Central Bank fires warning shot across stockbrokers' bows

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Comment

Concerns arising from review include personal account dealing, gifts and entertainment, and intragroup relationships

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It is good to see that feedback is being given to the stockbroking and investment industry by the Central Bank following a thematic conflict of interest (CoI) review. Otherwise specific findings would be made known only to the firms which fell short of the rules and expectations.

The Central Bank's inspections said it "clearly identified that the majority of the firms reviewed were not operating in a CoI aware environment, and could not demonstrate that they had ensured that the best interest of the client was paramount in all instances".

This very worrying finding about the majority of firms is compounded by the fact that a number of firms failed to clearly communicate with and train employees on their CoI obligations.

In such an environment, how can a board of a regulated firm be confident that the management team are able not just to identify conflicts from the ground up, but manage and control these so that they do not act to the detriment of their clients' best interests?

The Central Bank has stated it expects (read: "requires") its letter to be discussed, considered and minuted by the board of all investment firms before June 30.

The letter is sure to be of interest, and in some circumstances a concern, to non-executive directors. Such persons who faithfully exercise their duties will be very surprised should their company be one of the firms where the Central Bank has in fact identified risks to consumers.

If a non-executive director needs an example of what to ask his/her management team, then they need look no further than where the Central Bank says that practices that should cause the board concern includes the firm not recognising any CoI in the business, and believing the business model does not create any CoI.

Although there is no hint that enforcement action is being immediately planned, the Central Bank has nonetheless fired a warning shot. If firms fail to consider the letter, the Central Bank will take such a lack of consideration into account when exercising its enforcement powers.

The specific areas the Central Bank called out as part of its thematic review of CoIs include personal account dealing, gifts and entertainment, and intragroup relationships. Although overall the Central Bank seemed pleased about firms having and executing adequate personal account dealing procedures, the supervisors were concerned that only one firm carried out post-trade analysis. Post-trade checks on personal account deals are an important (some would say vital) tool to help satisfy the board that management can identify any trends or patterns, such as front-running client orders or investment research.

One of the significant catalysts for the Irish financial crisis was clearly the conflicts of interest which arose at banks and public institutions which went unchecked before they crystallised, causing the impact and devastation of which we are all too familiar – and of course still paying the bill. We are also well aware of conflicts of interest at failed insurers and investment firms; the costs of which were also picked up by the Irish taxpayer.

The Central Bank also found that many of the firms with policies and procedures in place to address CoIs still fell short of meeting the requirements and some of the firms failed to implement their policies and procedures in line with the requirements.

The review found that certain firm's CoI logs were not live documents and, very worryingly, some of these logs were blank.

These failings, in the view of the Central Bank, represent "greater concerns about the ability of the firms to capture their firm specific CoI".

You cannot manage a conflict if you haven't identified it. If it is not being managed, you obviously run the real risk of an actual or 'perceived' conflict of interest arising.

Depending on the nature of the conflict, the impact can be any or all of reputational damage, financial loss and enforcement action, plus you open up your business to civil litigation.

These are matters that must be considered by the board of directors. Little wonder then that the Central Bank has stated it expects (read: "requires") its letter to be discussed, considered and

These are two activities where customers' interests and financial wellbeing are disregarded in order to benefit the employee's personal account dealings and/or benefit a firm's own position or that of 'special' clients.

On the topic of gifts and entertainment, the Central Bank said it was surprised that many of the firms reviewed did not consider how the acceptance of gifts and entertainment could compromise their duty to act in the clients' best interests.

Indeed, the Central Bank saw examples of expensive gifts received by staff that, if disclosed to clients, might have caused concern about the objectivity of decisions taken on the clients' behalf. More than half of the firms reviewed did not have a control process around outgoing gifts.

There are clear failures of regulations here. Management of any investment firm needs to make dealing with CoI a priority before it comes back to haunt them.

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