

# CONFLICTS OF INTEREST MANUAL AND POLICY FRAMEWORK-CONTROLS & PROCEDURES

NETTO FINANCIAL SERVICES (PTY) LTD



Compli-Serve  
SA (Pty) Ltd

RELEASE DATE: June 2008

IMPORTANT NOTICE: THIS DOCUMENT CONTAINS INFORMATION OF A  
CONFIDENTIAL NATURE AND IT'S USE IS LIMITED TO THE INTENDED RECIPIENT

ONLY AND UNDER NO CIRCUMSTANCES SHALL IT BE SHOWN OR FORWARDED TO  
ANY UNAUTHORISED PERSON/S BY THE INTENDED RECIPIENT WITHOUT THE  
WRITTEN PERMISSION OF COMPLI-SERVE SA

## REPORT CONTENTS

SECTION A	Forward by Richard Rattue-CONFLICTS OF INTEREST-ARE YOU MANAGING YOURS?
SECTION B	PURPOSE OF CONFLICTS OF INTEREST POLICY
SECTION C	SETTING THE SCENE Underlying principles
SECTION D	IMPORTANCE OF A CONFLICTS OF INTEREST POLICY AND MECHANISMS FOR MANAGING THEM
SECTION E	SENIOR MANAGEMENT RESPONSIBILITIES
SECTION F	CONFLICTS OF INTEREST- A DEFINITION
SECTION G	EXAMPLES OF CONFLICTS OF INTEREST-WHAT TO RECORD
SECTION H	TYPES OF CONFLICTS-INTERESTS AND AFFILIATIONS, NON CASH INCENTIVES AND INDIRECT CONSIDERATIONS
SECTION I	OTHER OBLIGATIONS
SECTION J	DOCUMENTATION AND RECORDKEEPING
SECTION K	CONTROLLING AND AVOIDING CONFLICTS OF INTEREST
SECTION L	ENSURING ARRANGEMENTS ARE ADEQUATE
SECTION M	ENSURING ARRANGEMENTS ARE IMPLEMENTED AND MAINTAINED
SECTION N	INTERNAL STRUCTURES
SECTION O	REMUNERATION
SECTION P	TREATING CLIENTS FAIRLY
SECTION Q	AVOIDING CONFLICTS OF INTEREST
SECTION R	DISCLOSING CONFLICTS OF INTEREST
SECTION S	TIMELY, PROMINENT, MEANINGFUL DISCLOSURE

SECTION T  
SECTION U  
SECTION V

DISCLOSURES FOR FINANCIAL PRODUCT ADVICE  
WHEN DISCLOSURE BECOMES INAPPROPRIATE  
CHECKLIST TO AID IN CONTROLLING AND  
AVOIDING CONFLICTS OF INTEREST  
CONFLICT MITIGATION AND MARKET PRACTICE-  
DEVELOPING STRENGTHENED PROCEDURES AND  
FORMAL CONFLICTS OF INTEREST POLICIES

SECTION W

**ANNEXURES**

ANNEXURE A  
ANNEXURE B  
ANNEXURE C  
ANNEXURE D  
ANNEXURE E  
ANNEXURE F  
ANNEXURE G

**POLICY-FSP PROCEDURES FOR HANDLING COI**  
OFFICIAL COMPLI-SERVE GUIDANCE NOTE ON COI  
COI PRELIMINARY QUESTIONNAIRE-KEY PERSONS  
DISCLOSURE OF AFFILIATIONS-DISCLOSURE OF  
INTERESTS AND CONTROL MEASURES  
MASTER CONFLICTS REGISTER-NON CASH  
INCENTIVES-BENEFITS-INTERESTS EXCL. GIFTS  
GUIDANCE ON NON CASH INCENTIVES INCL  
EXAMPLES  
SECTOR SPECIFIC EXAMPLES OF CONFLICTS OF  
INTEREST, INCL INSURANCE, INVESTMENTS AND  
ASSET MANAGEMENT

**GLOSSARY OF TERMS**

FSP  
FAIS  
FSB  
FINANCIAL SERVICES PROVIDER  
FINANCIAL ADVISORY & INTERMEDIARY  
SERVICES ACT 2002  
FINANCIAL SERVICES BOARD

FICA  
COI

FINANCIAL INTELLIGENCE CENTRE ACT 2001  
CONFLICTS OF INTEREST

Last updated May 2008

**CONFLICTS OF INTEREST MANUAL AND POLICY FRAMEWORK**

**A. Forward by Richard Rattue, MD of Compli-Serve SA**

**Conflicts of Interest: Are you managing yours?**

I am sometimes surprised at the low levels of recognition and understanding of conflicts of interest given that certain areas of the financial services industry are literally riddled with them. Of course first best world is to avoid all conflicts of interest and not engage in business where a conflict may even potentially exist. In a more practical world however this is not always possible and it then comes down to recognizing that a conflict exists, understanding the impact it will have in your dealings with associates and clients and acting accordingly.

If the conflict is deemed to be extreme it should always be avoided however lower level conflicts can be managed via appropriate internal procedures and disclosures. Such procedures are to ensure that the conflict does not cause a individual or entity to act to further their own interest at the expense of the client. Some immediate examples of conflict on a massive scale come to mind in US insurance and investment banking circles where directors tremble and share prices have tumbled courtesy of one Mr. Elliot Spitzer. Closer to home we have our own skeletons tumbling out of closets in the retirement fund industry where material conflicts have been entrenched for years and are now being undone by one Mr. Vuyani Ngalwana better known as the Pensions Funds Adjudicator.

Clearly where conflicts do exist they must be disclosed to the client and this goes to the heart of making an "informed decision". In effect the client must be able to understand how the conflict of interest might affect the substance and efficacy of a recommendation that is being made to them. It is however not only the fact that we should disclose to clients when we have a material conflict but also the manner in which such disclosures are made to ensure that it is effective i.e. disclosures should not be a lengthy attachment to a report full of non-specific dense legalese. Empirical evidence shows that most clients almost never read such disclosures and certainly don't print them. It is therefore recommended that the disclosure documentation provided by the advisor to the client should clearly and concisely disclose the actual relationships associated with conflict and the disclosure should be in a prominent position.

In terms of the FAIS General Code of Conduct an advisor must have acted with due care and skill and in their clients' best interest. This includes numerous statutory contact stage disclosures, which includes conflicts of interest.

Commission based sales have been the subject of some controversy in recent times and there is certainly a risk that conflicts of interest will where sales individuals are

remunerated on a commission only basis particularly when such individuals are under pressure to make sales to reach targets. Once again it is important that clients are aware that such individuals are remunerated by commission and in many cases are given clear incentives to sell products of a provider or are actually restricted to the in house product set. A common situation arises whereby the company providing advice is also an owner or partial owner of the recommended product. The advisor will naturally gravitate towards sending clients to an in house product as opposed to an external one particularly if encouraged via incentives to do so.

In summary conflicts of interests do exist and must be managed as they will certainly impact on the quality of advice rendered. Disclosure alone is rarely sufficient to manage the conflict and accompanying internal controls are generally needed. At the very least a basic policy document should be drafted laying out the company policy in respect of conflicts and identifying where they may occur and identify steps that are in place to manage them. A gift register could be implemented and monitored by the compliance officer. In an investment environment policies in respect of insider and personal account trading are essential. Certain conflicts are so serious they will always cause actual harm to clients should be avoided and made a disciplinary offence if breached

Compliance officers and key individuals should work to ensure that conflicts of interest are identified and disclosed in their disclosure documentation that the client would receive at a contact stage.

In the current environment FSP's that ignore conflicts of interest and do not bring them to the client's attention will find it difficult to get past "due care and clients best interests" in the event of a client complaint.

**Richard Rattue**  
**May 2008**

#### **B. PURPOSE**

For a guidance note on conflicts of interest for FAIS please see annexure A attached to this manual.

The purpose of a conflicts policy is to outline a suitable approach and response to the identification and management of conflicts of interest. Potential conflicts of interest are inherent in any business, therefore it should not be the aim of a financial services provider to avoid all conflicts of interest but rather to identify and manage any potential conflicts that may arise.

This manual and policy framework will form part of the compliance manual and should be read and understood by all affected employees. The guidelines and recommendations contained herein should be considered and applied where relevant, and Employees should raise any queries regarding potential conflicts of interest to their manager.

#### **C. SETTING THE SCENE Underlying principles**

In the financial services industry, conflicts of interest can be described as circumstances where some or all of the interests of clients to whom a financial services provider provides financial services are inconsistent with, or diverge from, some or all of the interests of the FSP or its representatives.

Adequate conflicts management helps to minimise the potential adverse impact of conflicts of interests on clients. Without adequate conflicts management, FSPs whose interests conflict with those of the client are more likely to take advantage of that client in a way that may harm that client and may diminish confidence in that FSP and in the financial services industry as a whole.

Adequate conflicts management should also help an FSP to ensure that the quality of their financial services is not significantly compromised by conflicts of interests.

While it is conceded that all potential conflicts of interest do not necessarily manifest themselves into actual conflicts, it is submitted that the very perception of bias is a negative one, and carries a negative impression of the industry.

Conflicts of interest management needs to be addressed in order to enhance the levels of professionalism and perceived professionalism of the financial services industry. Disclosure on its own is not always adequate. Management of conflicts as well as transparent, effective disclosure needs to be achieved.

Whereas it is reasonable to expect financial services providers to manage and avoid conflicts of interests, it can be difficult for them to adhere to this principle in an environment where product suppliers are constantly devising reward and remuneration schemes that present conflicts of interests and encourage behaviour that could result in unsuitable sales. It is submitted that this results in an unhealthy tension between the FSP's FAIS obligations on the one hand and the enticements on offer in the market on the other.

The same disclosure and avoidance of conflict of interests requirements should be simultaneously applied to all competing product types to avoid both inconsistency and the situation where less regulated industries profit at the expense of those whose practices have been curtailed.

FAIS legislation already requires an FSP to disclose conflicts of interest to its clients. The FAIS General Code of Conduct for Authorised Financial Services Providers and Representatives currently requires an FSP to disclose to the client

the existence "of any circumstance which gives rise to an actual or potential conflict of interest, and take all reasonable steps to ensure fair treatment of the client". "Non-cash incentives offered and/or other indirect consideration payable by another provider, a product supplier or any other person to the provider could be viewed as a potential conflict of interest".

However, there does not appear to be a common understanding of what indirect benefits need to be disclosed, or how disclosure is to be carried out. Disclosure of direct and indirect benefits is generally not made in a consistent or transparent manner across the industry. This has resulted in the perception that non-cash and

indirect incentives are not being disclosed, or where they are disclosed, such disclosure is vague and inadequate. This is extremely damaging to the public's perception of the integrity of the financial services industry.

#### **D. IMPORTANCE OF A CONFLICTS OF INTEREST POLICY AND MECHANISMS FOR MANAGING THEM**

It will shortly be a requirement that all Financial Services Providers "FSP's" keep internal written conflicts management policies for their businesses.

FSP's need to understand what minimum arrangements they need to have in place to comply with their obligations under FAIS and other legislation.

Managing conflicts of interest should form a fundamental part any risk management programme of FSP's. All FSP's should be in a position to identify, assess and respond to the conflicts of interest that arise in their businesses.

To comply with any conflicts management obligation FSP's should have arrangements in place to manage all conflicts of interest affecting their business. These arrangements must involve the following mechanisms:

- **Controlling Conflicts of Interest-** identify the conflicts that exist, assess and evaluate the conflicts; decide upon and implement, an appropriate response to those conflicts
- **Avoiding Conflicts of Interest altogether-** if serious potential impact on a FSP or a client of a FSP. Merely disclosing them and imposing internal controls is not enough.
- **Disclosing Conflicts of Interest appropriately-** An integral part of managing conflicts. Clear, concise and effective disclosure so that client can make an informed decision. What constitutes appropriate disclosure to a client will depend on all facts presented and a number of circumstances including the level of financial literacy of the client, the extent to which other clients are likely to rely, directly or indirectly, on the service, how much the client already actually knows about the specific conflict and the complexity of the service being presented to the client.

Where conflict may arise avoidance or declining to act for the client is the safest course of action but is often simply not a practical solution. If the conflict is to arise then it must be managed effectively using a combination of tools namely

- Disclosure: disclosing an interest to a client
- Chinese Walls

- Internal Policies and Procedures: systems and controls to minimize the impact that any conflict is likely to have on the client's interest
- An FSP should demonstrate that any activity it undertakes does not disadvantage a client.

All FSP's must go beyond their disclosure obligation, and be able to demonstrate that they have management procedures in place to assess impact and manage conflicts, which are to be monitored to ensure that such procedures have been complied with.

#### **E. SENIOR MANAGEMENT RESPONSIBILITIES**

Senior management are responsible for the creation, implementation and oversight of appropriate processes and procedures for the effective management of conflicts of interest within their organizations. There is no 'one size fits all' that can effectively address the full range of conflicts of interest that arise in the business of the FSP.

In summary

- Senior management should be engaged fully in all aspects of conflicts identification and management and take a broad view of the risks posed to their business. The responsibility needs to be allocated to accountable individuals and controls to mitigate conflicts need to be reviewed on a regular basis.
- Senior management are responsible for ensuring that the broad spread of conflict risk to which their business is exposed is addressed, including latent and emerging conflicts. They need to make informed judgments about the materiality of the conflict risk. A business culture that supports the management and mitigation of conflicts of interest will greatly aid in the process.

FSP's should consider the wider issues of dealing with clients in a manner that is fair and seen to be fair: Businesses should take a critical view of how conflicts may affect the fair treatment of clients, and to respond accordingly. Clear guidance should be in place for employees on how to recognise a potential issue and when to escalate matters to senior management.

By having an adequate conflicts policy in place an FSP will assist in minimising the potential adverse impact of conflicts of interest on clients. Such arrangements thereby help promote consumer protection and maintain market integrity.

#### **F. CONFLICTS OF INTEREST- A DEFINITION**

For the purpose of this policy document, conflicts of interest are circumstances where some or all of the interests of people (clients) to whom a FSP (or representative/key individual) provides financial services are inconsistent with, or diverge from, some or all of the interests of the FSP. This may include actual, apparent and potential conflicts of interest.

#### **G. EXAMPLES OF CONFLICTS**

officers of the FSP should obtain such prior approval from the Board of Directors (the "Board").

## **2. Service on Boards and Committees**

Employees must obtain approval prior to accepting any position to serve on a board of directors, an advisory board or on a committee of any entity. Employees who are not executive officers should obtain approval from relevant persons before accepting any board or committee position. The FSP should at any time be able to rescind prior approvals to avoid a conflict or appearance of a conflict of interest for any reason deemed to be in the best interests of the company.

## **3. Self Dealing transactions**

The FSP should not engage in any self-dealing. Generally speaking, sales of property, goods, or services; exchanges and loans between the FSP and a disqualified person (such as a director or officer or a member of their families); payment of compensation to a disqualified person; and use of FSP assets by or for the benefit of a disqualified person constitute self-dealing and should be prohibited as a matter of course.

## **4. Gifts and improper personal benefits (example of a gift policy-each FSP needs to have a policy on gifts) - refer to the GIFT AND NON-CASH INCENTIVE REGISTER to be completed. REFER TO POINT 6.**

No employee should obtain any material personal benefits or favors because of his or her position with the financial services provider. For specific guidelines, please refer to "Conflicts of Interest -gift policy guidance" and the gift register information pack.

Example of a gift policy: Directors, advisors, and staff members, and members of their families, may not knowingly receive or accept any pecuniary gain or anything else of value (including gifts, honoraria, loans, and entertainment) from recent, current, or potential grantees, vendors, suppliers, consultants, or others who have existing or proposed business or grantor-grantee relationships with the FSP. It is permissible to accept gifts of nominal value, meals, and social invitations that are in keeping with good business ethics and do not obligate the recipient to take or refrain from taking any action or decision on behalf of the FSP. Where it would be awkward to decline a gift, it should be accepted on behalf of the FSP, and senior management should be consulted as to its disposition.

## **5. Provisions Specific to Staff and Investment in private companies**

An employee's private interest cannot interfere with the interests of the financial services provider. Employees of the FSP have a full-time responsibility to the FSP and may not engage in activities that would interfere with the discharge of this responsibility. No employee may have business dealings with the financial services provider beyond receipt of salary and personnel benefits and reimbursement of authorized expenses.

Permission will be granted only when it is determined that the interests of the FSP are not compromised by the service to the other organization. Full disclosure of the

## **• INTERESTS AND AFFILIATIONS (refer to control measures-register of interests which must be completed)**

*A conflict of interest exists if a relevant person is in a position to make or influence a decision about whether and how to proceed with the proposed transaction, and has an affiliation with any other party to a business transaction. An apparent conflict is one that a sceptical viewer might reasonably believe might cause the relevant person's decision to be tainted by self-interest.*

In order to ensure proper corporate governance, and the accountability and transparency of our organisation, relevant persons are required to declare any private interests that might affect the carrying out of their duties. They are also required to take steps to resolve any conflicts that arise in a way that protects the public interest. To fulfil this requirement, any relevant interests must be declared on the Register of interests. These are personal or business interests that might influence their judgement, deliberation or action as employees of the financial services provider, or which might be perceived by a reasonable member of the public as doing so.

Relevant persons must consider whether they need to disclose personal involvement with persons or organisations, which members of the public might reasonably think, could influence their judgement.

Where there is uncertainty about whether a particular interest should be declared, advice should be sought from the compliance officer.

## **H. TYPES OF CONFLICTS-INTERESTS AND AFFILIATIONS, NON-CASH INCENTIVES AND INDIRECT CONSIDERATIONS**

*The provider must disclose to the client the existence of any personal interest in the relevant service, or of any circumstances, which gives rise to annual or potential conflict of interest in relation to such service, and take all reasonable steps to ensure fair treatment of the client.*

### **1. Moonlighting**

One may not engage in any employment or activity other than for (the FSP) in any business in which the FSP is engaged or contemplates engaging. While employed at the FSP, your full business energies and time should be devoted exclusively to the FSP's business. If one wishes to pursue a second job with any other entity or to participate in an outside business venture ("Moonlighting"), one must ensure that the engagement in such activity does not create a conflict with the interests of the FSP or in any way use or risk disclosure of the confidential information of the FSP. Any outside activity should be strictly separated from the FSP's employment and should not harm one's job performance at the FSP. To avoid problems in this area, one should be required to disclose and receive approval from compliance/senior management prior to engaging in any such activity. Employees who are executive

relationship should be a requirement. If any recommendation goes forward, the disclosure must be presented to the Board and recorded in the Board minutes.

Employees may find themselves in a position to invest in clients of the FSP, partners or suppliers. It is imperative that employees presented with such opportunities understand the potential conflict of interest that may occur in these circumstances. Investing in private companies with which the FSP has an actual or potential business relationship may not be in the best interests of the FSP. The following guidelines are intended to cover such circumstances:

#### **NON-CASH INCENTIVES AND INDIRECT CONSIDERATIONS**

*Non-cash incentives offered and/or other indirect consideration payable by another provider, a product supplier or any other person to the provider could be viewed as a potential conflict of interest*

Material benefits are any forms of non-cash incentives or benefits that are R500.00 or more in value for any single item or part thereof, including benefits that are passed to the spouse, partner, family member, business associate or employee of a provider or provider's representative by a product supplier; and also includes such non-cash incentives or benefits that amount to more than R1.000 per natural person from a single product supplier over any calendar year.

Refer to annexure entitled '**NON CASH INCENTIVES/INDIRECT CONSIDERATIONS**' for an example on how to handle such situations

Non-cash Incentives include (non exhaustive list)

- Overseas trips-Incentivised
- Domestic trips-Incentivised
- Sponsorships by product suppliers for financial services providers
- Gifts that amount to material benefits-motor vehicles, gift vouchers, loans on more favourable terms
- Payment or provision of all or part of the costs of any business service or other business expense, including but not limited to: Office rental; Computer hardware and commercial software
- Entertainment
- Domestic educational or professional development conferences
- Sponsorship of domestic provider events, including conferences, by a product supplier
- Accommodation and travel costs where the provider is invited as a speaker at a domestic conference/professional development event held by a product supplier
- Access to preferential, differentiated service and/or training and/or advice facilities, and the like
- Shareholdings, equity entitlements, sales quota obligations or performance fee entitlements that they, or an entity in which they have an interest, have in the product suppliers of the products or administrative financial services providers that the provider and/or its representatives recommend to clients
- The fact that during the preceding 12 month period, the provider received more than 30% of total remuneration, including commission from the product supplier;

- Where a provider markets or gives advice in respect of the products of more than one product supplier, should the representatives of such provider be rewarded in any way that could, or could be perceived to, bias advice in favour of one product supplier over another, this fact must be disclosed;
- Where a provider markets or gives advice in respect of the products of one or more product suppliers, should the representatives of such provider be rewarded in any way that could, or could be perceived to, bias advice in favour of one particular product or underlying product option over another, this fact must be disclosed
- Computer software linked to a product supplier's products, such as a product-linked advice tool
- Benefits that are not material and are not in the form of cash or gift vouchers.
- Professional development conferences/courses that meet the following criteria: eg. The conference may be for no longer than three days and two nights.

#### **I. OTHER OBLIGATIONS**

Other obligations already exist in and outside of FAIS, which deal with or relate to conduct potentially affected by conflicts of interest, including

- An FSP must have acted with due care and skill and in their clients' best interest. This includes numerous statutory contact stage disclosures, which includes conflicts of interest. The obligation to operate with due care and skill and in the best interest of the client and the conflicts management obligation is all interconnected. An FSP is unlikely to act with any due skill if they have inadequate policies in place surrounding conflicts of interest.
- The obligation to have adequate risk management systems in place
- The obligation to comply with all financial services laws
- To have adequate compliance arrangements
- The FSP's obligation to disclose any non cash incentives or indirect considerations relating to a sale of a financial product.
- A range of prohibitions, including for misleading or deceptive conduct in the provision of a service, and insider trading

- The duties of a responsible entity of a registered collective investment scheme, including duties to act in the best interests of the members of the scheme and, if there is a conflict between the member's interests and its own interest, to give priority to the members' interests.

Many FSP's are also bound by common law obligations that affect their management of conflicts of interest, for example fiduciary obligations to their clients to whom they render advice.

#### **J. DOCUMENTATION AND RECORDKEEPING**

For any conflicts arrangements to be deemed adequate, they need to be documented. This generally involves having a written conflicts management policy (can form part of an existing compliance manual or internal procedures guide) Compli-Serve has a number of procedures and controls in the handling of conflicts of interest. Please refer to the Annexures provided at the end of the manual.

FSP's should keep records for at least 5 years of

- Conflicts identified and actions taken
- Any reports given to the FSP's senior management about matters relating to conflicts
- Copies of written conflicts of interest disclosures given to clients

Example

- All licensees should keep copies of written conflicts disclosures given to individual clients or otherwise made available (e.g. on a website)

#### **K. CONTROLLING AND AVOIDING CONFLICTS OF INTEREST**

Clearly it is not practical to prohibit all conflicts of interest regardless of impact. Any policy should not dictate that a FSP could never provide a financial service if a conflict of interest exists. Rather any policy must advocate that all conflicts of interest be adequately assessed for impact, reported to the compliance function and/or senior management who will then decide how to proceed, i.e. either to proceed with caution, or in severe cases to avoid the conflict altogether.

If it is decided to proceed the conflict can be normally managed by a combination of internal controls and

Appropriate disclosures

Depending on the circumstances and the nature of any given conflict, it may be appropriate to:

1. Disclose the conflict of interest to the client;
2. Allocate another representative to provide the service to the client
3. Decline to provide a service to the client
4. Initiate internal/external disciplinary action (referring matter to regulator for instance) where warranted.

What constitutes an appropriate response to a given conflict of interest will always depend on the circumstances and facts of the case.

#### **L. ENSURING ARRANGEMENTS ARE ADEQUATE**

One must identify the conflicts and control the effects of those conflicts on the provision of financial services so that the quality of the service is not significantly compromised.

Robust and effective internal policies and procedures need to be in place to address potential conflicts emerging.

FSP's must have monitoring procedures in place to ensure that any non-compliance with the FSP's conflicts management arrangements are identified and appropriately acted on. The FSP's in conjunction with compliance must record any action taken on breaches for instance.

Note: Systemic instances of non-compliance with a conflicts policy will suggest that the arrangements themselves are inadequate.

Any arrangements must be tailored according to the nature, scale and complexity of the business.

#### **M. ENSURING ARRANGEMENTS ARE IMPLEMENTED AND MAINTAINED**

FSP's must ensure that the conflicts arrangements they have in place to control conflicts of interest are:

1. Approved and endorsed by senior management
2. Designed according to the nature, scale and complexity of the FSP business
3. Effectively implemented (accompanied by effective compliance monitoring)
4. Regularly reviewed to ensure adequacy.
5. Overseen by a member of the senior management team who takes responsibility for implementation, reviewing and updating.

#### **N. INTERNAL STRUCTURES**

It is important that internal structures and reporting lines support a FSP's management of conflicts. FSP's for instance should carefully consider whether it is appropriate:

1. To have advisory staff reporting to marketing staff

2. For stand-alone advice units within the organisation to be in the same physical location as sales or investment management staff.

Robust information barriers may help a FSP manage conflicts. By insulating one group of staff from the information or other circumstances that give rise to a particular conflict, so that the group is not affected by the conflict.

#### **Q. REMUNERATION**

FSP's need to consider their remuneration practices (including non monetary) as part of ensuring that they operate efficiently, honestly and fairly.

1. If a product provider pays a higher rate of commission to an FSP for achieving certain volumes of sales, one would expect disclosure to be part of how the FSP manages that conflict.

2. Trustees taking fees based on funds under management should consider how to ensure they address any tendency to act other than in the best interests of their clients.

Disclosure to clients is an adequate mechanism for controlling conflicts of interest arising from remuneration practices.

Remuneration practices that place the interests of the FSP in direct and significant conflict with those of its clients should be avoided (and not merely disclosed)

1. The need for a robust policy is likely to be higher where a FSP relies heavily on commission-based remuneration

2. When providing advice to clients, advisers are specifically obliged to ensure their advice is appropriate (regardless of remuneration)

#### **P. TREATING CLIENTS FAIRLY**

All FSP's must treat their customers fairly. Providers must

- Not provide financial services that unfairly puts the interests of the FSP ahead of that of their clients

- Not provide financial services in a way that unfairly puts the interests of one client ahead of the interests of other clients.

- Not use knowledge about clients in a way that is likely to advance their own interests without sufficient disclosure to affected clients. (Transparency in disclosure)

FSP's needs to manage conflicts between the interests of various clients (Existing/potential) as well as conflicts between the FSP's own interests and those of their clients.

#### **Example**

FSP's should avoid situations where they unfairly favour one client or group of clients over another client or clients. This includes avoiding the scenario known as late trading where a client is permitted to trade in interests in a managed fund after the relevant trading period has closed (and in some instances after prices have been set)

#### **Q. AVOIDING CONFLICTS OF INTEREST**

Certain conflicts have such a serious potential impact on a FSP or its clients that the only way to adequately manage those conflicts will be to avoid them. In these cases simply disclosing them and imposing internal controls may be inadequate.

#### **Examples**

1. FSP's should not permit their staff to offer to publish or give positive advice about a particular financial product issuer, or include their product on a recommended list, solely in return for benefits or continuing business from that issuer.
2. FSP's should not disclose pending client orders to third parties associated with the FSP (which would enable the third party to trade ahead of the client)
3. Discretionary FSP's should not permit 'late trading' by some of their clients and
4. Where an adviser is significantly affected by conflicts of interest for particular financial product advice, the adviser may need to decline to provide the advice.

FSP's are responsible for their own conduct and that of their representatives. As far as possible, FSP's should avoid placing themselves in a position where there is material conflict between their own interests and those of their clients.

#### **R. DISCLOSING CONFLICTS OF INTEREST**

FSP's should make appropriate disclosure to clients as part of any arrangement to manage conflicts of interest. Clients have a right to be adequately informed about a conflict that may affect the provision of financial services to them.

Adequate disclosure = providing enough detail in a clear, concise and non-misleading way to allow clients to make an informed decision.

Disclosure assists clients to assess the service they are being offered in light of the FSP's own interests and to decide on the extent (if any) to which they will rely on the service.

#### **S. TIMELY, PROMINENT, MEANINGFUL DISCLOSURE**

Disclosure should

- Be timely, prominent, specific and meaningful
- Occur before or when the service is provided, at a time that allows the client a reasonable time to assess its effect
- Refer to the specific service to which the conflict relates

The use of 'generic' disclosures is unlikely to satisfy any conflicts management obligation. Disclosure should refer to the specific service to which it relates, and should be clear enough for the client to fully understand its implication.

#### **I. DISCLOSURES FOR FINANCIAL PRODUCT ADVICE**

What to disclose?

- The extent to which the FSP (or any associated person) has a legal or beneficial interest in the financial products that are the subject of the advice; can be inputted in the Letter of Introduction at contact stage;
- The extent to which the FSP (or any associated person) is related to or associated with the issuer or provider of the financial products that are the subject of the advice;
- The extent to which the FSP (or any associated person) is likely to receive financial or other benefits depending on whether the advice was followed or not.

FSP's need to provide the above disclosures in the same form as the advice (e.g. written disclosures where the relevant advice is in writing)

While the conflict of interest will not necessarily cause the advice to be compromised, it should still be brought to the client's attention.

Example

1. An FSP in a group that is owned by a product issuer, in giving advice about a product issued by that product issuer, should disclose this relationship when giving the advice.

NB Similar disclosures to the information above are already required before financial advice is given to clients (in a letter of introduction) and when personal financial product advice is rendered (in a recommendation or in the record of advice)

#### **U. WHEN DISCLOSURE BECOMES INAPPROPRIATE**

There are times when disclosing a conflict may be inappropriate. Conflicts that arise may be confidential, and even amount to 'inside information' under insider trading rules. In situations like these FSP's will need to assess whether any disclosures can be given and whether the conflict can be adequately managed through other mechanisms. In such cases the conflict needs to be avoided altogether.

Example

An adviser is prevented from making an adequate disclosure because the information to be disclosed is commercially sensitive or is protected by confidentiality agreements. Such situations are difficult to manage and it may be that the adviser will need to avoid providing the advice.

**Less is more when clear and concise**

Excessive disclosure is likely to confuse clients and reduce disclosure effectiveness. Detailed and maze-like disclosures should not be used to obscure conflicts. The focus should be on material conflicts at all times.

**Conflicts of Interest Internal Policy Document-case studies per subject area**

This policy uses hypothetical case studies illustrating real or perceived conflicts across the financial services industry. We then look at how a regulator may react to the real or perceived conflicts as described.

#### **V. CHECKLIST TO AID IN CONTROLLING AND AVOIDING CONFLICTS OF INTEREST**

- How do you identify conflicts of interest?
- What are the procedures for assessing and evaluating conflicts?
- Do the arrangements you have in place enable you to decide how to respond to or deal with a conflict?
- Does the FSP have a written policy on conflicts of interest?

- When were your arrangements last reviewed?
- When were your arrangements last updated?
- How does the organization's structure support the management of conflicts?
- What information barriers exist in the FSP? How do they help in managing the flow of information?
- How do your conflicts arrangements ensure that clients are not treated unfairly?
- How do your conflicts arrangements ensure that nay advice rendered is appropriate?
- How were the conflicts policies approved in your organisation?
- How are conflicts arrangements communicated to other members of staff and the other stakeholders, including clients?
- Is there a nominated person responsible for the implementation, reviewing and updating of internal policy?
- Are there procedures in place to identify instances of non-compliance? How is non-compliance dealt with and recorded?
- What impact do remuneration and other benefits practices have on the internal management of conflicts?
- And the impact on trading or other dealing practices?
- Are there processes in place to ensure that the quality of service provided is not significantly compromised by the presence of conflicts of interest?
- What procedures are used to assess the seriousness of a conflict?
- Is there an escalation process for ensuring that serious conflicts are referred to senior management responsible?
- In what circumstances would you avoid conflicts altogether? How are these decisions made and are they recorded appropriately?

## DISCLOSING CONFLICTS

- What procedures are in place for disclosing conflicts?
- How does one ensure that clients receive adequate and specific disclosures?
- How does one ensure that procedures are followed consistently and at all times?
- What disclosures do you give for financial service advice?
- How do you deal with conflicts of a confidential nature?

## W. CONFLICT MITIGATION AND MARKET PRACTICE-DEVELOPING STRENGTHENED PROCEDURES AND FORMAL CONFLICTS OF INTEREST POLICIES

Set out below is a number of features of conflicts mitigation procedures and practice found during a recent study:

- Some conflicts policies began with an attempt to define what constituted a conflict. Businesses should consider whether a definition might be either too narrow (i.e. tied exclusively to remuneration issues) or too general (i.e. a conflict where the interests of the intermediary differ from the interests of the client.) An alternative approach was to start with a general definition of a conflict of interest followed by an analysis of how this may apply in common business situations.
- An attempt was made in some procedures to tie all documents relating to personal and corporate conflicts into one overarching framework. Other approaches had an array of different conflict-related documents that were not always consistent with one another. An alternative approach is to start with a high level conflicts framework, with subsequent consistent sub-manuals relevant to the appropriate business area.
- Whilst all employees should be aware of conflicts and should be responsible for the ownership of conflicts arising out of their own conduct, a senior manager should own the overall conflicts policy, with regular reporting on such issues.
- Smaller FSP's did not have an internal audit "IA" function. Where an IA function is not present, a strong culture of consistent internal acceptance checking of files by an individual not involved in the placement of the risk (normally compliance) is one method of ensuring that risks arising out of conflicts have not crystallised. The approach of some smaller FSP's to handling conflict identification was regular file reviews with senior staff showing a serious approach to making sure exceptions are closely monitored, followed up, and managed effectively.

**ANNEXURE A POLICY FRAMEWORK- FSP PROCEDURES FOR HANDLING CONFLICT OF INTERESTS**  
**CONFLICTS OF INTEREST-FSP PROCEDURES**

**IDENTIFY CONFLICT OF INTEREST**



**ESCALATED TO APPOINTED COMPLIANCE CHAMPION/COMPLIANCE #2**



**LOGGED IN CONTROL SHEET (APPROPRIATE REGISTER) \*1**



**ASSESSED FOR MATERIALITY (BY KEY INDIVIDUAL/COMPLIANCE CHAMPION IN CONJUNCTION WITH COMPLIANCE OFFICER \*3**



**DECISION MADE AS TO MATERIALITY**



**PROCEED**



**AVOID**



**DISCLOSURE REQUIRED LOG REASON FOR AVOIDING CONFLICT INREGISTER**



**LOG REASON FOR ACCEPTANCE IN THE CONTROL SHEET (REGISTER)**



**MONITOR FOR COMPLIANCE (with compliance)**

Guide

\*1 Log the date and contents of the COI (real, existing or potential)

\*2 can be communicated via email but must be in writing to the "conflicts officer". All correspondence relating to conflict to be placed in a company conflicts file

\*3 Conflicts officer to liaise with the compliance function to evaluate the conflict and to decide which mechanism to be used to manage conflict (control, avoid or disclose)

If the conflict can be resolved immediately, take the necessary action and advise compliance immediately. Continually record in the register as to the ongoing status. If the conflict requires further clarity and investigation by any party, insert comments as appropriate in the conflicts register.

**NOTES TO PROCEDURES (AMEND AS APPROPRIATE)**

1. Assign a member of staff with primary responsibility for identifying, recording and managing conflicts of interest. (To be known as the Conflicts Officer). In most circumstances this will be the person with primary responsibility for internal compliance (for example the current in house compliance champion). If an external compliance officer is appointed it may be that the FSP will appoint an internal conflicts officer who will liaise with the compliance function directly to effectively manage conflict situations.

2. The "Conflicts Officer" will advise all relevant staff of:

- The definition of 'conflict of interest';
- The main features; and
- Examples or possible conflicts of interest that may emerge

3. At the same time the Conflicts Officer will co-ordinate a questionnaire (annual) of directors and relevant staff, requiring them to assess all aspects of their responsibilities and their business relationships, with a view to identifying actual or potential conflicts (and circumstances that might be perceived as conflicts). Directors, managers and internal legal and compliance officers should attempt to identify conflicts across the business, while other staff will focus on their individual circumstances.

Even when individuals completing the questionnaire are confident that objective financial advice will be provided, in spite of a potential conflict, **they should report the conflict**: clients and regulators may not easily be persuaded that advice was objective.

4. The "conflicts Officer" together with compliance will assess the seriousness (with compliance) of identified possible conflicts, and will determine (in consultation with senior management) how the conflict should be managed. Typically this can involve:

5.1 If current disclosures constitute adequate management

5.2 What further disclosures would constitute adequate management?

5.3 Whether or not disclosure alone can adequately manage the conflict. Where it cannot all stakeholders can decide how the conflict should be avoided, or whether the conflict should be referred for prompt board consideration.

6. The Conflicts Officer will keep adequate records of the controls management process, from identification through to effective resolution of the conflict.

7. The Compliance officer can prepare a report on the management of conflicts of interest, for the Board to consider at intervals appropriate to the business.

8. Conflicts of interest will become a standing agenda item for Board meetings.

9. Procedures can be drafted and adopted by the Board to form part of the compliance documentation, addressing the above steps and responsibilities...

10. The COI procedures and their efficacy in operation will be reviewed by senior management of the FSP in conjunction with compliance.

**ROLE OF COMPLIANCE**

Compli-Serve, as compliance officers of the FSP, are in a position to assist the FSP in facilitating the handling of any identified conflict relating to the FSP. This may involve assessing and evaluating the conflict with the FSP, and decide upon, and implement, an appropriate response to the conflict.

Compli-Serve to assist with the implementation of conflict-monitoring procedures within the FSP and highlight areas of ensures that any non-compliance with the FSP's conflicts management arrangements are identified and appropriately acted on.

As part of the conflict management arrangements Compli-Serve will monitor agreed conflicts documentation as part of its wider scale-monitoring programme within the FSP.


**ROLE OF ALL EMPLOYEES IN FSP**

All employees of the FSP are obliged to report actual, perceived or potential conflicts of interest-see procedures above to senior management. The failure of employees to notify management to the potential conflict of interest may result in disciplinary action being taken against the affected individual/s.

**ROLE OF ALL SENIOR MANAGEMENT**

Those individuals responsible for the internal oversight function have responsibilities to implement appropriate processes and procedures for the effective risk management of conflicts of interest and other risks arising within their organizations.

It is the responsibility of senior management to implement arrangements, policies and procedures to manage conflicts effectively. There is no 'one size fits all' that can effectively address the full range of conflicts of interest that arise in the business of the FSP.

<b>ANNEXURE B- COMPLI-SERVE GUIDANCE NOTE "G-Note"</b>		 Compli-Serve
Compli-Serve G-Notes are prepared to assist clients with the interpretation and application of Compli-Serve documentation.		
Subject	Conflicts of Interest in FAIS environment	
Document	Compli-Serve Guidance Note	
Date Issued	6 May 2008	
Version	1.7	

**UNDERLYING PRICIPLES**

To have an adequate conflicts policy in place will assist in minimising the potential adverse impact of conflicts of interest on clients. Such arrangements thereby help promote consumer protection and maintain market integrity.

**CONFLICTS OF INTEREST**

**A DEFINITION**

Conflicts of interest are circumstances where some or all of the interests of people (clients) to whom an authorised financial services provider (or representative/key individual) provides financial services are inconsistent with, or diverge from, some or all of the interests of the FSP. This may include actual, apparent and potential conflicts of interest.

**IMPORTANCE OF A CONFLICTS OF INTEREST POLICY AND THE THREE MECHANISMS FOR MANAGING THEM**

It should be a requirement that all professional financial services providers keep internal written conflicts management policies and records. Presently in the South African context there is no direct and specific regulatory obligation to have adequate arrangements in place to manage conflicts of interest. (Could mention FAIS Gen Code disclosure requirements re conflicts FSP's need to understand what minimum arrangements they will need to have in place to comply with their obligations under FAIS and other legislation.

Managing conflicts of interest is an important part of a FSP's obligations. As part of managing conflicts of interest all FSP's should be in a position to identify, assess and respond to the conflicts of interest that arise in their businesses.

To comply with any conflicts management obligation FSP's should have arrangements in place to manage all conflicts of interest affecting their business. These arrangements must involve the following mechanisms:

- **Controlling Conflicts of Interest-** Identify the conflicts that exist, assess and evaluate the conflicts; decide upon and implement, an appropriate response to those conflicts

- **Avoiding Conflicts of Interest altogether-** If serious potential impact on a FSP or a client of a FSP. Merely disclosing them and imposing internal controls is not enough.

**Disclosing Conflicts of Interest appropriately-** An integral part of managing conflicts. Clear, concise and effective disclosure so that client can make an informed decision. What constitutes appropriate disclosure to a client will depend on all facts presented and a number of circumstances including the level of financial literacy of the client, the extent to which other clients are likely to rely, directly or indirectly, on the service, how much the client already actually knows about the specific conflict and the complexity of the service being presented to the client.

Where conflict may arise avoidance or declining to act for the customer is the safest course of action but is often simply not a practical solution. If the conflict is to arise then it must be managed effectively using a combination of tools namely

- Disclosure: disclosing an interest to a client
- Chinese Walls
- Internal Policies and Procedures: systems and controls to minimize the impact that any conflict is likely to have on the client's interest
- Declining to act for a client

A financial institution must at all times demonstrate that any activity it undertakes does not disadvantage a client.

All FSP's must be able to demonstrate that they have active conflicts management procedures in place and compliance will continually monitor that these procedures have been complied with.

This policy is more than just a disclosure obligation. The obligation is to have adequate arrangements in place to manage conflicts of interest.

#### SENIOR MANAGEMENT RESPONSIBILITIES

Those individuals responsible for the oversight function ("Key Individuals") have responsibilities to implement appropriate processes and procedures for the effective risk management of conflicts of interest and other risks arising within their organizations.

It is the responsibility of management to implement arrangements, policies and procedures to manage conflicts effectively. There is no 'one size fits all' that can effectively address the full range of conflicts of interest that arise in the business of the FSP.

FSP's should consider the wider issues of dealing with clients in a manner that is fair and seen to be fair: Businesses should take a critical view of how conflicts may affect the fair treatment of clients, and to respond accordingly. Clear guidance should be in place for employees on how to recognise a potential issue and when to escalate matters to senior management.

#### Examples of Conflicts

Conflicts can arise in many ways inside financial institutions particularly where research and execution are involved. Examples of conflicts that would be deemed as contrary to standards of fair dealing for clients would include

- Analysts issuing favorable reports on clients to boost investment banking income
- High percentage of buy recommendations to increase trading activity and subsequent fee levels
- Issuing recommendations in support of proprietary or in-house portfolios
- Exposure to non public information
- Trading/Dealing ahead of investment research
- Pre-hedging trades ahead of client approval
- High percentage of recommendations to buy or sell an investment in which the institution has respectively a long or short position
- An institution not executing client orders fairly and in due turn
- Not achieving a timely execution of client orders
- Not adopting an effective Personal Account Dealing procedure. Such dealings must never be in conflict with the firm's duties to its clients.

#### Practical Examples

**Example 1:** FSP A has an interest in encouraging Client B to invest in higher risk products that result in high commissions, which is inconsistent with Client B's personal desire to obtain a lower risk product.

**Example 2:** FSP X has an interest in maximizing trading volume by its clients (including client Y) in order to increase its commission, which is inconsistent with client Y's personal objective of minimizing his or her investment costs.

#### DOCUMENTATION AND RECORDKEEPING

For any conflicts arrangements to be deemed adequate, they need to be documented. This generally involves having a written conflicts management policy (can form part of an existing compliance manual or internal procedures guide)

FSP's should keep records for at least 5 years of

- Conflicts identified and actions taken
- Any reports given to the FSP's senior management about matters relating to conflicts
- Copies of written conflicts of interest disclosures given to clients

#### Example

- All licensees should keep copies of written conflicts disclosures given to individual clients or otherwise made available (e.g. on a website)

## CONTROLLING AND AVOIDING CONFLICTS OF INTEREST

The conflicts obligation does not prohibit all conflicts of interest. It should never provide that a FSP could never provide a financial service if a conflict of interest exists. Rather any policy must advocate that all conflicts of interest be adequately managed. Many conflicts can be managed by a combination of:

- Internal controls
- Disclosures

However some conflicts cannot be managed in this way. In this scenario all conflicts are best avoided.

Depending on the circumstances and the nature of any given conflict, it may be appropriate to:

5. Disclose the conflict of interest to the client;
6. Allocate another representative to provide the service to the client
7. Decline to provide a service to the client
8. Initiate internal/external disciplinary action (referring matter to regulator for instance) where warranted.

## ANNEXURE C

### Conflict of Interest Questionnaire (1) 2008

#### ATTENTION KEY INDIVIDUALS OF FSP LICENCE NUMBER \_\_\_\_\_

FSP (" ") requires each key individual of the business to annually

- 1) Review the FSP's Conflicts of interest policy (the "Policy");
- 2) to disclose any possible personal, familial, or business relationship that reasonably could give rise to a conflict of interest or the appearance of a conflict of interest in the **Conflict of Interest Questionnaire (found here)**; and
- 3) To acknowledge by his or her signature that he or she is acting in accordance with the letter and spirit of such Policy on the Pledge of Personal Commitment.

Please respond to the following questions to the best of your knowledge.

1. Please list all corporations, partnerships, associations or other organizations of which you are an officer, director, trustee, partner, or employee, and describe your affiliation with such entity.

2. In terms of the FAIS Code of Conduct you must disclose to the client the existence of any personal interest in a relevant service, or of any circumstances which gives rise to annual or potential conflict of interest in relation to such service, and take all reasonable steps to ensure the fair treatment of the client: Comment

3. Non-cash incentives offered and/or other indirect consideration payable by another provider, a product supplier or any other person to the provider could be viewed as a potential conflict of interest. Please list any received in last 12 months (can include incentive trips, sponsorships, gifts that amount to material benefits, business services, entertainment expenses, access of preferential, differentiated service/training/advice facilities, shareholdings, sales quota obligations, product biases etc)

4. Where applicable, the fact that the provider - directly or indirectly holds more than 10% of the relevant product supplier's shares COMMENT

Has any equivalent substantial financial interest in the product supplier; during the preceding 12 month period received more than 30% of the total remuneration, including commission, from the product supplier- COMMENT

Has the information above been disclosed on the disclosure documentation of the FSP? YES or NO

5. Please list all corporations, partnerships, or other entities in which you and/or the FSP have a material financial interest as defined in the manual.

6. Please list any proposed business dealings between product suppliers and you/the FSP, your family members, and/or entities. Describe each such relationship listed and the actual and potential financial benefits as you can best estimate them.

7. Are you aware of any other relationships, arrangements, transactions, or matters which could create a conflict of interest or the appearance of conflict? If so, please describe.

I have read the FSP conflicts of interest policy. I am currently, and agree to remain, in compliance with the Policy.

Entered into on this the \_\_\_\_\_ day of \_\_\_\_\_, 2008.

**ANNEXURE D**

**DISCLOSURE OF AFFILIATIONS-DISCLOSURE OF INTERESTS AND CONTROL MEASURES**

In order to ensure proper corporate governance, and the accountability and transparency of our organisation, relevant persons are required to declare any private interests that might affect the carrying out of their duties. They are also required to take steps to resolve any conflicts that arise in a way that protects the public interest. To fulfil this requirement, any relevant interests must be declared on the Register of Interests. These are personal or business interests that might influence their judgement, deliberation or action as employees of the financial services provider, or which might be perceived by a reasonable member of the public as doing so.

**Conflicts of interest control measures**

**Declaration of Interests**

<ul style="list-style-type: none"> <li>The disclosure of interests to be completed by the FSP (as the entity), key individuals in the financial services business and the members of the management board</li> </ul>
<ul style="list-style-type: none"> <li>In order to ensure proper governance, and the accountability and transparency of the FSP, relevant persons are required to declare any private interests that might affect the carrying out of their duties. The key persons will also be required to take steps to resolve any conflicts that arise in a way that protects the clients of the FSP. To fulfil these duties, any relevant interests must be declared on the Register of Interests</li> </ul>
<ul style="list-style-type: none"> <li>The defining purpose of this disclosure is to be able to provide information to clients about the relevant interests of the FSP and the key individuals. These are personal or business interests that might influence their judgement, deliberation or action, or which might be perceived by a 'client' as doing so.</li> </ul>
<ul style="list-style-type: none"> <li>Relevant parties must consider whether they need to disclose personal involvement with persons or organisations, which clients might reasonably think, could influence their judgement.</li> </ul>
<ul style="list-style-type: none"> <li>Any interest, which comes to light, should be declared prior to discussion at a Management Board meeting. It should take place irrespective of whether the interest has already been recorded in the register.</li> </ul>

<ul style="list-style-type: none"> <li>Where there is uncertainty about whether a particular interest should be declared, advice should be sought from the compliance officer of the FSP.</li> </ul>
<ul style="list-style-type: none"> <li>The interest disclosure should be intended as a record available to clients on request. All material conflicts of interest should however be disclosed to affected clients. An appropriate mechanism would be to disclose such conflicts in the initial disclosure documentation of the FSP, or other suitable means.</li> </ul>
<ul style="list-style-type: none"> <li>It is each person's responsibility to inform the internal person responsible for conflicts of interest, including compliance, of any relevant changes as they occur and to register their interests in the register provided.</li> </ul>
<ul style="list-style-type: none"> <li>The disclosure will be reviewed on an annual basis by Compli-Serve SA as your designated compliance officers.</li> </ul>
<ul style="list-style-type: none"> <li>Where there is a complaint received about a failure of the FSP to disclose a relevant interest, the complaint should immediately be sent to compliance for evaluation and response.</li> </ul>

**TO BE COMPLETED ON APPOINTMENT AND ANNUALLY THEREAFTER. THE DISCLOSURE FORM COVERS ONGOING AFFILIATIONS THAT MAY PRESENT CONFLICTS, BUT KEY PERSONS SHOULD ALSO BE ALERT TO OTHER CONFLICTS OF INTEREST THAT MAY ARISE DURING THE COURSE OF THE YEAR**

**THE REGISTER IS A MATTER OF PUBLIC RECORD. COPIES ARE MADE AVAILABLE ON REQUEST**

**FSP NAME-**

**NAME OF INDIVIDUAL/TITLE-**

**1. COMPANY INTERESTS**

Responsibility of all directors, advisors and staff to outline here their outside business interests, major shareholdings in other product suppliers, personal interests, family interests, directorships, consultancy, paid employment, other affiliations with other parties to a business transaction etc

**LIST**

**2. NON-CASH INCENTIVES offered and/or other indirect consideration**

Payable by another provider, a product supplier or any other person to the provider could be viewed as a potential conflict of interest. Please list any received in last 12 months (can include incentive trips, sponsorships, gifts that amount to material benefits, business services, entertainment expenses, access of preferential, differentiated service/training/advice facilities, shareholding\*, sales quota obligations, product biases etc)

**3. Where applicable, the fact that the provider or yourself – directly or indirectly holds more than 10% of the relevant product supplier's shares**

**Date**

**Signature**

**4. Have you or FSP any equivalent substantial financial interest in the product supplier; during the preceding 12 month period received more than 30% of the total remuneration, including commission, from the product supplier**

**5. Public appointments-remunerated/non remunerated**

**6. Memberships (external bodies & Associations)**

**7. Close Family links (family interests in any of the above)**

**8. Other interests not covered by the above**

I confirm that the above declaration is complete and correct to the best of my knowledge and belief.



- If you feel the gift is inappropriate, discuss it with a colleague, or a superior. Don't simply return the gift in haste. Ensure that the best course of action is taken with the approval of a superior and without damaging the relationship with the giving entity;

Never accept monetary gifts or gifts that make you feel uncomfortable. For example a woman who receives a gift of lingerie from a client or supplier has to question the intention and virtue of the giver.

### **3.2 Gift Register Checklist: When giving:**

- Feel free to give gifts for special occasions and for the festive season, if that is the practice you have been adhering to and you have created that expectation in your business associations. But make your intentions clear - state the reason for each and every gift given;
- Ensure the gift is appropriate in terms of what is and of its value. When in doubt ask the opinion and advice of others with experience in gift giving;
- As an employee, establish from the outset what the company policy is in terms of giving and receiving gifts;
- Expect that some of the gifts you have given may be returned. Be gracious when accepting the gifts back where there are good reasons for the receiver to return your gift;
- Keep a record of how the gift was funded, in other words from company funds or bought at personal expense.

### **4. Best Practice. Discipline in application**

Employees are required to adhere to any guidance the FSP sets out and, where directed, to retain a proper record of their activities for justification purposes. Failure to do so should result in disciplinary action.

Employees should be required to record the receipt of all gifts (except perhaps business meals); details of gifts declined, received and donated; and details of any fees received as a guest speaker at conferences and the like.

Employees may choose with their Head of Department / Area Manager/Compliance Officer which location is appropriate to record this information.

### **Compli-Serve Practice Note 2008**

## COMPLI-SERVE PRACTICE NOTE "P-Note"

Compli-Serve P-Notes are prepared to assist key individuals and internal compliance personnel with the application of particular aspects of regulatory environments.



Subject	Best Practice-The Giving/Receiving of Gifts (Registry)
Document	Practice Note
Date Issued	06.05.2008
Version	1.3

### Glossary

FAIS	Financial Advisory & Intermediary Services Act
FSP	Licensed Financial Services Provider
Code	FAIS General Code of Conduct for FSP's

### 1. Preambles and Scope

This practice Note sets out best practice policy for all staff that provides gives/receives gifts to or on behalf of third parties, for example clients.

These guidelines have been prepared with international best practice in mind.

### 2 The Acts

**2.1 The Prevention and Combating of Corrupt Activities Act "PCCA"** embraces criminal liability regarding corruption. The legislation aims at reducing and preventing corruption and to promote accountability and transparency. The legislation dictates that any gift, regardless of size, is illegal if it serves as *"unauthorized or improper inducement to do or not to do anything"*.

If the intention of the gift - and the Act includes holidays, property, discounts, loans, contracts for employment - is to influence or to compel someone to do or deliver something, it becomes legally questionable.

However, a gift presented as a mere thank you or the dinner offered as a relationship-strengthening exercise is completely acceptable.

It is ultimately a question of business ethics. Companies should ideally be setting out internal policies that guide the giving and receiving of gifts.

It is wholly recommended FSP's keep a register of gifts received and of sharing gifts, such as edibles, that can be shared between everyone in the company.

As people on all levels are now faced with the dilemma of whether to give and/or accept gifts, Compli-Serve attaches the following guidance.

**2.2 The Financial advisory and Intermediary Services Act "FAIS"** (Section 3 of the General Code of Conduct) states that when a FSP renders a financial service, the provider must disclose to the client the existence of any personal interest in the relevant service, or of any circumstance which gives rise to an actual or potential conflict of interest in relation to such service. The provider must also disclose any non-cash incentives offered and/or indirect considerations payable by another provider, a supplier or any other person/s to the provider. This could be viewed as a conflict of interest.

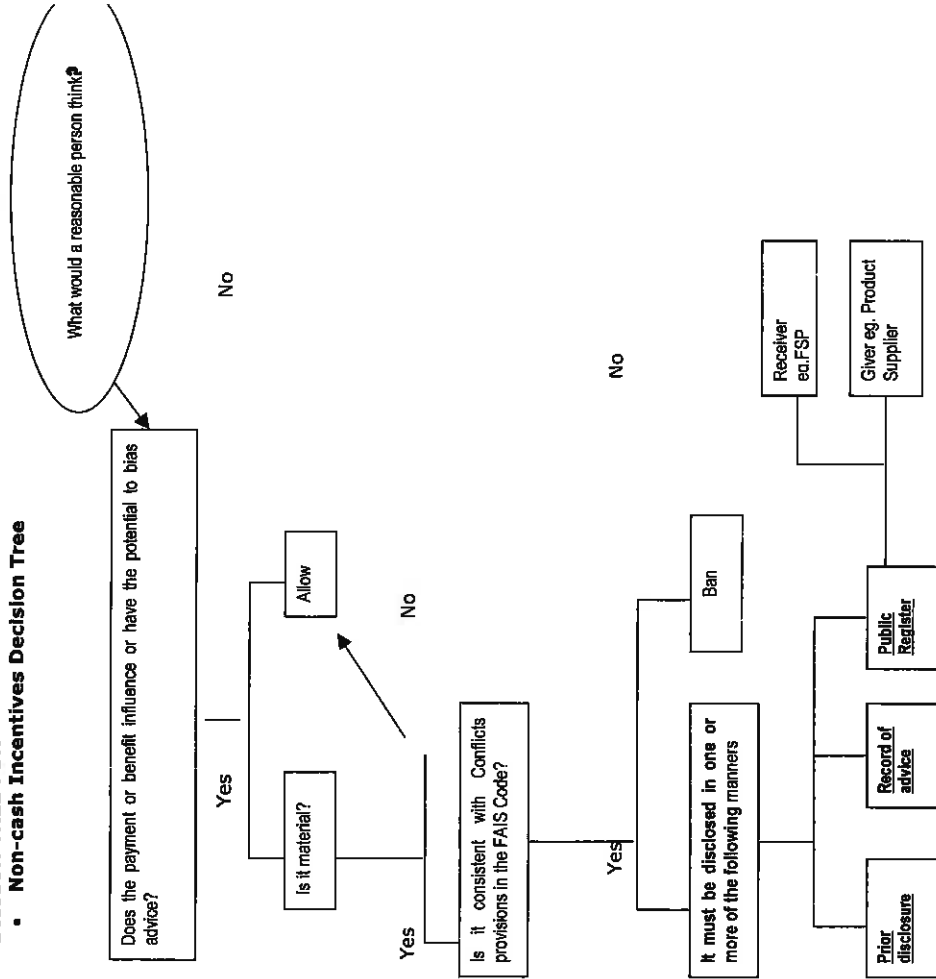
The nature, extent and frequency of any incentive offered should be recorded.

### 3. Gift Registers Best Practice

#### **3.1 Checklist: When receiving:**

- Establish the motive of the person or company who has given the gift. Not everyone has ulterior motives, and a bona fide gift should be accepted graciously;
- Never keep a gift a secret. Report it to your superior or in case of where a register is kept; ensure that the gifts you receive are recorded. Secrecy, whether intentional or not, may lead to suspicions about the gift;

**ANNEXURE F NON CASH INCENTIVES/INDIRECT CONSIDERATIONS EXAMPLES**  
**DECISION TREE FOR**  
**Non-cash Incentives Decision Tree**



The following are examples of incentives and benefits that should always be recorded in a gifts and non-cash incentives register. COI procedures as laid out should be followed.

This is an example of the categorisation of alternative non-cash incentives/conflicts of interest/indirect benefits  
 Source: Association of Collective Investment Schemes "ACI"

**NOTES**

Compl-Serve has reviewed the FSB discussion paper 'Conflicts of Interest and Transparent Disclosure' and come of the industry submissions on this subject AND INCLUDES HERE A PROPOSAL MADE BY THE ASSOCIATION OF COLLECTIVE INVESTMENT SCHEMES with respect to the certain forms of non-cash incentives that should not be permitted/permitted with disclosure and permitted with no disclosure requirement.

The following is intended to act as guidance only.

**ANNEXURE B1 (Amend as appropriate)**

Categorisation of Alternative non-cash incentives/conflicts of interests/ indirect benefits

(a) Certain forms of non-cash incentives should not be permitted, for example:

- i) International "incentive trips", educational or professional development conferences, accommodation and travel arrangements with which financial services providers and/or their representatives are rewarded by a product supplier, including any part payment towards these costs;
- ii) Domestic "incentive trips", educational or professional development conferences, accommodation and travel arrangements with which financial services providers and/or their representatives are rewarded partially or exclusively for the volume of business placed with such product supplier, including any part payment towards these costs;
- iii) Sponsorships by product suppliers for financial services providers and/or their representatives to attend and/or hold international conferences.
- iv) Sponsorships by product suppliers for financial services providers and/or their representatives to attend and/or hold domestic conferences, where the sponsorships are granted subject to a certain volume of business having been placed or in anticipation of its being placed with such product supplier;
- v) Gifts that amount to material benefits;
- vi) Cash or gift vouchers;
- vii) Provision of motor vehicles;
- viii) Mortgage bonds and/or other loans on more favourable terms than those normally available in the market to the provider or provider's representative;
- ix) Payment or provision of all or part of the costs of any business service or other business expense, including but not limited to:
  - i. Office rental;
  - ii. Computer hardware and commercial software;
  - iii. Practice management;
  - iv. Compliance services;
  - v. Provision of staff or payment of all or part of staff salaries.

### **ANNEXURE B2 (Amend as appropriate)**

(b) Certain forms of non-cash incentives should be permitted, but must be disclosed by both the giver and receiver, for example:

- i) Entertainment, tickets for sporting and other events with a value over R500.00 per person per single item,
- ii) Domestic educational or professional development conferences, accommodation and travel arrangements that are awarded to the provider using selection criteria that are not partially or exclusively based on sales volumes, including any part payment towards the costs,
- iii) Sponsorship of domestic provider events, including conferences, by a product supplier, which includes the purchasing of advertising and promotional space,
- iv) Accommodation and travel costs where the provider is invited as a speaker at a domestic conference/professional development event held by a product supplier, including any part payment towards the costs,
- v) Access to preferential, differentiated service and/or training and/or advice facilities, and the like;
- vi) Shareholdings, equity entitlements, sales quota obligations or performance fee entitlements that they, or an entity in which they have an interest, have in the product suppliers of the products or administrative financial services providers that the provider and/or its representatives recommend to clients;
- vii) The fact that during the preceding 12 month period, the provider received more than 30% of total remuneration, including commission from the product supplier;
- viii) Where a provider markets or gives advice in respect of the products of more than one product supplier, should the representatives of such provider be rewarded in any way that could, or could be perceived to, bias advice in favour of one product supplier over another, this fact must be disclosed,
- ix) Where a provider markets or gives advice in respect of the products of one or more product suppliers, should the representatives of such provider be rewarded in any way that could, or could be perceived to, bias advice in favour of one particular product or underlying product option over another, this fact must be disclosed; and
- x) Any other non-cash incentives that are material and are not specifically described in the Code.

### **ANNEXURE B3 (Amend as appropriate)**

(c) The following are examples of benefits that should be permitted, with no requirement to disclose.

- i) Computer software linked to a product supplier's products, such as a product-linked advice tool.
- ii) Benefits that are not material and are not in the form of cash or gift vouchers.

iii) *This one is debatable – may well need to be in section (b) above i.e. allowed but disclosure required, or maybe not allowed at all: Professional development conferences/courses that meet the following criteria:*

- (a) The conference may be for no longer than three days and two nights. The professional development must account for at least 4 hours per day.
- (b) Flights and other forms of transport must be domestic only and must be the regular class (not for example, business or first class).
- (c) The total cost of accommodation, meals and incidentals must not exceed R1750.00 per day.
- (d) Only the financial services provider or representative may be paid for – not any spouse, family member or other person.
- (e) The location of the conference/ course must be domestic.

## ANNEXURE G SECTOR SPECIFIC CONFLICTS AND GUIDANCE

### INSURANCE.Short term / Long Term.Separation.suggested

The management of conflicts is an important factor in the business of insurance intermediaries and has been the recent focus of regulators around the world. It should be senior management's responsibility to implement appropriate processes to enable your FSP to manage conflicts of interest effectively.

There is generally a greater likelihood for conflicts to exist in respect of close links with an insurer. A recent international study found the impact of this relationship can be lessened by management information that identified the proportion of business placed with the linked insurer(s). This permitted senior management to identify any unusual placement volumes or patterns. However bad practices can always be identified where little evidence of formal procedures is available to ensure that the broker's duty to the client was not being compromised by the relationship with the insurer.

Consideration should be given to formal business procedures to specifically address the issue of close links.

**Claims handling authorities** Where the intermediary is permitted to place insurers on risk under a delegated underwriting authority, there is sometimes an equivalent claims handling authority with the same person.

Intermediaries with binding authorities are often remunerated in accordance with the volume and profitability of the underlying business, meaning that they may be incentivised to handle claims to the detriment of policyholders. While most binders have limited claims settling authorities, meaning the potential for the conflict to generate policyholder detriment is reduced, some scope for conflict remains.

**Inducements** Many retail firms did not consider the issue of inducements to be a high-risk conflict given the nature of their business, and whilst this is the case to a certain extent, it is an area that intermediaries should continue to monitor.

Most firms had some form of strategy in place to deal with inducement related conflicts, although some of these were not far reaching enough. Such strategies generally relied on the policyholder being relatively price sensitive and on disclosure where the intermediary had not been able to obtain quotes from a wide spread of risk carriers.

Intermediaries stated that commercial clients very rarely asked for commission to be disclosed but, in those instances where the request was made, it was not complicated for the firm to identify and release the commission details. This suggests, albeit anecdotally, that there is not currently a demand for commission details even amongst sophisticated insurance buyers.

Specific examples of inducement-related conflicts identified were:

**Binding authorities** – where an intermediary operates a binding authority with a profit commission, there is an inherent conflict whereby business the intermediary knows to have a good loss history may be directed to the binding authority, whilst other business is directed to other markets. This conflict is sometimes reduced by operating the binding authority on an 'arm's-length' basis, or under a separate division, however, this practice is not prevalent across the market.

**Premium finance** – an intermediary may be involved in premium financing through ownership or participation in a premium finance provider, or through interest/administration charge sharing arrangements with such a provider. The risk is that policyholders may be encouraged unduly to use the premium finance services, or where they elect to use premium finance, are obliged so to do through the broker's preferred supplier. Most intermediaries had written procedures to mitigate this risk; however, some intermediaries saw this as a legitimate means of earning additional income through their business.

**Soft loans & cash gifts** – Product providers have, in some cases, been willing to make large gifts or uneconomic (soft) loans to intermediaries. Such gifts or loans may be construed as being in return for the provider's products being placed on the intermediary's panel or recommended list of insurers. In some cases the gift or loan is given on condition of a target for the sale of the provider's products. Such an arrangement is incompatible with the adviser's duty to recommend the most suitable product within its range. Disclosure of the gift or loan to clients was not found to be universal.

### **Conflict mitigation**

There are many FSP's that have not as yet started the process of thinking about conflicts

As many do not believe that they are exposed to any risk. Set out below are a number of features of conflicts mitigation procedures and practice:

- Some conflicts policies start with an attempt to define what constituted a conflict. FSP's should consider whether a definition may be either too narrow, for example, tied to remuneration issues; or too general, in that it is a conflict where the interests of the intermediary differ from the interests of the client. An alternative approach was to start with a general definition of a conflict of interest followed by an analysis of how this may apply in common business type situations.
- Attempts are made in some procedures to tie all documents relating to personal and corporate conflicts into one overarching framework. Other approaches tend to have an array of different conflict-related documents, i.e. principles for dealing with clients, senior management conflicts policies or staff ethics guides, which were not always consistent with one another. An alternative approach to handling conflicts could be to start with a high-level conflicts framework, with subsequent consistent sub-manuals relevant to the appropriate business area.
- Whilst all staff should be aware of conflicts and should be responsible for ownership of conflicts arising out of their own conduct, the overall conflicts policy should be owned by a member of the Board or senior management, with regular reporting backed by strong management information highlighting exceptions.(register of exceptions) In some cases, FSP's may consider having a director responsible for the

conflicts policy, and there needs to be regular reporting to the Board/senior management.

- Smaller FSP's may not have an internal audit (IA) function. Where an IA function is not present, a strong culture of consistent internal acceptance checking of files by an individual not involved in the placement of the risk is one method of ensuring that risks arising out of conflicts have not crystallised. (External compliance monitoring programme) The approach of smaller FSP's to handling conflict identification could consist of regular file reviews with senior staff showing a serious approach to making sure exceptions are monitored, followed up, and managed effectively.

#### **Key points for FSP's**

The following actions should be taking place at FSP firms:

- Senior management should be fully engaged in all aspects of conflicts identification and management and take a broad view of the risks posed to their business. This means that responsibility for conflicts identification and management is allocated clearly to accountable individuals, and that controls to mitigate conflicts are reviewed on a regular basis. Relevant management information should be available to support this process.

- FSP's often perceive conflicts of interest in too narrow a manner or to be solely about remuneration. Senior management are responsible for ensuring that the broad spread of conflict risk to which their firm is exposed is addressed, including latent and emerging conflicts. They should also make informed judgments about the materiality of the conflict risk. This should take place within a business culture that supports the management and mitigation of conflicts of interest.

- A formal conflicts policy should be put in place or, where already in place, reviewed, with FSP's setting out clearly how they propose to mitigate the conflicts identified.

While avoiding conflicts is linked with observation of the duties of agency, intermediaries should also ensure that they consider the wider issue of dealing with clients in a manner that is fair. One can expect that all FSP's take a critical view of how conflicts may affect the fair treatment of its clients and to respond accordingly. Clear guidance should be in place for staff on how to recognise a potential issue and when to escalate matters to senior management/compliance.

#### **FINANCIAL PLANNING**

Any recommendation of a financial services product needs to be carefully matched to the client's needs. Some products involve greater risks and may have significant adverse consequences if they are not appropriate to the client's individual circumstances.

1. FSP A has an interest in encouraging CLIENT Y to invest in a higher risk product that results in higher commissions, which is inconsistent with CLIENT Y's personal desire to obtain a lower risk product.

2. FSP B has an interest in maximizing trading volume by its clients (incl. CLIENT Z) in order to increase its commission revenue, which is inconsistent with CLIENT Z's personal objective of minimizing investment costs.

3. Licensee K occupies office space adjacent to Accountant U and Solicitor T. Licensee K can expect referrals from U and T, if U and T are receive preferential referrals from licensee K, even though K knows that other accounting practices are better qualified to serve K's client.

4. Licensee J allows staff to give positive advice about a particular financial product provider, solely in return for continuing business from that provider.

5. A product issuer, in giving advice about its own product, should identify it as both the adviser and the product issuer.

6. A licensee in a group that is owned by a product issuer, in giving advice about a product issued by that product issuer, should disclose this relationship when giving the advice.

7. In a situation where the adviser is prevented from making adequate conflict of interest disclosure because the information to be disclosed is commercially sensitive or is protected by confidentiality agreements. Such situations are difficult to manage adequately and it may be that the adviser will need to avoid providing the advice altogether.

#### **Licenses/financial advisers (retail)**

##### **Commission only remuneration**

Hippo Ltd, a stockbroking firm, employs advisers who are solely remunerated by way of broking commission. If advisers do not advise a client to buy or sell a security, they are not remunerated.

##### *Possible response*

In this case, the interests of Hippo's advisers in earning remuneration for their services might be entirely at odds with the interests of its clients in receiving appropriate investment advice. This conflict is serious and as a matter of best practice should be avoided. While we think the conflict should be avoided, the conflict could potentially be managed in one of two ways:

- First, Hippo could implement additional incentives structures that reward advisers for providing quality, compliant and consumer-focused advice. For example, it could create a remuneration pool where remuneration is paid on the basis of criteria such as whether any complaints are made by clients against the adviser, whether the adviser regularly provides clients with timely and appropriate statements of advice and whether the adviser attends relevant education sessions.
- Second, Hippo could make full and frank disclosure to its clients about how the adviser is remunerated and why this method of remuneration can lead to a conflict of interest. The client needs this information so that he or she can decide how much weight to place on the adviser's advice.

##### **Product pipeline**

Sue has worked as a private client adviser at Brookfield Stockbroking for about 15 years. In the last 5 years, Brookfield has started pressuring advisers such as Sue to encourage clients to apply for new issues that Brookfield is underwriting or to apply for new managed fund products on which Brookfield gets commissions. This often involves Sue having to suggest that her clients sell securities or other products that she would otherwise recommend they retain so they can invest in these new issues or products.

#### *Possible response*

- The conflict here is that Brookfield is putting its own interests above those of its clients. Unless the adviser reasonably believes that it is in a client's best interests to sell an existing holding so that the client can take up new securities, the only way of adequately managing this conflict is by avoiding it. Advisers should avoid situations where the interests of the licensee in earning brokerage, fees and commission are preferred to the interests of clients.

#### **Buyer of last resort**

Wedgetail Alfinanz Limited is a major provider of banking, insurance, and fund management services. It has a large number of managed fund products and a large network of advisers who recommend its products to their clients. In its arrangements with many of these advisers, Wedgetail agrees to 'buy' their businesses on a 'last resort' basis. The purchase price is a multiple of the annual commission on income stream, with a higher multiple payable for sales of Wedgetail's products.

#### *Possible response*

- The conflict here is that Wedgetail's advisers have incentives to recommend Wedgetail's products (which might or might not be appropriate to their clients' needs) to maximise the value of their businesses. The easiest and most reliable way to manage this conflict of interest is by not using this methodology to set a purchase price.
- For disclosure to be an effective part of managing this conflict of interest, the client must be able to make an informed assessment about how the conflict of interest might affect the adviser's product recommendations. In particular, the client should understand that the arrangement might result in a preference for recommending Wedgetail's products.
- Wedgetail's internal controls should also ensure that the integrity and quality of the advice is maintained at a high standard. Wedgetail needs to be confident that all advice provided is appropriate and in the best interests of clients.

#### **Relationship between product issuer and adviser**

Wealthinvest, a product issuer, owns a financial planner group called Lark. Lark's advisers only advise on and sell Wealthinvest's products. Lark does not use any of Wealthinvest's branding or logos, but if you look closely enough on Lark's website there is a small paragraph which says that Lark is a wholly-owned subsidiary of Wealthinvest. Lark's financial services guide and statement of advice also say, in the fine print, that Wealthinvest owns Lark.

#### *Possible response*

- The conflict here arises because clients might not realise that Lark's services are restricted and that the advice that its advisers give is biased. Lark needs to be confident that, given the limited product range available to its advisers, it is still possible to provide advice that is appropriate and in the best interests of clients.

- For disclosure to be an effective part of managing this conflict of interest, the client must understand the relationship between Lark and Wealthinvest and how that relationship affects Lark's advisers' product recommendations. The client should clearly understand that the adviser cannot recommend other issuer's products and that the advice will be limited and as such the client might suffer detriment.

#### **Advice on platforms**

Jane, an adviser at Finco Super Pty Ltd, recommends to clients to switch to a wrap account provided by Leopard Financial Limited. Finco is a wholly-owned subsidiary of Leopard. Leopard's wrap account offers similar functions to the client's current platform, however it makes administration of the client's portfolio easier for Jane. Jane also gets up front and trailing commissions when clients switch to Leopard's platform.

#### *Possible response*

- In this case study, Jane is receiving a financial benefit in moving clients to the new platform in circumstances where there is no discernible benefit to the clients in making the move. Generally, moving clients to the adviser's platform merely because it makes it easier for the adviser to service the clients is not a sufficient reason to justify the switch. The new platform should be objectively better for the client (e.g. in the service it provides or in lower fees and costs) to justify a switch. If there is no discernible benefit, the commission should be rebated to the client.
- For disclosure to be an effective part of managing this conflict of interest, the client should understand the relationship between Leopard and Finco, the amount of commissions that Jane will get as a result of the switch, the differences between the two platforms, including the advantages and disadvantages of the switch and the reasons why the adviser considers the switch suitable.
- Finco's internal controls should also ensure that despite the biasing influence of the ownership structure, all advice provided is appropriate and in the best interests of clients. Effective supervising and monitoring of the advice provided is an important part of this.

#### **ASSET MANAGEMENT**

Will include having a soft dollar or commissions policy and a policy on personal account trading (All cat discretionary financial services providers should have a personal account trading policy and policy in place)

Conflicts can arise in many ways inside financial institutions particularly where research and execution are involved. Examples of conflicts that would be deemed as contrary to standards of fair dealing for clients would include

- Analysts issuing favorable reports on clients to boost investment banking income
- High percentage of buy recommendations to increase trading activity and subsequent fee levels
- Issuing recommendations in support of proprietary or in-house portfolios
- Exposure to non public information
- Trading/Dealing ahead of investment research
- Pre-hedging trades ahead of client approval
- High percentage of recommendations to buy or sell an investment in which the institution has respectively a long or short position
- An institution not executing client orders fairly and in due turn
- Not achieving a timely execution of client orders
- Not adopting an effective Personal Account Dealing procedure. Such dealings must never be in conflict with the firm's duties to its clients.

In practice conflicts may manifest themselves in an FSP as below: -

**Example 1:** FSP A has an interest in encouraging Client B to invest in higher risk products that result in high commissions, which is inconsistent with Client B's personal desire to obtain a lower risk product.

**Example 2:** FSP X has an interest in maximizing trading volume by its clients (including client Y) in order to increase its commission, which is inconsistent with client Y's personal objective of minimizing his or her investment costs.

#### **Product issuers/fund managers**

##### **Directed brokerage**

Pickrel, a fund manager, gives Moose, a stockbroker, a large portion of its routine stockbroking work (i.e. buying and selling securities for its funds) because Moose's advisers, in turn, sell large amounts of Pickrel's products in return for commissions from Pickrel at prevailing market rates. However, Moose charges higher commission than other brokers for its execution services. The execution services provided by Moose are generic and do not involve any kind of 'value added' service.

##### *Possible response*

- In this situation, Pickrel is favouring its own interests ahead of its

clients by paying Moose above market commission rates. We think that this conflict of interest can only be adequately managed by avoiding it. The higher commissions charged by Moose will be reflected in increased management costs for Pickrel's products and a correspondingly reduced return for investors (all other things being equal).

- Pickrel must act in the best interests of its (fund member) clients. This applies to its selection of service providers, including its stockbroker.

#### **Asset management advice**

Antelope charges a fee for the advice it gives to super funds generally about new products. Antelope frequently advises funds to select Jaguar to manage fund assets. Antelope has a relationship with Jaguar, providing investment product reviews for a fee. Antelope tells Jaguar when it has recommended it to manage a fund in the hope of getting more product review work.

##### *Possible response*

- The potential conflict in this case is that Antelope might be putting its own interests above those of its clients by selecting Jaguar if it is motivated more by getting product review work than getting the best manager for its clients. Generally, this conflict of interest can be managed by internal controls and disclosure. Any recommendation to use Jaguar should disclose Antelope's relationship with Jaguar and fees that it gets from Jaguar. The recommendation should also disclose that Jaguar will be told of the recommendation to use it.
- Antelope's internal controls should also ensure that the advice is not biased and is in the best interests of the funds.

#### **Related entities**

Peacock is a fund manager and a wholly-owned subsidiary of Honeybee. Honeybee provides asset management services to Peacock (and other entities). Honeybee also markets and distributes interests in the fund. The performance of the fund that Peacock is responsible entity for is below market expectations largely due to poor asset management by Honeybee. The ownership and governance structure of the two companies, however, prevents Peacock from terminating the relationship with Honeybee and selecting another asset manager.

##### *Possible Response*

- Regardless of the structure of its corporate group, a fund manager must act in the best interests of its members (investors) and Peacock is clearly not doing so in this scenario. Some corporate structures involve inherent conflicts of interest. This includes structures where a fund manager is obliged or expected to use other members of the corporate group as service providers. Such a corporate structure does not diminish the fund manager's obligation to act in the best interests of members at all times.
- For example, the fund manager must still ensure that the service providers it selects are appropriate and that it is reasonably able to supervise them. The fund manager should also ensure that the fees paid

and other benefits (e.g. interests in the fund at a discount) given to service providers are competitive and reflect value-for-money for fund members.

- A fund manager should assess all asset management recommendations and consider which recommendations it will act on, based on whether they are in the best interests of fund members.

#### **Embedded termination benefit for responsible entity**

Cougar is the responsible entity of the Bigfee Growth Fund, a registered managed investment scheme. Under the terms of Bigfee's constitution, if Cougar is removed as the responsible entity, it will be paid a one-off termination fee equal to 3.5% of funds under management at the time of removal.

The termination fee is in addition to other fees payable to Cougar including establishment and ongoing management and performance fees, broadly in line with market rates. All fees are disclosed in Bigfee's product disclosure statement. Cougar is a wholly owned subsidiary of Bigfee Holdings, a financial services conglomerate and the promoter of the Bigfee Growth Fund.

#### *Possible response*

- The conflict here is that the Bigfee Group has set up a scheme under which its interests will prevail over the interests of scheme members in two ways:
  - the entrenchment of its wholly-owned subsidiary Cougar (thereby locking in a range of ongoing fees); and
  - In imposing a pecuniary penalty, unrelated to the performance of management services, in the event that scheme members want to terminate Cougar's services.

#### **CASE STUDY: International Best Practice-INVESTMENT MANAGERS/INVESTMENT BANKING**

The UK Financial Watchdog, the FSA, conducted a Review late in 2005 on Conflicts of Interest and how businesses are managing it. Set out below are some examples of the best practice the UK regulator observed, together with an indication of where best practice appears to be still evolving.

Much of what is outlined below can be applied to the S African scenario.

Best practice requires a blend of having the right culture and effective management coupled with appropriate, relevant and up-to-date policies and procedures.

- **The FSP has an up to date view of the totality of the types of conflicts that can emerge in its business activities:** Undertake a thorough review to identify actual and potential conflicts both within and across business lines, taking into account the local regulatory landscape. Best practice is for the assessment to be kept current to take account of new business initiatives, changes in reputation and market practice. The results can be reported to senior management through audit committee.

- **The FSP reviews on a regular basis the types of mitigation it considers appropriate to address conflict risks:** Having mapped out the circumstances in which conflicts may arise, it would be best practice to ensure regular assessments of the appropriateness of the policies and practices by which conflicts are managed. This may include changing business practice or exiting a particular activity if the conflict risk cannot be satisfactorily mitigated.

- **FSP has a conflict architecture that is able to deliver the mitigation resulting from the review process (as above):** Best practice here includes:

1. Having a clear, documented policy on conflicts identification and management governing general conduct and procedures for managing conflicts where they arise.

2. Ownership of conflict risk resides with business line management, who are responsible for identifying and managing the risk, supported by compliance and other control functions. You may even appoint conflicts officers and establish conflicts frameworks, which set out the responsibilities of each employee to manage conflicts in accordance with internal controls and procedures.

3. Having clear arrangements for dealing with significant or sensitive transactions (if applicable) that may affect the reputation or financial stability of a business. The arrangements may allow for transactions to be escalated for senior management consideration and approval. Independent challenge can perhaps be provided through formal committee structures or referral to compliance personnel.

4. Record all decisions, along with specific measures taken to control or manage the conflict

- **Senior management involvement:** Must play a key role in the review of conflict types and their mitigation. This ensures the integrity of the conflict architecture

- **Culture of the business supports effective management of conflicts:** Embedding in the culture an understanding of what constitutes acceptable and unacceptable behaviour. This can be reinforced through a combination of senior management involvement in training initiatives, the way in which difficult transactions are handled.

- **Process must be subject to independent Review:** Business's approach to conflicts management to be sufficiently documented and transparent to stand up to external review.

#### **HYPOTHETICAL CASE STUDIES ILLUSTRATING REAL/PERCEIVED CONFLICTS OF INTEREST AND EXAMPLES OF HOW CONFLICTS COULD BE MANAGED**

