



VIEWPOINT - Dec 08

Managing conflicts of interest – tighter regulation or just being aware?

The way things are.....

The Australian financial markets are a complex mix of relationships and inter-relationships.

Advisers and their clients have in the past been reluctant to bear the true cost of advice. This has led to a myriad of symbiotic relationships that give rise to the potential for conflict of interest.

We, in the industry, all know that the potential for this conflict exists but manage it to the best of all of our ability.

Take any one of the myriad of Conferences offered to financial planners for example. The registration costs of these conferences generally in no way cover the actual cost of putting on the Conference, so sponsorship is obtained from various fund managers who are happy to have their name associated with the event. For the FPA Conference for example there are different levels of sponsorship with the more money spent translating in to better and bigger promotional stands and key speaker spots. Is this a conflict of interest or is this economic reality?

When putting together their lists of Approved Products (APL) dealer groups often try and streamline the process by developing a relationship with a select number of funds management groups. The same thing happens with administration platforms – there are a number of preferred partner type arrangements in place for some of the larger platforms in the market. These relationships benefit the fund manager because he can have preferential access to the APL, the administration platform and to the advisers of the dealer group for presentations at conferences, workshops etc. The dealer group benefits by getting a VIP relationship with that fund manager, and hence access to the resources at the fund manager's disposal. Usually a fund manager will pay a fee for access to this exclusive relationship. Is this conflict of interest or again is this economic reality?

Some Research houses charge a fee to do review and rate investment products on offer to the market; others get paid via the subscription of their clients. In either case the payment of a fee creates a potential conflict of interest, how do researchers manage this?

In these difficult economic times, it is important that conflicts are properly managed to ensure that financial services are still provided without influence. A conflict of interest in itself is not necessarily wrong, or unethical. However, identifying and managing the situation is important.

From the regulators view

Chapter VII of the Corporations Act 2001 (Cth), requires Australian Financial Services Licensees to avoid and manage any potential, apparent or actual conflicts of interest. Australian Financial Services Licensees are also obligated to comply with general duties to avoid conflicts of interest imposed by:

- general Australian Financial Services Licensee obligations, in particular the obligations to act efficiently, honestly and fairly and comply with any financial services laws;
- legislation prohibiting misleading or deceptive conduct and benefiting from secret commissions;
- contractual responsibilities which give rise to express or implied obligations to avoid conflicts of interest; and
- the common law which imposes the obligation to avoid conflict of interest, for example, where is the existence of a fiduciary duty.

Policy Statement 181 sets out ASIC's guidelines for Australian Financial Services Licensees for avoiding, managing and controlling conflicts of interest. Refer <http://www.asic.gov.au/asic/ps181.pdf>. As well as that a specific obligation for financial services licensees to have adequate arrangements in place to manage conflicts of interests was introduced as part of the CLERP 9 reforms. This was the Australian Government's response to Sarbanes-Oxley.

So how best to ensure conflicts of interest affecting you are managed?

There are some questions that fund managers and advisers should be asking themselves;

1. Could there be benefits for me or my business partners now, or in the future, that could cast doubt on objectivity?
2. Perception is important. How will involvement in the decision/action be viewed by others? Are there risks associated for my business?
3. Does involvement in the decision appear fair and reasonable in all the circumstances?
4. What are the consequences a conflict of interest is ignored? What if it was questioned publicly?

There is likely to be more than one way to effectively manage conflicts of interest. The choice of strategies will be dependent on the operating environment, legislative requirements and practical solutions. Often a combination of strategies will be required.

Some Gateway suggestions on how to manage conflicts

- ✓ Removal – avoiding them entirely, this often proves to be very difficult
- ✓ Disclosure – ask all the parties with whom you deal with what possible conflict situations they might be in, so that you can make an assessment.
- ✓ Code of Ethics - Codes of Ethics help to minimize problems with conflicts of interests because they can spell out the extent to which such conflicts should be avoided, and what the parties should do where such conflicts are permitted by a Code of Ethics. This means that individuals cannot claim that they were unaware that their behaviour was unethical. In addition, the threat of disciplinary action helps to minimize unacceptable conflicts or improper acts when a conflict is unavoidable.
- ✓ Third party evaluation – for example an audit of in house procedures to ensure that an objective third party can see no problems. Third-party evaluations can also be used as proof that transactions were, in fact at “arm’s-length”.

Finally.....

Importantly, we all should remember that conflicts of interest are a part of daily business life, an economic reality. Large organisations with several different business divisions simply could not survive if all conflicts of interest were removed. Gateway’s view is that managing conflicts is both art and science, it will never be totally eliminated or controlled by regulators alone. Businesses need to be cognisant of limitations afforded by conflicts, but also to be flexible enough to develop a culture whereby employees can utilise the “art” to avoid conflict situations. We agree this is harder to do than simply following rules, but nevertheless a business imperative. Art and science - proactive management and awareness will enable most conflict situations to be dealt with in a fair and equitable manner.

About Gateway

Gateway Financial Marketing (Gateway) was established in February 2004 by Amanda Rethus and Edwina Best for the purpose of offering fund managers, other product providers and international new entrants, expert advice, services and assistance in negotiating entry into the Australian Retail Financial Services market. Use of Gateway’s services provides the opportunity for clients to overcome the hurdles that can often confront fund managers when transitioning from institutional to retail and hence improve participation in retail funds flow. Prior to Gateway, Amanda and Edwina spent over 30 years combined with major institutions in the Retail Financial Services market.

Our qualifications

Amanda has over 20 years experience in the Financial Services industry and was formerly a Divisional Director in the Financial Services Group of Macquarie. Amanda managed investment portfolios for over 10 years, and has spent in excess of 10 years introducing investment products to the Australian Retail market.

Edwina has a Bachelor of Business from UTS majoring in Marketing and International Business. She has over 12 years experience in the financial services market, concentrating in relationship management, product management and marketing. They both have extensive contacts in the retail financial services market especially with key decision makers.

If you would like to confidentially discuss your current approach to the retail market or have any questions on the above please do not hesitate to contact us on – Edwina 0404 046 179 or Amanda or 0414 658 323.