A. DUTIES OWED TO CLIENTS, 1. FIDUCIARY DUTY:

11: THE FIDUCIARY DUTY AND AN A SHARE CLASS RECOMMENDATION

John, a CFP® professional, works at NestEgg, a broker-dealer. John receives commissions as well as a bonus if he meets his quarterly sales goals. His Client, Emily, recently received a $75,000 inheritance. She asks John for investment recommendations. After gathering information, John determines that Emily does not need to use the funds for at least 15 years, when she expects to make a down payment on a retirement home. John recommends that Emily invest in a portfolio of mutual funds. John explains to Emily that he recommends only mutual funds that charge a sales load or bear some other type of sales charge, such as a 12b-1 distribution or marketing fee, which compensate him (and his firm) for his services. Emily tells John that she understands she will be paying such a fee in working with him.

John recommends that Emily invest in a mix of equity and bond funds from a family of mutual funds that John believes are the best match for Emily from among those available for him to recommend. Each fund has two different classes of shares that offer Sales-Related Compensation. Each class offers the identical investment experience except for the fees that investors will directly (sales load) or indirectly (12b-1 fees) bear:

- The A share class has a 4% sales load and a 0.25% 12b-1 fee.
- The C share class has no sales load but a 1% 12b-1 fee that will last as long as Emily holds the fund.

John recognizes that he and his firm have Material Conflicts of Interest because the more fees Emily pays (including the sales load and any 12b-1 fees), the greater his and his firm's compensation will be.

Because Emily intends to hold the funds for at least 15 years, the A shares likely would be the lower cost alternative. John determines that the A share class would be the better option. John recommends the A share class to Emily. There are no other professional services that John provides to Emily.

QUESTION:

When John recommended the A share class, did John fulfill his Fiduciary Duty with regard to the consideration of costs?

RESPONSE OPTIONS:

A. Yes.

B. No.

Best Response: Response A is the best response. This case involves the Fiduciary Duty (Standard A.1.) and the definition of Financial Advice (Glossary).

At all times when providing Financial Advice to a Client, a CFP® professional must act as a fiduciary, and therefore, act in the best interests of the Client. Financial Advice includes communications that, based on their content, context, and presentation, would reasonably be viewed as a recommendation to take or refrain from taking a particular course of action with respect to the advisability of investing in, purchasing, holding, gifting, or selling Financial Assets.

The Fiduciary Duty includes a Duty of Loyalty, a Duty of Care, and a Duty to Follow Client Instructions. The Duty of Care requires a CFP® professional to act with the care, skill, prudence, and diligence that a prudent professional would exercise in light of the Client's goals, risk tolerance, objectives, and financial and personal circumstances. The Duty of Loyalty requires a CFP® professional to (a) place the interests of the Client above the interests of the CFP® professional and the CFP® Professional's Firm; (b) avoid Conflicts of Interest, or fully disclose Material Conflicts of Interest to the Client, obtain the Client's informed consent, and properly manage the conflict; and (c) act without regard to the financial or other interests of the CFP® professional, the CFP® Professional's Firm, or any individual or entity other than the Client, which means that a CFP® professional acting under a Conflict of Interest continues to have a duty to act in the best interests of the Client and place the Client's interests above the CFP® professional's. The Duty to Follow Client Instructions requires a CFP® professional to comply with all objectives, policies, restrictions, and other terms of the Engagement and all reasonable and lawful directions of the Client.

John has an Engagement with Emily. John recommended that Emily invest in particular mutual funds. Therefore, John has provided Financial Advice to a Client and is subject to the Fiduciary Duty with respect to that advice.

John is required to fulfill the Duty of Care. John is making an investment recommendation that will affect Emily's prospective returns and her ability to meet her goals. John should evaluate the effect the different mutual fund share class fee structures would have on Emily's prospective returns. Emily is a longer-term investor. John determines, based on economic analysis, that the aggregate costs of the C class shares will be greater than the A class shares over time. Thus, absent extenuating circumstances, John fulfilled the Duty of Care when he recommended the A class shares to Emily.

John also is required to fulfill the Duty of Loyalty. John and his firm have Material Conflicts of Interest because the amount of compensation that John and his firm will receive depends on which share class Emily selects. To fulfill the Duty of Loyalty, John must disclose to Emily the compensation structure associated with the A class shares and C class shares, the incentives each compensation structure creates for John and his firm, and the costs that Emily will bear. John also must obtain Emily's informed consent to the Material Conflicts of Interest. To manage the Material Conflicts of Interest, John must make the recommendation he determined was in Emily's best interests (to invest in the A class shares) without regard to the compensation he and his firm would receive.

Relevant Standards and Definitions: Fiduciary Duty (Standard A.1.); Definition of Financial Advice (Glossary).