

Matters to Discuss

- Fiduciary duty of advisers
- Conducting a conflicts of interest survey
- Addressing identified conflicts
 - How do you keep your conflicts inventory fresh?
 - Do I need a conflicts officer or committee?



History and Background

- Fiduciary Duty
 - *SEC v. Capital Gains*
 - Standard of Care
- Regulatory Expectations
 - Regulator's view disclosure of conflicts as paramount
 - Focus of recent regulatory and legislative activity
 - Firms should avoid conflicts where possible; if not, mitigate and disclose



Conflicts Overview

- Definitions

- Regulatory:

- The SEC has not clearly defined “conflicts of interest” for Investment Advisers
 - Provides other forms of guidance (See Instructions to new Form ADV Part 2)

- Practical:

- Any practice (personal or business) which provides the adviser with an incentive (real or perceived) to not place the client’s interest first and foremost, whether or not such an incentive is acted upon



Conflicts Overview (con't.)

- Application
 - Every adviser has conflicts
 - Accept that you have conflicts, but work to manage and mitigate, rather than ignore



Types of Business Conflicts

- Affiliates
 - Trading with affiliates
 - Payment/referral arrangements
 - Use of affiliated service providers
 - Sharing of/access to client information
- Portfolio Management and Trading
 - Aggregation and allocation - incentive to favor
 - Most profitable or biggest clients
 - Accounts with a performance-based fee



Types of Business Conflicts (con't.)

- Portfolio Management and Trading (con't.)
 - Access to nonpublic information
 - Cross trades, soft dollar arrangements, principal transactions, proxy voting
- Marketing
 - Political contributions (i.e. Pay to Play)
 - Solicitor arrangements
 - Testimonials and client lists



Types of Business Conflicts (con't.)

- Operations
 - Valuation of manually priced securities
 - Sale of higher-valued securities results in greater fees and higher performance returns
 - The ability to select valuation method may conflict with fiduciary duty
 - Vendor Selection
 - Choice of pricing vendor – be consistent
 - Utilizing vendors that are also clients



Types of Business Conflicts (con't.)

- Code of Ethics
 - Trading in same securities as client
 - Gifts and entertainment
 - Charitable and political contributions
 - Receipt of inside information



Types of Business Conflicts (con't.)

- Firm Structure
 - Employees wearing multiple hats (President/CFO; CCO/General Counsel)
 - Client Base- consider the key regulations and regulators
 - Standard Adviser Clients (Advisers Act of 1940)
 - ERISA Clients (Adviser Act and DOL/ERISA)
 - Mutual Fund Clients (Advisers Act and Investment Company Act of 1940)



Types of Business Conflicts (con't.)

- Financial Arrangements
 - Financial/fee sharing arrangements with outside entities
 - Affiliated consulting services
 - Solicitor arrangements



Types of Personal Conflicts

- Significant relationship with individuals doing business with the firm
 - Ex. Brokers, Service Providers, Vendors, Clients
- Family members in the business
 - Ex. Competitors, Private Equity Firms, Brokerage firms
- Outside business activities
 - Ex. Arrangements with select clients



Addressing Conflicts

- Three Step Process
 1. Identify
 2. Mitigate
 3. Disclose



Identifying Conflicts

- Consider process as evolutionary
- Strategies to Identify
 - Interviews
 - Education
 - Surveys
 - Internet search
- Inventory
 - Description and nature of conflict
 - How conflicts are mitigated
 - Incorporate in annual review process



Mitigating Conflicts

- **Policies and Procedures** – may address key conflicts, but likely not all conflicts
- **Risk Matrix** – Conflicts identified should tie to risk matrix
- **Conflict Inventory** – Be able to demonstrate to SEC/institutional due diligence team how you address conflicts
- **Testing** – Should include tests of conflicts identified and methods to mitigate



Mitigating Conflicts (con't.)

- Should I have a conflicts officer?
 - Depends on several factors
 - Size, complexity and culture of the organization
 - Whether position will be dedicated or shared
- Should I have a conflicts committee?
 - Ideally, but does not need to be stand alone
 - Can be a responsibility of an existing oversight structure



Disclosing Conflicts

- Disclose, Disclose, Disclose!
- When disclosing conflicts, remember to
 - Use plain English
 - Consider newly adopted ADV Part 2 requirements
 - Where a conflict exists, err on the side of disclosure, even if it is not required
 - Consider the impact to the end-user of ADV



Questions?

