CHARTA LEARNING · LESSON NOTES

Conflicts of interest and your responsibilities as a member or candidate

CFA Level I · Ethical and Professional Standards

You will learn: Apply Standard VI (conflicts of interest) and Standard VII (responsibilities as a CFA Institute member or CFA Program candidate) to short cases: avoid or disclose conflicts, put clients' trades first, disclose referral fees, protect the exam, and describe your credentials exactly.

Running example: Examples use made-up people and firms and made-up figures.

1. VI(A) Avoid or Disclose Conflicts

- A conflict of interest is a situation where your own interest, or someone else's, could pull against your duty to a client or your employer.
- Members and candidates must avoid, or make full and fair disclosure of, all matters that could reasonably be expected to impair independence and objectivity or interfere with duties to clients, prospective clients and the employer.
- The twelfth edition names avoidance in the Standard itself, and it comes first. Order: spot the conflict (would a reasonable investor want to know?); avoid it if reasonably possible; if not, mitigate; then disclose, prominently, in plain language and effectively. A footnote on page forty does not do the job.
- Typical sources and first move: owning the stock you recommend (step aside); an investment banking tie to a company (disclose); pay that rises with product sales (decline); a gift or payment from a promoter (decline).
- Disclosure is a fallback, not a cure-all. It never excuses an act another Standard prohibits, such as trading on inside information.

CASES 1 AND 2

Mira's spouse inherits 4,000 shares	4,000 × $60	**$240,000**
Share of household savings of $600,000	240,000 ÷ 600,000	**40%**
Mira's verdict	nothing wrong so far; Jonas can write the report	**avoid (step aside)**
Daniel: $2 extra per share, 5,000 shares	2 × 5,000	**$10,000**
Daniel's verdict	he can decline, so small-print disclosure fails	**breach**

Watch out: Avoidable but disclosed instead: breach. Unavoidable but disclosed in small print: breach. Unavoidable and disclosed plainly: acceptable.

2. VI(B) Priority of Transactions

- Transactions for clients and the employer must have priority over transactions in which the member or candidate is the beneficial owner. Personal investing is not banned; the order matters, and you must never disadvantage a client through your own trading.
- Front running is buying or selling for yourself ahead of a client order you know is coming, to profit from the price move it causes. The test is priority, not size or price impact.
- Firm controls: blackout periods (a window around client trades when staff may not trade the security), restricted lists, pre-clearance by compliance, and reporting of personal holdings.
- Oversubscribed offering: every share the manager takes is a share a client does not get. No disclosure changes that arithmetic.

CASE 3: SANA BUYS BEFORE HER FUND'S 600,000 SHARE ORDER

Her own purchase the day before	3,000 shares at $40; price rises to $41	**gain 3,000 × $1 = $3,000**
Her defence: size	3,000 ÷ 600,000	**0.5%: no defence**
Verdict	traded first and profited from the clients' move	**VI(B) violation (front running)**
Kofi: 200 × $25	pre-cleared, reported, not restricted	**$5,000: allowed**

Watch out: Thinking VI(B) bans personal investing; thinking a small trade cannot matter.

3. VI(C) Referral Fees

- Members and candidates must disclose to their employer, clients and prospective clients any compensation, consideration or benefit received from or paid to others for the recommendation of products or services. Referral fees are not banned, they must not be hidden.
- Purpose: the client can judge how objective the recommendation is and what the relationship costs. Disclose before the client engages the service. Telling them afterwards is too late.
- Anything of value counts, not just cash: cash fees, a percentage of assets referred, reciprocal referrals (swaps of clients with no money), discounts and benefits in kind. It covers fees you pay as well as fees you receive, so the payer has its own duty to disclose.

CASES 4 TO 6

Lena: custodian pays 0.25% of Thandi's $450,000	450,000 × 0.25%	**$1,125 a year: disclose before she acts**
Ines pays accountant Hugo 15% of first year fee	fee 1% × 300,000 = 3,000; 15% × 3,000	**$450: Ines must disclose**
Lena and lawyer Marcus swap clients	no cash, but each gains something of value	**disclose before signing**

Watch out: Disclosing after the client has signed; counting only cash; thinking an old advisory agreement covers a new recommendation.

4. VII(A) Conduct as Members and Candidates in the CFA Program

- Members and candidates must not engage in conduct that compromises the reputation or integrity of CFA Institute or the CFA designation, or the validity of the exams. This includes cheating, disclosing exam content to others (even only the broad topics tested), and removing materials from the testing room.
- Why: a leak, even with a kind motive, stops the exam measuring what people know and makes the charter mean less for every holder. A good motive is no defence.
- Opinions about the institute's policies, programme and fees are allowed. Anything about the exam itself is not.

CASE 7: WHO BREACHED?

Tomas: post one	fee too high; topic weights shortchange ethics	**opinion: allowed**
Tomas: post two	3 questions on bond duration, a long pensions set	**exam content: breach**
Anika tells a friend	heavy on fixed income, light on derivatives	**broad topics: breach**
Rohan takes scratch notes out	removing materials	**breach**

5. VII(B) Reference to CFA Institute, the CFA Designation and the CFA Program

- Members and candidates must not misrepresent or exaggerate the meaning or implications of membership, holding the designation, or candidacy. There is no partial designation: a candidate may state facts (a candidate, passed a level) but may not use a title such as Level II CFA.
- Do not claim the charter guarantees better results.
- The marks CFA and Chartered Financial Analyst must be used as adjectives, never as nouns, in the plural or possessive. The noun is charterholder.
- Stages: enrolled, say you are a candidate in the CFA Program; passed a level, say which level; charter awarded after all three levels and other requirements, then use the designation.

CASES 8 AND 9

Maria Lopez, CFA charterholder / Maria is a CFA	adjective vs noun	**correct / wrong**
Our four CFAs / the CFA's view	plural / possessive	**wrong / wrong**
Rafael: A Level II CFA, B a partial CFA, C passed Level II and a candidate for Level III	fact or invented status?	**only C is correct**
Fieldstone: return 8.4% vs benchmark 7.2%	8.4% − 7.2%	**1.2 points; crediting it to the charter is wrong**

Key takeaways

- VI(A): avoid a conflict where reasonably possible; otherwise mitigate and disclose prominently, plainly and effectively.
- Disclosure never excuses an act another Standard prohibits.
- VI(B): clients and the employer go first. Personal investing is allowed, front running is not.
- Firms use blackout periods, restricted lists, pre-clearance and holdings reports.
- VI(C): disclose any referral benefit, cash or not, received or paid, before the client signs.
- VII: opinions on policy are fine, exam content is not; state facts about candidacy, no partial designation, marks as adjectives.

Quick check

1. Broker could decline a per-share bonus but discloses it. Enough?
   Answer: No: avoidance is preferred where reasonably possible, so disclosure alone falls short.
2. Referral payment disclosed the day after the client signs?
   Answer: No: disclosure must come before the client engages the service.
3. Candidate passed Level II prints 'Level II CFA'. Allowed?
   Answer: No: there is no partial designation; she may state that she passed Level II.