

CFP BOARD

GUIDE TO MANAGING MATERIAL CONFLICTS OF INTEREST

CFP BOARD'S CODE OF ETHICS
AND STANDARDS OF CONDUCT

GUIDE TO MANAGING MATERIAL CONFLICTS OF INTEREST

The Duty to Manage Conflicts of Interest is one of the most important duties of a CFP® professional set forth in CFP Board's *Code of Ethics and Standards of Conduct (Code and Standards)*. This guide addresses some approaches a CFP® professional may take to fulfill that duty. CFP Board intends for case studies to apply these approaches to specific factual circumstances.

Conflicts of Interest are present in every business model. A CFP® professional must be aware of the Material Conflicts of Interest that are present in the CFP® professional's practice. Material Conflicts of Interest most commonly arise from a CFP® professional's receipt of cash or non-cash compensation (both direct and indirect), but there are other kinds of conflicts.

The conflict management tools that are available to a CFP® professional depend on the CFP® professional's Control over the CFP® Professional's Firm. Some CFP® professionals have positions of authority that enable them to eliminate or minimize incentives to place the CFP® professional's interests or the interests of the CFP® Professional's Firm above the interests of the Client. All CFP® professionals may utilize business practice processes reasonably designed to ensure that the CFP® professional acts in the best interests of the Client.



Conflicts of Interest are present in
every business model



THE RELEVANT STANDARDS OF CONDUCT

The *Code and Standards* does not require a CFP® professional to eliminate Conflicts of Interest. CFP Board's *Code of Ethics* provides that a CFP® professional must either (a) avoid or (b) disclose and manage conflicts of interest. The *Standards of Conduct* elaborates upon this principle in the Fiduciary Duty (Standard A.1.). One of the three duties that a CFP® professional must fulfill to satisfy the Fiduciary Duty is the Duty of Loyalty, which includes specific conflict of interest requirements. The Duty to Disclose and Manage Conflicts of Interest (Standard A.5.) captures these requirements in detail. If a CFP® professional does not avoid Material Conflicts of Interest, then a

Relevant Definitions:

Conflict of Interest:

When a CFP® professional's interests (including the interests of the CFP® Professional's Firm) are adverse to the CFP® professional's duties to a Client; or When a CFP® professional has duties to one Client that are adverse to another Client.

Material:

Information is material when a reasonable Client or prospective Client would consider the information important in making a decision.

CFP® professional must:

-  **1** Fully disclose Material Conflicts of Interest,
-  **2** Obtain the Client's informed consent to the conflict, and
-  **3** Manage the conflict by adopting and following business practices reasonably designed to prevent Material Conflicts of Interest from compromising the CFP® professional's ability to act in the Client's best interests.



Material Conflicts of Interest may not compromise a CFP® professional's ability to act in the **best interests of the Client.**



THE THREE-STEP PROCESS FOR MANAGING CONFLICTS UNDER THE *CODE AND STANDARDS*

A CFP® professional may manage Material Conflicts of Interest in a variety of ways, including through a combination of several methods. CFP® professionals will need to consider the Material Conflicts of Interest that arise in their own practices and determine which conflict management approaches are reasonably designed to prevent a particular Material Conflict of Interest from compromising their ability to act in the best interests of the Client. Some methods may be reasonable in certain circumstances but not in others.

In developing and adopting business practices for conflicts management, a CFP® professional should follow a three-step process:

1

Identify Material Conflicts of Interest

Develop (and periodically review and update) a comprehensive list of the Material Conflicts of Interest that may arise in the CFP® professional's practice.

2

Review & Evaluate Existing Practices for Management of Conflicts

Review the CFP® Professional's Firm's conflict management or mitigation practices and any additional conflict management practices that the CFP® professional follows.

3

Implement Any Additional Conflict Management Practices

Consider any additional steps the CFP® professional needs to take to properly manage conflicts under the *Code and Standards* and implement any such practices.

The first step in managing conflicts is to develop a comprehensive list of the Material Conflicts of Interest that may arise in the CFP® professional's practice. A CFP® professional may find that the CFP® Professional's Firm already has compiled such a list. Then, for each identified conflict, a CFP® professional should review the CFP® Professional's Firm's conflict management or mitigation practices and the additional practices that the CFP® professional follows and evaluate whether these existing practices are "reasonably designed to prevent Material Conflicts of Interest from compromising the CFP® professional's ability to act in the Client's best interests." If not, then the CFP® professional must implement additional conflicts management practices to satisfy the Duty to Manage Conflicts of Interest set forth in the *Code and Standards*.

CFP Board deliberately adopted a principles-based duty to allow CFP® professionals flexibility in developing business practices for conflicts management that fit their circumstances. With the introduction of new investment types, products, investment strategies, and account types, however, such business practices must evolve to adapt to new and different conflicts of interest.

The greater the conflict of interest, the more closely CFP Board will scrutinize the CFP® professional's approach to conflict management. A Material Conflict of Interest may be so great that it cannot be managed in the Client's best interests and therefore must be avoided. This includes, for example, the receipt by a CFP® professional of certain non-cash compensation such as sales contests, trips, prizes, and other similar bonuses that are based on sales of certain securities or accumulation of assets under management.





A CFP® PROFESSIONAL'S PROCESS TO MANAGE COMPENSATION CONFLICTS

The potential for a CFP® professional to earn more compensation by recommending one investment or investment strategy over another investment or investment strategy is one of the most common types of Material Conflicts of Interest. For example, a CFP® professional (or the CFP® Professional's Firm) may receive more or less compensation based on recommendations of different types of investments (e.g., mutual fund versus an annuity), different offerings within investment types (e.g., stock mutual fund versus bond fund), or different account types (e.g., an account that pays fees versus an account that pays commissions). Material Conflicts of Interest also arise when a CFP® professional is evaluating whether to recommend investments or investment strategies that will provide compensation to the CFP® professional instead of other investments or investment strategies that will not provide compensation to the CFP® professional (e.g., using assets to invest versus paying off debt or retaining funds in an employer plan versus rolling them into an Individual Retirement Fund ("IRA")). Management of such conflicts will require a process, in accordance with the CFP® professional's Duty of Care, reasonably designed to result in Financial Advice that is in the Client's best interests, despite the conflict of interest.



Some common conflict scenarios include:

Rollovers from an Employer Plan to an IRA

When recommending a rollover from an employer plan, such as a 401(k) or 403(b) account, to an IRA, the conflicts of interest can be difficult for a CFP® professional to manage through an approach that is designed to eliminate or minimize the differential in compensation (e.g., of the CFP® Professional Firm will not receive compensation if the assets stay in the plan but will receive compensation if the assets are rolled to an IRA). Accordingly, the CFP® professional needs to have a prudent process for making a rollover recommendation that is in the best interests of the Client.

Using Assets to Invest Versus Paying off Debt

When a CFP® professional recommends that a Client invest assets rather than use the assets to pay off debt, the conflict of interest also is difficult for the CFP® professional to manage through an approach to eliminate or minimize the compensation differential. Like the rollover example, there likely would be either no compensation to the CFP® professional or the CFP® Professional's Firm, or significantly less compensation, if the Client pays off debt than there would be if the Client invested the assets. Here too, the CFP® professional will need a prudent process for recommending what is in the best interests of the Client.

Recommending an Asset Allocation Strategy

If the asset classes of the investments under consideration (e.g., equity versus fixed income funds) offer different compensation, as is often the case, then the CFP® professional's compensation will vary depending on what asset allocation the CFP® professional recommends. Accordingly, the CFP® professional will need a prudent process for recommending an asset allocation that is in the best interests of the Client.

In each of these circumstances, a CFP® professional can manage the Material Conflict of Interest by relying on a prudent process to determine which alternative is in the best interests of the Client based on the Client's goals, risk tolerance, objectives, and financial and personal circumstances. That process must reflect the practices of a prudent CFP® professional. The process may be proportional to the size of the conflict. The greater the conflict of interest, the more carefully CFP Board will scrutinize the conflict management process. A CFP® professional also should consider documenting the basis for the recommendations, including the conflict management process that the CFP® professional followed.



COMPENSATION MODELS OR STRUCTURES

A CFP® professional also should be aware of the various compensation structures or models that can help manage Material Conflicts of Interest by reducing or eliminating the differential in compensation, including:



Level Compensation

A CFP® professional may receive “level” compensation, for example, by a firm paying a CFP® professional the same amount of compensation regardless of the investment or investment strategy that the CFP® professional recommends. This structure may help a CFP® professional manage compensation conflicts.



Receiving Differential Compensation Based On Neutral Factors

When choosing between recommending two or more different types of investments (such as an annuity or a mutual fund) that offer different levels of compensation, Material Conflicts of Interest may be managed by basing any compensation differential on neutral factors that reflect the difference in the work or expertise that is needed to develop and implement the recommendation.



Other Compensation Models

Material Conflicts of Interest also may be managed through compensation models that place less or no emphasis on the individual investments or investment strategies recommended, such as flat fee arrangements, fee arrangements based on assets under management, or hourly fee arrangements.

There are different levels of control over the compensation that a CFP® professional may have at the CFP® Professional’s Firm, and this may affect how a CFP® professional manages such conflicts. One alternative for a CFP® professional who Controls a firm is to employ policies and practices to help reduce the conflicts that arise from such compensation differentials. However, a CFP® professional who has Control is not required to do more than a CFP® professional who does not have Control. In any circumstance, a CFP® professional may manage compensation conflicts through a process, consistent with the CFP® professional’s Duty of Care, that is reasonably designed to result in Financial Advice that is in the Client’s best interests despite the conflicts of interest. A CFP® professional’s lack of Control over the CFP® Professional’s Firm does not absolve a CFP® professional of the responsibility to disclose and manage conflicts of interest. In all cases, a CFP® professional has a duty to act in the Client’s best interests in addressing these issues. If a CFP® professional is unable to do so, then the CFP® professional may need to limit the Scope of Engagement or decline to provide the Financial Advice.

No particular compensation model is free of conflicts. Whether a particular account type is in the best interests of the Client depends on the Client’s particular facts and circumstances.

CFP Board developed this guide to identify some general approaches a CFP® professional may take to fulfill the Duty to Manage Material Conflicts of Interest. CFP Board will continue to develop case studies, including with respect to conflict management, that apply the *Code and Standards* to specific factual situations.



Regardless of compensation structure, a CFP® professional needs to
adopt processes to manage conflicts
to ensure that the Financial Advice is in the best interests of the Client.



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