Conflicts of Interest

In November 2012 the FSA published a paper ‘Conflicts of Interest between asset managers and their customers’. This can be found at [http://www.fsa.gov.uk/static/pubs/other/conflicts-of-interest.pdf](http://www.fsa.gov.uk/static/pubs/other/conflicts-of-interest.pdf). Whilst this is geared towards investment managers and stockbrokers, it is actually a useful paper to read by the Financial Planner, helping to identify what questions they should ask a discretionary fund manager for example, when conducting due diligence and perhaps enhancing their own conflicts of interest policy.

For example, the overall premise that the FSA is looking to enforce is that the asset manager must always act in the client’s best interest. This can mean acting against the firm’s short term objectives. The reason for this is to enhance consumer confidence in asset managers but this mantra can equally apply to financial advisors.

Effective handling of conflicts of interest is nothing new. It is principle 8 of the FSA Principles for Business and I do not believe that there will be any changes to these principles when the FCA comes into force.

Between June 2011 and February 2012, the FSA conducted a review of asset management firms and how they managed conflicts of interest. Some of the best practice points identified were:-

1. Firm culture is central to identifying conflicts of interest i.e. training staff on how to look for conflicts of interest and report them and conducting reviews of the operational practices involving the operations team as well as compliance and legal departments.
2. The best control frameworks were designed and monitored by both business and compliance functions – where only compliance departments were relied upon firms were unable to demonstrate how they effectively challenged the operations staff on the trading decisions made.
3. Having effective management information and reviewing whether the controls in place continued to meet their objectives
4. Having a dedicated committee on conflicts of interest
5. Effective personal account dealing policy in place
6. Effective procedures for handling mistakes i.e. staff to report errors made, encourage staff to admit mistakes made – the MI is then reviewed by compliance and the Board. Customer would be placed back into the position they would have been had the mistake not been made – paid for by the firm themselves and no other stakeholder.

Examples of poor practice identified included:-

1. Inadequate control on spending on research and execution services
2. Irregular or no review of whether the services provided were eligible to be paid by customer commissions
3. Lack of disclosure to customers regarding commission payments
4. Trades were not allocated between different clients in an equitable manner
5. Unable to demonstrate that cross trading was always in the best interest of both customers
6. Trading to ease liquidity on a particular fund
Therefore when conducting due diligence on a potential asset manager, these are the kind of subjects to challenge them upon, particularly as each asset manager has to send in a declaration confirming that the management team has reviewed the paper and made any changes necessary. Particular focus I believe should be in the handling of errors on a client portfolio and how are commissions received on the client portfolio distributed – how does a fund manage justify a trade?

In the review the FSA also looked at managing gifts and entertainment. This I believe has a dual purpose to help evidence that bribery is not taking place and therefore the firm is confirming to the Bribery Act.

A key concern identified was a lack of care on the value and frequency of gifts and entertainment received. FSA saw practices that, if disclosed to the customer, they might question the objectivity of the decisions made on their portfolio.

However the FSA did identify some good practices such as:-

- Limits on both the value of any gift or event and the frequency of the gifts or event within a given timeframe. The gifts/event was valued on the basis of the cost by the provider or market value, not the face value of the ticket.
- The policy included conferences and the entertainment included on the trips – paying for accommodation and travel was not allowed.
- Policy identified that some events may be more targeted to specific individuals.
- If there was no valid business purpose to the event then the member of staff was to pay.
- Line managers and/or compliance to sign off gifts and entertainment.
- Policy highlighted the risk that staff may be influenced in carrying out their responsibilities.
- Personal account dealing procedures did that applied to all staff i.e. senior management were included from the policy.

The FSA having identified these best practices are giving a clear heads up on some of the best practices that they would expect to see across the board, including financial planning firms therefore it may be worthwhile looking at your firm’s Conflicts of Interest Policy and/or Anti Bribery statement to include some of the best practices identified above and ensure that your firm cannot be accused of having some of the poor practices identified.

*Melony Holman CFP™*

*Compliance & Training Solutions Ltd*