Standard VI(A) Avoid or Disclose Conflicts
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Members and Candidates must avoid or make full and fair disclosure of all matters that could reasonably be expected to impair their independence and objectivity or interfere with respective duties to their clients, prospective clients, and employer. Members and Candidates must ensure that such disclosures are prominent, are delivered in plain language, and communicate the relevant information effectively.

Guidance

A conflict of interest is any matter that could reasonably be expected to impair independence and objectivity or raise a question about whether actions, judgment, or decision making is free from bias. Conflicts of interest occur when there is a personal or professional interest that may impair a member's or candidate's ability to perform his or her professional responsibilities in an independent and objective manner. Conflicts of interest often arise in the investment profession. They can occur between the interests of clients, the interests of employers, and the member's or candidate's own personal interests. A common source of conflict is compensation structure, especially incentive and bonus structures that provide immediate returns for members and candidates with little or no consideration of long-term value creation. Identifying and managing conflicts of interest are critically important to engaging in ethical conduct.

Best practice is to avoid actual conflicts of interest and the appearance of them. When it is not reasonable for members and candidates to avoid a conflict, clear and complete disclosure of the conflict is necessary. Members and candidates should also seek to mitigate the conflict to the extent possible and disclose how the conflict has been mitigated.

Standard VI(A) protects investors and employers by requiring members and candidates to avoid or fully disclose to clients, potential clients, and employers all actual and potential conflicts of interest. When a member or candidate has made full disclosure of an unavoidable conflict, the member's or candidate's employer, clients, and prospective clients will have the information needed to evaluate the objectivity of the investment

advice or action taken on their behalf
To be effective, disclosures must be prominent and must be made in plain language and in a manner designed to effectively communicate the information. Members and candidates are responsible for determining how often, in what manner, and in what particular circumstances the disclosure of conflicts must be made. Best practice dictates updating disclosures when the nature of a conflict of interest changes materially—for example, if the nature of a conflict of interest worsens through the introduction of bonuses based on each quarter's profits as opposed to annual profits. In making and updating disclosures of conflicts of interest, members and candidates should err on the side of caution to ensure that conflicts are effectively communicated.

Disclosure of Conflicts to Employers
Disclosure of conflicts to employers may be appropriate in many instances. When reporting conflicts of interest to employers, members and candidates must give their employers enough information to assess the impact of the conflict. By complying with employer guidelines, members and candidates allow their employers to avoid potentially embarrassing and costly ethical or regulatory violations.

Reportable situations include conflicts that would interfere with rendering unbiased investment advice and conflicts that would cause a member or candidate to act not in the employer's best interest. The same circumstances that generate conflicts to be reported to clients and prospective clients also dictate reporting to employers. Ownership of stocks analyzed or recommended, participation on outside boards, and financial or other pressures that could influence a decision are to be promptly reported to the employer so that their impact can be assessed and a decision on how to resolve the conflict can be made.

The mere appearance of a conflict of interest may create problems for members, candidates, and their employers. Therefore, many of the conflicts previously mentioned may be explicitly prohibited by an employer in order to avoid those conflicts altogether. For example, many employers restrict personal trading, outside board membership, and related activities to prevent situations that might not normally be considered problematic from a conflict-of-interest point of view but that could give the appearance of a conflict of interest. Members and candidates must comply with these employer restrictions. Members and candidates should take reasonable steps to avoid conflicts. However, if the conflicts are not resolved, they must report conflicts promptly.

Standard VI(A) also deals with a member's or candidate's conflicts of interest that might be detrimental to the employer's business. Any potential conflict situation that could prevent clear judgment about or full commitment to the execution of a member's or candidate's duties to the employer should be avoided. If the member or candidate does not avoid the conflict, it must be reported to the member's or candidate's employer.
Disclosure to Clients
Members and candidates must maintain their objectivity when rendering investment

advice or taking investment action. Investment advice or actions may be perceived to be tainted in numerous situations. For instance, a member or candidate may not be objective if he or she owns stock in the company that is the subject of an investment recommendation or if the member or candidate has a close personal relationship with the company's managers. Requiring members and candidates to disclose all matters that reasonably could be expected to impair their objectivity when a conflict exists allows clients and prospective clients to judge motives and possible biases for themselves.

While avoiding conflicts altogether is preferred, often in the investment industry, a conflict or the perception of a conflict is not reasonably avoidable. The most obvious conflicts of interest, which must always be avoided or disclosed, are relationships between an issuer and the member, the candidate, or his or her firm (such as a directorship or consultancy by a member; investment banking, underwriting, and financial relationships; broker/dealer market-making activities; and material beneficial ownership of stock). For the purposes of Standard VI(A), members and candidates beneficially own securities or other investments if they have a direct or indirect pecuniary interest in the securities, have the power to vote or direct the voting of the shares of the securities or investments, or have the power to dispose or direct the disposition of the security or investment.

Members and candidates must take reasonable steps to determine whether a conflict of interest exists and disclose to clients any known conflicts of their firm. As an example, disclosure of broker/dealer market-making activities alerts clients that a stock purchase or sale might be made from or to the firm's proprietary account and that the firm has a special interest in the price of the stock.

Additionally, disclosures must be made to clients regarding conflicts that may arise in fee arrangements, subadvisory agreements, or other situations involving nonstandard fee structures. Equally important is the disclosure of arrangements in which the firm benefits directly from investment recommendations. An obvious conflict of interest is the rebate of a portion of the service fee some classes of mutual funds charge to investors. Members and candidates must disclose such relationships so clients can fully understand such conflicts.

Cross-Departmental Conflicts

Other circumstances may give rise to actual or potential conflicts of interest. For instance, sell-side analysts working for broker/dealers may be encouraged, not only by members of their own firm but also by corporate issuers themselves, to write research reports about particular companies. Buy-side analysts are likely to face similar conflicts as banks exercise their underwriting and security-dealing powers. A marketing division may ask an analyst to recommend the stock of a certain company in order to obtain business from that company.

The potential for conflicts of interest also exists with broker-sponsored limited partnerships formed to invest venture capital. Members and candidates may be expected not only to follow issues from these partnerships once they are offered to the public but also to promote the issues in the secondary market after public offerings. Members and candidates must resolve situations presenting potential conflicts of interest or disclose them in accordance with the principles set forth in Standard VI(A).

Conflicts with Stock Ownership

The most prevalent conflict requiring disclosure under Standard VI(A) is members' and candidates' ownership of stock in companies that they recommend to clients or that clients hold. The simplest method for preventing such a conflict is to prohibit members and candidates from owning any such securities, but this approach may be overly burdensome and too restrictive. Members and candidates must disclose any beneficial ownership interest in securities or other investments that they recommend. Conflicts arising from personal investing are discussed more fully in the guidance for Standard VI(B).

Conflicts as a Board Member or Director

Service as a board member or director poses three basic conflicts of interest. First, a conflict may exist between the duties owed to clients and the duties owed to shareholders of the company. Second, investment personnel who serve as directors may receive securities or options to purchase securities of the company as compensation for serving on the board, which could raise questions about trading actions that might increase the value of those securities. Third, board service creates the opportunity to receive material nonpublic information involving the company. Even though the information is confidential, the perception could be that information not available to the public is being communicated to a director's firm—whether a broker, investment adviser, or other type of organization. When members and candidates providing investment services also serve as directors, they should be isolated from those making investment decisions by firewalls or similar restrictions.

Back to top

Application of the Standard

Example 1 (Conflict of Interest and Business Relationships):

Weiss is a research analyst with Williamsburg Company, a broker and investment banking firm. Williamsburg's merger and acquisition department has represented Jimco, a conglomerate, in all of Jimco's acquisitions for the last 20 years. From time to time, Williamsburg officers sit on the boards of directors of various Jimco subsidiaries. Weiss is writing a research report on Jimco.

Comment: Weiss must disclose in his research report Williamsburg's special relationship with Jimco. Broker/dealer management of and participation in public offerings must be disclosed in research reports. Because the position of underwriter to a company entails a special past and potential future relationship with a company that is the subject of investment advice, it threatens the independence and objectivity of the report writer and must be disclosed.

Example 2 (Conflict of Interest and Business Stock Ownership):

The investment management firm of Dover & Roe sells a 25% interest in its partnership to a multinational bank holding company, First of New York. Immediately after the sale, Hobbs, president of Dover & Roe, changes her recommendation for First of New York's common stock from "sell" to "buy" and adds First of New York's commercial paper to

Dover & Roe's approved list for purchase.
Comment: : Best practice would be for Hobbs to discontinue research coverage of First of New York because the new ownership interest in this company creates a conflict of interest. At minimum, Hobbs must disclose the new relationship with First of New York to all Dover & Roe clients. Hobbs must also require the ownership interest to be disclosed to clients by the firm's portfolio managers when they make specific investment recommendations or take investment actions with respect to First of New York's securities.
Example 3 (Conflict of Interest and Personal Stock Ownership):
Fargmon, a research analyst who follows firms producing office equipment, has been recommending the purchase of stock in Kincaid Printing because of its innovative new line of copiers. After his initial report on the company, Fargmon's wife inherits from a distant relative US$3 million of Kincaid stock. One year after his initial report on the company, Fargmon is asked to write a follow-up report on Kincaid.
Comment: At minimum, Fargmon must disclose his wife's ownership of Kincaid stock to his employer and in his follow-up report. Best practice is to avoid the conflict by asking his employer to assign another analyst to draft the follow-up report.
Example 4 (Conflict of Interest and Personal Stock Ownership):
Roberts is speculating in penny stocks for her own account and purchases 100,000 shares of Drew Mining, Inc., for US$0.30 a share. She intends to sell these shares at the sign of any substantial upward price movement of the stock. A week later, her employer asks her to write a report on penny stocks in the mining industry to be published in two weeks. Even without owning the Drew stock, Roberts would recommend it in her report as a "buy." A surge in the price of the stock to the US$2 range is likely to result once the report is issued.
Comment: Roberts must disclose the conflict to her employer and should consider declining the research assignment on Drew Mining. If Roberts's employer has her write the report despite the conflict, Roberts must disclose the conflict in her report.
Example 5 (Conflict of Interest and Compensation Arrangements):
Snead, a portfolio manager for Thomas Investment Counsel, LLC, specializes in managing public retirement funds and defined benefit pension plan accounts, all of which have long-term investment objectives. A year ago, Snead's employer, in an attempt to motivate and retain key investment professionals, introduced a bonus compensation system that rewards portfolio managers on the basis of quarterly performance relative to their peers and to certain benchmark indexes. To improve the short-term performance of her accounts, Snead changes her investment strategy and purchases several high-beta stocks for client portfolios. These purchases are seemingly contrary to the clients' investment policy statements (IPSs). No change in objective or strategy has been recommended by Snead during the year.
Comment: Snead violated Standard VI(A) by failing to inform her clients of the changes in her compensation arrangement with her employer, which created a conflict of interest between her compensation and her clients' IPSs. Firms may pay employees based on performance, but pressure by Thomas Investment Counsel to achieve short-term performance goals conflicts with the requirement to take only investment actions that are

consistent with the objectives of Snead's accounts.

See also Standard III(C)–Suitability.
Example 6 (Conflict of Interest, Options, and Compensation Arrangements):
Carter is a representative with Bengal International, a registered broker/dealer. A stock promoter for Badger Company offers to pay Carter additional compensation for sales of Badger Company's stock to Carter's clients. Carter accepts the stock promoter's offer but does not disclose the arrangement to his clients or to his employer. Carter sells shares of Badger stock to his clients.
Comment: Carter violated Standard VI(A) by failing to disclose to clients that he is receiving additional compensation for recommending and selling Badger stock. At minimum, Carter must disclose the arrangement with Badger to his clients so they can evaluate whether Carter's recommendations to buy Badger were affected by this arrangement. Best practice is for Carter to avoid this conflict of interest altogether by declining the offer of additional compensation from Badger Company.
Example 7 (Conflict of Interest and Compensation Arrangements):
Papis is the chief investment officer of his state's retirement fund. The fund has always used external managers for the real estate allocation, and this information is clearly presented in all fund communications. Nagle, a recognized sell-side research analyst and Papis's business school classmate, recently left the investment bank he worked for to start his own asset management firm, Accessible Real Estate. Nagle is trying to build his assets under management, and he contacts Papis about gaining some of the retirement fund's real estate allocation. In the previous few years, the performance of the retirement fund's real estate investments was in line with the fund's benchmark but was not extraordinary. Papis decides to help out his old friend and also to seek better returns by moving the real estate allocation to Accessible. The only notice of the change in managers appears in the next annual report in the listing of external managers.
Comment: Papis violated Standard VI(A) by not disclosing to his employer his personal relationship with Nagle. Disclosure of his history with Nagle would allow his firm to determine whether the conflict may have impaired Papis's independence in deciding to change external managers.