

# Webinar: Yesterday's Synergies are Today's Conflicts

Best Practices for Managing Conflicts of Interest

Mitch Avnet, CEO & Managing Partner of Compliance Risk Concepts

September, 2017

# Agenda

- Welcome and Introductions
- Conflicts of Interest – The Fundamentals
- Managing Conflicts of Interest Today
- Regulatory Review
- Best Practices
- Questions & Answers

# Founder



## **Mitch Avnet, CEO and Managing Partner of *Compliance Risk Concepts***

Avnet is responsible for business development, relationship management and overseeing the execution of all client driven / business focused Compliance and Ethics Risk Management strategic engagements.

Prior to launching CRC, Avnet was a member of Corporate Leadership Group (CLG) at Lincoln Financial Group (LFG) where he was Senior Vice President and Chief Ethics and Compliance Officer, having direct oversight of the company's anti-money laundering, privacy, ethics and compliance risk management programs. In addition, Avnet maintained responsibility for Lincoln's entire Compliance and Ethics Technology strategic initiatives, developing and implementing a long term strategic approach to upgrade and modernize the effectiveness and efficiency of Lincoln's overall Compliance programs. Avnet was a member of the Social Media Governance Committee, having direct influence regarding LFG's overall strategy toward the enablement and usage of Social Media outlets across the LFG footprint.

Throughout the course of Avnet's 20 plus-year career in the financial services industry, he has worked for top-tier investment banks, commercial banks and hedge funds such as Wachovia Capital Markets, PNC Bank and D E Shaw, developing an extensive knowledge of both buy side and sell side businesses, with a deep understanding of Equity and Fixed Income Markets, Derivative Instruments, Structured Products and Variable Products, Avnet is the epitome of executive leadership.

Avnet has built Compliance Risk Management programs to support the manufacturing / origination and distribution of proprietary products (closed architecture), as well as source third party products on behalf of customers / client relationships (open architecture). During this time frame, Avnet has served in a leadership role, building and integrating Compliance teams to be a meaningful and sought after component of the business process.

Avnet maintains the Series 3, 4, 7, 9, 10, 14, 24, 55, 63 and 65 securities license designations. He obtained his bachelor's degree in economics, graduating magna cum laude from the State University of New York at Oneonta.

# CRC Company Overview

- Team of regulatory executives and senior compliance professionals providing top-tier compliance advisory services to clients for long-term, as-needed and part-time projects, plus ongoing compliance support.
- Delivering best-in-class regulatory guidance and processes that lead to actionable and realistic outcomes.
- Industry professionals tailor advice to each client's specific needs – No “cut-and-paste” prescriptions ignoring the client's size, scope or business model.
- Providing clients with critical skills and expertise to demonstrate a strong commitment to a culture of compliance and risk management.
- Empowering clients to succeed by lowering the “cost of compliance” while upholding effective supervision and surveillance techniques that securely protect their firms.

# Conflicts of Interest

Managing Conflicts Today

# Introduction

- Think about Compliance holistically.
- Conflict Management is a piece of a robust Compliance Program.
- A Conflict Management Program should fit within the overall Compliance Program.
- The volume of regulatory change is elevating the importance of compliance within financial institutions.

- Compliance trends to be prepared for:
  - ✓ **A culture of compliance remains important.**
  - ✓ **Regulators require formal compliance structures.**
  - ✓ **Automation is required.**

# 2017: Culture of Compliance Managing Conflicts Today

- Conflicts issues managed on an ad hoc basis.
- Firms react to issues being investigated at other firms.
- Regulations have grown in number and complexity.
- Financial Institutions must prove strict compliance on all fronts at any time.
- Firms must shift from reactive compliance to a calculated and universal process.



# 2017: Culture of Compliance The Conflicts Take Away

- Conflict Management activities are often unknown to senior management.
- Conflicts findings are typically addressed behind the scenes.
- Programs should “fit” within the over-all compliance program.
- Processes should be documented.
- Identified issues should be documented and reviewed.





# Surveillance of Conflicts of Interest Within the Over-All Compliance Program

Surveillance needs to be built into the over-all compliance program, and it should have the following attributes:

- Flexibility
- Link to the Risk Assessment
- Coordinated with Supervision & Compliance Testing
- Documented Processes and Issues Identified
- Report Findings/Lack of Findings to Senior Management Methodically



# Manual Intensity

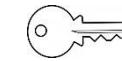
- Regulations have broadened the scope of required monitoring.
- Detecting behaviors like insider trading and market manipulation remain important, yet are a smaller task.
- The variety of covered asset classes and the number of automated mechanisms have drastically increased.
- Surveillance must perform analytics, establish preventative controls, and leverage huge volumes of data.
- The volume of alerts needs to be managed efficiently.
- Automation of surveillance is becoming more important.



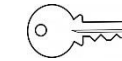
# Automation is Required

- Regulatory changes overwhelm financial institutions that manage compliance manually.
- Regulators are aware of the difficulties and errors that can result from manual compliance systems.
- There is expectation that financial institutions deploy as much automation as possible.
- Manual compliance processes contain hidden costs.
- Automation reduces errors that could lead to costly enforcement actions.
- Transition from "compliance as a project" to "compliance as a process".

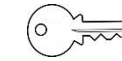
## The Keys to Success:



**Automated Systems**



**Formal Processes**



**Company-wide  
Commitment to  
Compliance**

# Regulatory Review

The Cost of Non-Compliance

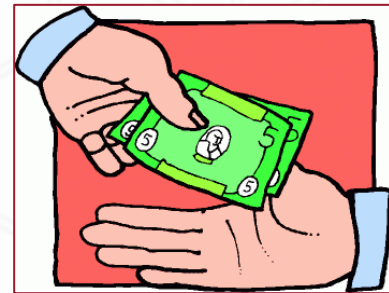
# Recent Regulatory Action: FINRA Fine Addresses Broker Compensation and Conflicts of Interest

- ***A member firm settled charges brought by FINRA and agreed to pay a fine of \$1,750,000.***
- The case includes allegations involving failure to supervise, train and monitor the sales process for variable annuities.
- Primary concerns were about how the firm compensated its sales force.
- Similar concerns are likely of interest to a wide range of broker-dealers.
- According to FINRA, the implementation of sales incentives favoring proprietary products was quickly followed by a marked increase in the sale of certain proprietary products, in some cases generating more than 600% growth.
- Well after implementing the new sales incentives, the firm required customers to sign a disclosure document which provided general disclosures about the compensation payable to its financial advisers, including the fact that compensation would be “more favorable” for the sale of proprietary products.



# Recent Regulatory Action: Investment Adviser Fails to Disclose Affiliate Broker-Dealer Conflicts of Interest

- The SEC issued an enforcement action against an investment adviser firm for its alleged failure to disclose two fee sharing arrangements with its third-party broker dealer.
- The SEC alleged that the fee sharing arrangements created a financial incentive for the investment adviser to recommend its clients invest in mutual funds of the broker-dealer and the conflict of interest was not disclosed to the investment adviser firm's clients or in its Form ADV.
- The SEC alleged the investment adviser firm lacked adequate policies and procedures relating to conflicts of interest.
- The SEC alleged that such policies would have enabled the investment adviser firm to identify, disclose, and mitigate its conflicts of interests.
- In consenting to the SEC Order, the investment adviser firm is required to provide written notice of the SEC Order to its investment advisory clients and to disclose the Order as a material change in its Form ADV.
- Additionally, the investment adviser firm is required to provide the SEC with a certification of compliance, including exhibits demonstrating its compliance, within 60 days.
- ***Finally, the SEC ordered the investment adviser firm to pay approximately \$3 million in disgorgement, pre-judgement interest, and civil money penalties.***



# Recent Regulatory Action: SEC fines Investment Bank \$9.5M for Failing to Protect Material, Non-Public Information

- ***The SEC announced that a global investment bank has agreed to pay a \$9.5 million penalty for failing to properly safeguard material nonpublic information generated by its research analysts.***
- The Bank also published an improper research report and failed to properly preserve and provide certain electronic records sought by the SEC during its investigation.
- According to the SEC's order, The Bank encouraged its analysts to communicate with customers as well as its own sales and trading personnel, but lacked adequate policies and procedures to prevent analysts from disclosing yet-to-be-published views and analyses, changes in estimates, and short-term trade recommendations during morning calls, trading day squawks, idea dinners, and non-deal road shows.
- ***Two months earlier, The Bank paid a \$12.5 million fine to FINRA over "significant supervisory failures" after FINRA said the bank failed to properly supervise the squawk system to ensure employees wouldn't pass confidential and material nonpublic information to customers or other third parties.***
- In addition to the financial penalty, The Bank agreed to be censured and must cease and desist from committing or causing violations and any future violations of Sections 15(g) and 17(a) of the Securities Exchange Act of 1934 and Rule 17a-4 as well as Rule 501 of Regulation AC.



# Conflicts of Interest

Best Practices



# Automation is Required

## Automation Will:

- Replace inefficient tasks:
  - Sorting spreadsheets
  - Manual reports
  - Reviewing large data sets
- Clearly identify issues
- Reduce errors
- Improve management reporting
- Communicate conflict findings to senior management



# Assessing Types of Conflicts

- Conflicts applicable to all employees
- New Product Review
- Firm vs. Client Conflicts
- Client vs. Client Conflicts
- Employee vs. Client Conflicts
- Employee vs. Firm Conflicts
- Vendor vs. Client Conflicts



# What does a Conflicts Review Look Like?

- **Business Unit Review should Include:**

- Business Unit Meetings
- Review of Business Unit Compliance Policies and Supervisory Procedures
- Identify conflicts and review conflict management procedures
- Review the New Product Approval Process, Vendor Management Process, Public Entities and Incentive Compensation Policy

- **Policies, Procedures and Training Review should Include:**

- Business Unit Compliance Policies, Procedures, Training and Forms
- Consider whether regulatory identified conflicts as well as prohibited and restricted conflicts are covered within relevant policies and procedures.
- Add consistent “Conflicts of Interest” language where necessary.

- **Conflicts of Interest Review:**

- Firm Wide Observations
- Business Unit Specific Observations
- Policies/Procedures/Training Observations
- Template supporting Applicable Conflicts are Covered
- Policies/Procedures/Training Reviewed
- Policies/Procedures/Training Conflict Comments



# Potential Conflicts Management Program Enhancements

- Gifts/Entertainment/Annual Attestations/Outside Business Activities/Private Investments
- Political and Charitable Contributions
- New Products Approval
- Augmenting Existing Processes with specific references to Conflicts of Interest



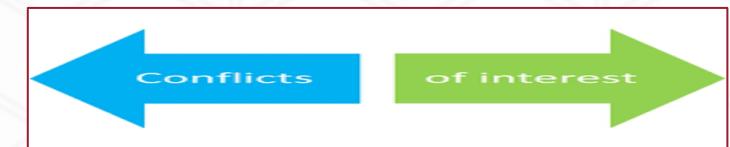
# Potential Conflicts Management Program Enhancements

- ***New Products Approval***

- Conflicts of Interest are not directly discussed, but inferred by the discussion of Risk, Legal and Compliance
- Recommend a review of the past three years to ensure potential conflicts of interest have been vetted
- Automated approval process – potential to upgrade entire New Product process with workflow too

- ***Augmenting existing processes with specific references to Conflicts of Interest***

- Regularly missing a reference to an issue being a conflict of interest
- Lacking an over-all Conflict of Interest Statement within
- When mentioning “Red Flags” that supervisors should look for – “Conflicts of Interest” isn’t mentioned – Suggested adding Conflicts as a potential Red Flag
- Document annual Conflicts of Interest review with management
- Systemic and Automated Reporting of Conflicts of Interest



# Conclusion

- Today's conflict practices are manual, in multiple systems, or a combination of manual and systemic.
- Regulators are prioritizing conflicts of interest.
- Management needs transparency into conflicts identified.
- Conflicts must be managed firm-wide.
- Conflicts reviews and enhancements are relatively simple and inexpensive.



# Contact Information

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