite for offering a solution which is tailored to, and appropriate for, the specific circumstances of the individual client.

A licence holder should be familiar with accepted asset liability modelling methods and be able to assess a suitable risk level for clients.

Risk management in practice

Developments on the financial markets in recent years have sharply increased the focus on targeted risk management. The financial crisis of 2008 and subsequent sovereign debt crisis have led to many important lessons, among other things since events occurred that statistically speaking should not have occurred. This, in turn, has led to stress testing of a large number of risk quantification methods and it has become particularly clear that many risk measurements/risk assessments are merely a simplification of reality. Accordingly, the risk management work among professional players has developed towards an increased understanding of actual risk, and that extreme events are more common than predicted by statistical methods.

A licence holder should have an understanding of the risk management work in a broad sense, including the limitations and simplifications that result from accepted risk measurements. Liquidity risks are particularly important, for example where a large block of shares in a small listed company cannot be sold at the most recent listed price due to a lack of buyers. The combination of other risk taking and losses, together with financial turbulence, has also resulted in large-scale forced sales. This has elucidated the liquidity risk, since the sales have been forced to take place at a significant discount due to lack of buyers in the market. It is thus important to understand and be able to assess various risks, and whether they are appropriate for different types of clients. Knowledge of the difference between theory and practice also involves measures of risk-adjusted return, e.g. Sharpe ratio and Jensen's alpha, including their advantages and disadvantages.

	Cognitive level			
Asset liability modeling	R	C	P	
Credit risks and counterparty risks	R	C	P	
Market risks (interest rate, currency, and price risks)	R	C	P	
Liquidity risks	R	C	P	

Section 4 -Ethics and rules and regulations

Investment fraud

The number of cases of investment fraud has increased in recent years. The fraudsters often turn to the banks' clients. And the clients, in turn, consult their ordinary adviser or bank contact person to obtain advice on how they should act, and perhaps to transfer money, etc.

The frauds are often based on the client investing in some security or other product which will generate a fantastic return, not infrequently with the added attraction of a tax advantage bordering on the unlawful. It also happens that the fraudsters return to clients who have previously been duped, e.g. by the fraudster offering, in exchange for payment, to convert the unsellable security which the client was once duped into buying. Or even more cunningly – pretending to be a foreign supervisory authority or law firm which will assist the client in recovering their money –naturally, in exchange for a fee.

Some warning signs about investment fraud are:

It's too good to be true – This is a simple rule of thumb. If it appears to be too good to be true, that's probably exactly what it is – not true.
Securities or investments that one doesn't really understand – one should be sceptical as regards foreign physical securities (share certificates and all forms of debt instruments) and securities that are listed on some trading platform with which one is unfamiliar.
Payment in advance – Many investment frauds are based on the client being required to pay some form of fee or tax in advance in order to obtain their securities or money, or to convert their securities into dematerialised securities.
Companies and funds without a license in Sweden – one should ask oneself why somebody who, for example, is sitting on the other side of the world should seek out an individual Swedish citizen in order to offer this fantastic investment to him or her. The most likely answer is "because it's a fraud".

A licence holder should recognise the warning signs of investment fraud in order to be able to warn clients and assist the client in obtaining more information.

More information is available on the Swedish Financial Supervisory Authority's website, which carries a list of companies they warn about regarding, e.g. investment frauds, examples of warning signs, etc. http://www.fi.se/Templates/AlertListPage____6163.aspx.

	Cognitive level			
Recognise and understand investment frauds	R	C		

Section 5 -Rules and regulations in the securities market

UCITS IV

On 1 August 2011, a number of new rules governing funds were introduced based on amendments to the EU's UCITS Directive.

Licence holders must be familiar with the major changes, i.e. must;

- know that a fund management company in one country can manage a fund in another country;
- be familiar with the concepts of master fund/feeder fund and how such funds operate;
- know that funds can be merged and split, and what this entails for the unit holders; and
- the main features of the new provisions regarding simplified prospectuses (referred to as KIID, Key Investor Information Document) –what they must contain and who is responsible for ensuring that clients receive the simplified prospectus.

Information is available in the Government Bill regarding the legislative amendments:
http://www.regeringen.se/content/1/c6/16/77/26/80eaa6cf.pdf

	Cognitive level			
The Investment Funds Act: fund management companies, foreign collective investment undertakings, mutual funds, special funds, depositaries	R	C		
Simplified prospectus and other information to clients	R	C		

Case descriptions

Purpose and area of use of case descriptions

SwedSec has decided that each year the annual knowledge update must include at least one case description. The case descriptions depict different situations which the licence holders may encounter in their work, and contain dilemmas in respect of which there is sometimes no correct answer; instead, the situation is more complex in nature. Even if there is a correct or obvious alternative, the licence holder should understand why that is the case – i.e. the ethical or moral considerations on which a certain rule might be based.

The purpose of the case descriptions is to serve as a basis for skills development and greater in-depth knowledge. Through such knowledge, SwedSec wishes to contribute with content (but not method) as regards each affiliated company's work going forward, i.e. it is up to each employer to decide *how* these cases are to be used. For example, seminars might be held for in-depth discussions in which several perspectives may be shown to advantage and/or the content of the case descriptions might be integrated in what is referred to as e-learning, provided that the content is structured in such a way as to reflect the same complexity as in these case descriptions. The case descriptions themselves may also need to be tailored to the operations of the individual affiliated company. It may very well be the case that the issues addressed in the descriptions can be better addressed through entirely different scenarios. This is up to the individual affiliated company – the essential thing is that the issues raised in the case descriptions are addressed in the seminar/training course and that the seminar/training course is carried out in such a manner that the licence holder doesn't merely "tick the correct box" or learn a certain rule, but rather reflects over why one particular alternative is better than another.

A case description is included in the proficiency requirements for the annual 2012 proficiency update.

Ethics case Annual Knowledge Update 2012

Note that the case below is not based on any event that has occurred. The case has been made deliberately incisive in order to clearly illustrate the issues that arise. The case primarily brings to the fore the rules regarding how the provision of investment advice is to be carried out, as well as the more general provisions in the Securities Market Act that the best interests of the client must be protected and regarding the handling of conflicts of interest. Thus, the case does not address the new so-called bonus rules which the Financial Supervisory Authority has introduced through FFFS 2011:1 and FFFS 2011:2.

Eva works as a financial adviser at a securities institution. The clients can, in principle, trade in all types of financial instruments through the institution. The institution issues its own financial instruments, but also offers instruments issued by other institutions. In those cases where the institution provides both its own and third-party products (of the same type), the institution's profit is larger when the institution sells its own products.

Eva and the other investment advisers at her department have fixed salaries and receive no variable remuneration. When considering salaries/careers, the institution applies a number of different parameters, such as client satisfaction, ability to collaborate, diligence, and judgement, etc. However, all else being equal, success in sales results in increased chances to succeed in salary negotiations and advance in one's career.

In connection with a reorganisation, the investment advisers obtain a new manager. The new manager is energetic and anxious that the department will deliver a strong result. The manager also wishes to find new ways to increase the advisers' motivation. In order to spur on the advisers to achieve even better results, the manager decides that the advisers' sales will be visible for the entire department, and that the adviser who sells the most per month (calculated in gross volume per sold product) will receive a gift voucher of SEK 1,000 paid for by the institution. The manager also establishes, and regularly refers to, a sales target for the entire department. The target is ambitious, especially as regards the bank's own products.

Eva is a single-minded and somewhat competitive individual. She has now learned that an attractive position at the institution will become vacant in half a year, and thus she really wishes to do as well as possible, not least as regards sales results. In addition, she is incentivised by the sales competition, which she considers to be an honour to win, and by the possibility in any case of negotiating a good increase in salary, even if she does not get the job.

In order to be able to sell as much as possible, in conjunction with advice/sales she now focuses on low risk instruments (primarily long fixed income funds) which are easy to explain to the clients and can thus be sold easily and quickly. This suits most of her clients, but there are also clients for whom other investments would have been more appropriate. In order to contribute to the sales targets and the bank's profitability, she sells exclusively the bank's products, even when there are products from other issuers that are equally appropriate and, in some cases, even better.

Thanks to her work efforts and selective sales method, she succeeds very well with sales and also wins the sales competition.

Her diligence pays off. After half a year, she gets the desired job, in part due to her successful sales.

Issues to discuss

• What circumstances may result in an adviser running the risk of serving his own interests, or those of the institution, rather than the client's interests?

• How should an institution structure its reward system for advisers – in broad terms, i.e. also covering career possibilities, position, benefits, work duties, etc. – if the institution wishes to avoid/reduce conflicts of interest between the client and the adviser?

• Assume that the institution in the case had paid variable remuneration to its advisers. What advantages and disadvantages (for advisers) are there with such a system? How does it affect the conflicts of interest between the client and the adviser?

• How can/should the institution act to avoid/reduce conflicts of interest between the client and the institution?

• When does the provision of advice become marketing/sales?

• Must/should the client receive information about internal reward systems regarding advisory services? In such case, what information?

The purpose with the case

The purpose with the case is to illustrate that if an adviser provides advice regarding products which, when sold, provide the adviser (and/or the institution) with some form of extra reward, there may be an increased risk of a conflict between the interests of the client, on the one hand, and those of the adviser (and the institution) on the other. The reward can consist of commission or other variable remuneration, but also of more indirect pecuniary remuneration (e.g. increased fixed salary) and/or rewards which do not directly involve money (e.g. improved career possibilities).

It easily happens that the provision of advice also contains elements of selling and marketing. It is in the nature of things that as the likelihood of this increases, the greater the conflict between the interests of the client, on the one hand, and those of the adviser/institution, on the other. Maintenance of the boundary between advice and selling is prerequisite for compliance with the rules governing the provision of advice.

Nor are there any specific rules as to how the reward system for advisers should be structured. Each institution and adviser should, however, be aware of the fact that benefits linked to increased sales may risk threatening the adviser's objectivity, since there is a risk that the

advice will be dictated by the benefit, and not by the client's best interests. Since rewards are a strong motive force, this influence may be subconscious.

This obviously does not mean that there may never be any reward system. Reward systems can contribute to increased efficiency and motivation, and to the adviser doing a better job, to the advantage of both the clients and the adviser personally (and the institution). Nor are rewards injurious *per se*. If a product generates the same result for the client, but more for the adviser or the institution, there can be nothing wrong in selecting the product. However, in such situations it is important that suspicions do not arise that the adviser/institution has benefited himself/itself at the client's expense, since such suspicions may damage confidence in the institution and in the securities market generally.

As regards rewards for advisers, it is of course also important that the employer does not merely consider the sales result, sales volumes, etc. There should, instead, be an overall assessment in which the quality of the advice is not least of key importance.

However, as stated above, reward systems make it more difficult to maintain the boundary between the provision of advice and selling/marketing. If an institution has commission and variable remuneration, the institution's guidelines should be so structured ─ and clearly establish ─ that the risk of the commission system influencing the adviser's objectivity, or otherwise impacting on the quality of the advice give, is as small as possible.

As regards information to clients, a prerequisite for the correct application of rules and regulations is that the institution/adviser makes it clear to the client that it/he is acting as an adviser or seller. There are, though, no specific rules requiring an institution to provide information about the remuneration received by advisers. However, this should be mentioned insofar as it may risk influencing the adviser's advice. (Cf. that the adviser is required to provide information regarding "the conditions for the provision of advice"; Chapter 16, section 9 of FFFS 2007:16.) This is primarily of relevance when the adviser receives variable remuneration. Note that a violation of the requirement that the client receive the most appropriate advice cannot be "cured" (as may be the case in conjunction with some other conflicts of interest) by the client receiving information about the remuneration that the adviser might possibly receive.