



# Conflicts of Interest



**ASIC**

Australian Securities &  
Investments Commission

**28<sup>th</sup> August 2006**

# History

- *Daly v Sydney Stock Exchange* (1986)
- Good advice policies
- Shadow shopping
- Research analysts report (2003)
- US litigation (e.g. NY AG, SEC)

# Definition of conflicts

- “Conflicts of interest are circumstances where some or all of the interests of people (clients) to whom a licensee (or its representative) provides financial services are inconsistent with, or diverge from, some or all of the interests of the licensee or its representatives. This includes actual, apparent and potential conflicts of interest.”  
[PS 181.15]

# PS 181 history

- CLERP 9 background
- Treasury discussion paper raised idea of conflicts management obligation
- Initially targeted at investment banking/research
- Broadened to licensees generally

# The conflicts management obligation

- “[PS 181.16] Licensees are obliged (among other things) to have adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to the provision of financial services by the licensee, or a representative of the licensee, as part of the financial services business of the licensee or the representative (the ‘conflicts management obligation’): s912A(1)(aa).”

# PS 181

- Conflicts management obligation commenced 1 January 2005
- Licensees and their advisers wanted guidance on what the new obligation meant
- ASIC had some expectations of licensees
- PS 181 published August 2004
- Key concepts in PS 181
  - Control, avoid and disclose
  - Licensees must identify the conflicts affecting their business, assess and evaluate those conflicts; and decide upon, and implement, an appropriate response to those conflicts. [PS 181.28]

# Research guide story

- Great interest in research analyst conflicts of interest
- In US, UK and Australia
- IOSCO interest (major research report and publication of internationally accepted principles – 2003)
- ASIC's own surveillance report (2003)
- ASIC published additional guidance on conflicts issues for Research Analysts (November 2004).

# Why conflicts matter – preventative concept?

- Adequate conflicts management arrangements are an important preventative tool. Good conflicts management arrangements are part of good compliance and risk management measures.
- Managing conflicts helps ensure consumer protection and market integrity. In our experience, poor conflicts management is clearly associated with greater consumer protection and market integrity problems.
- Shadow Shopping Report 2006 (poor advice 3 - 6 times more likely where conflicted)

# Conflicts breach may be breach of other things as well

- Conflicts are often the motivation behind misconduct (e.g. insider trading, poor advice etc.)
- Conflicts breaches will often also be a breach of another 'substantive' provision

# Discussion paper history

- PS 181 is a principles-based policy. Some licensees and their advisers wanted more concrete guidance and worked examples about what ASIC expected.
- We have been working on examples and further guidance for some time
- As part of this project, we published a discussion paper with additional guidance and a number of worked examples in April 2006
- Submissions closed June 2006. We received 30+ submissions

# Section D discussion paper

- Serious conflicts need to be avoided, not because they will always lead to actual harm to clients or to the market, but because allowing such conflicts to continue creates a high risk of that harm occurring.
- Disclosure alone will rarely be sufficient to manage a conflict of interest
- Conflicts management arrangements will not be adequate unless they are actually implemented and maintained.
- Compliance staff must have sufficient expertise, training and senior management support.
- Where disclosure is used as part of a licensee's conflicts management arrangements it must be meaningful, that is, it must be clear, concrete and specific.

# Sample section A example

- [A2] A highly rated research analyst is about to change a long-standing recommendation from 'accumulate' to 'sell'. Before the research report is issued, they advise a select group of clients to sell their holdings immediately.
- Conflict – putting interests of one group of clients ahead of others.

# Sample section B example

- [B1] 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.
- Conflict – only advice to buy or sell earns an income (as opposed to hold etc.)

# Sample section C example

- [C1] Fund manager gives stockbroker a large portion of its routine stockbroking work even though the stockbroker's commission rate is well above the industry average. (The execution services provided the stockbroker are generic and do not involve any kind of 'value added' service)
- Apparent conflict – is fund manager acting in best interest of its (investor) clients?

# Next steps for ASIC

- Considering submissions at present
- Looking at next steps, including potential further consultation
- No final decision made yet on which examples to retain, and in what type of document (policy, guidance note etc.)