SEPTEMBER 2007

MiFID Connect

INFORMATION MEMORANDUM ON THE APPLICATION OF THE CONFLICTS OF INTEREST REQUIREMENTS UNDER THE FSA RULES IMPLEMENTING MIFID AND THE CRD IN THE UK

This Information Memorandum does not purport to be a definitive guide, but is instead a non-exhaustive statement of the measures that common platform firms may adopt in complying with the requirements as to conflicts of interest under the FSA Rules implementing MiFID and the CRD in the UK. This Information Memorandum focuses only on the UK's implementation of MiFID and CRD requirements relating to conflicts of interest.

This Information Memorandum is directed at "common platform firms"; in summary those firms that are subject to either MiFID or CRD, or both, and are therefore subject to the FSA's common platform of systems and controls requirements set out in the FSA's SYSC Handbook.

This Information Memorandum covers only the requirements to identify and manage conflicts of interest set out in SYSC 10. It does not cover other requirements relevant to conflicts of interest, such as those contained in COBS 2.3 (Inducements) and COBS 13 (Investment Research - see separate MiFID Connect Guideline on Investment Research). In addition, it does not discuss the possible contents of a common platform firm's conflicts of interest policy adopted in order to comply with SYSC 10.1.10R.

This Information Memorandum is up to date as at the date of issue. It may be revised from time to time in the light of any relevant changes to the FSA Handbook. If you intend to place significant reliance on it, it would be sensible to check whether there have been any such changes to the FSA Handbook.

Unlike the MiFID Connect Guidelines, this Information Memorandum has not been in any way endorsed by the FSA. Consequently, it cannot be assumed that the FSA will take this Information Memorandum into account when exercising its regulatory functions. The terms of this Information Memorandum have, however, been agreed by all the trade associations making up MiFID Connect.

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SECTION ONE

1. INTRODUCTION TO PROPOSED CHANGES

This section summarises the effect of the new FSA Rules implementing the conflicts of interest requirements of the CRD and MiFID contained in SYSC 10 (the "**Implementing Rules**").

Under the pre-MiFID FSA Rules on conflicts of interest, firms were required to pay due regard to the interests of their customers and to manage conflicts of interest fairly. Where a firm had a material interest or a conflict of interest it could not knowingly advise or deal unless it had taken reasonable steps to ensure fair treatment for the customer. The Implementing Rules require firms to identify, manage, record and, where relevant, disclose actual or potential conflicts of interests between themselves and their clients and between one client and another and to have in place a policy relating to conflicts of interest (the "**Obligation**"). The main differences between the Implementing Rules and the pre-MiFID FSA Rules on conflicts of interest are:

(i) The pre-MiFID FSA Rules did not apply in relation to market counterparties whereas the Obligation applies irrespective of the type of client the firm is dealing with;

(ii) Under the pre-MiFID FSA Rules, a firm could deal with conflicts simply through disclosure and, with client consent, it could then continue to do business. Under the Implementing Rules, the firm must have in place arrangements to manage conflicts in the first instance. Where these arrangements are not sufficient to ensure with reasonable confidence that the risk of damage to clients' interests will be prevented, a firm shall disclose the conflict to the client before undertaking business on its behalf;

(iii) The pre-MiFID FSA Rules did not require firms to prepare a conflict of interest policy, whereas the Implementing Rules require firms to establish, implement and maintain a written conflicts of interest policy (the "**Policy**") (see section 3.1 below). Where a firm is a member of a group, the Policy must also take into account any circumstances which may give rise to a conflict of interest arising as a result of the structure and business activities of other members of the group; and

(iv) Firms are, furthermore required under the Implementing Rules to keep a record of circumstances in which a conflict of interest may arise or has arisen as a result of the activities carried on by the firm, and to update it regularly.

SECTION TWO

2. APPLICATION OF THE OBLIGATION UNDER THE IMPLEMENTING RULES

2.1 *Introduction*

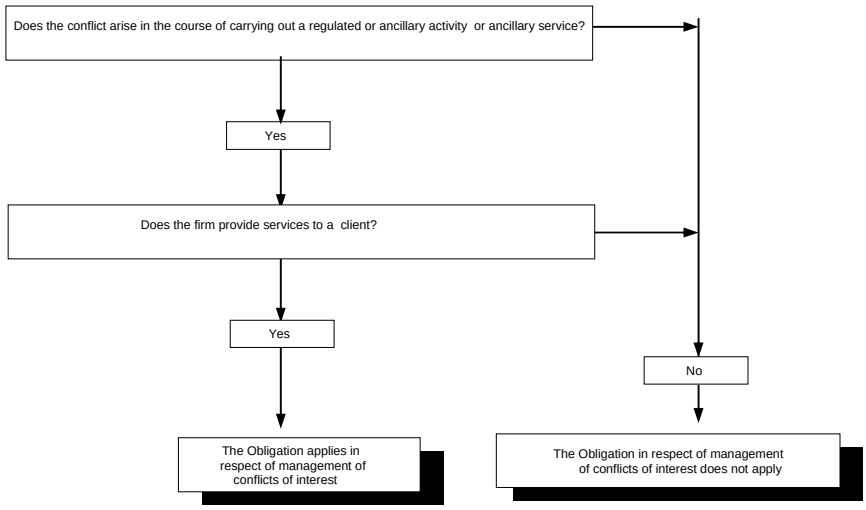
All common platform firms will be required to identify actual and potential conflicts during the course of carrying out regulated activities or ancillary activities or services. In order to establish whether a firm is subject to the requirement to manage a conflict under the Obligation, the following factors need to be assessed:

- Does the conflict arise in the course of carrying out regulated activities, ancillary activities or ancillary services (where the ancillary services constitute MiFID business)?
- Does the firm provide one or more services to a client?

Once a common platform has identified actual or potential conflicts of interest it must take all reasonable steps to prevent those conflicts of interest from constituting or giving rise to a material risk of damage to the interests of its clients.

The flowchart below summarises the process for determining whether a firm is subject to the Obligation in respect of the management of a conflict of interest. Each step of this process is explained in more detail below.

Figure 1: Identification of Conflicts of Interest (Scope of the Obligation)



2.2 ***Type of services***

SYSC 10.1.1 R
This section applies to a *common platform firm* which provides services to its *clients* in the course of carrying on *regulated activities* or *ancillary activities* or providing *ancillary services* (but only where the *ancillary services* constitute *MiFID business*).

The effect of SYSC 10.1.1R is that the Obligation applies in relation to conflicts that arise or potentially arise in the course of carrying out regulated activities, ancillary activities or ancillary services (in some circumstances) or any combination of regulated activities, ancillary activities or ancillary services (e.g. between proprietary desks and sales; when lending to investors to allow them to carry out a transaction in financial instruments and dealing; between corporate finance advisory and acquisition lending/financing).

The Obligation only applies where the firm in carrying out a regulated activity, ancillary activity or ancillary service provides a service to a client.

The Obligation applies on a home state basis. This means that firms are required to comply with the Obligation as implemented in their home state, regardless of whether they operate under the single passport on a cross-border basis or through local branches in other EEA Member States.

SECTION THREE

3. THE NATURE OF THE OBLIGATION

3.1 *Introduction*

Once a firm has established that the Obligation applies to it, it must:

- take all reasonable steps to identify conflicts of interest between (i) itself or any person directly or indirectly linked to the firm by control and its clients or (ii) one client and another (see sections 3.2 to 3.5 below);
- maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest from constituting or giving rise to a material risk of damage to the interests of its clients (see section 3.6 below);
- in the case of firms that produce "externally facing" investment research, put in place appropriate information controls or barriers to prevent information from those research activities flowing to the rest of the firm's business (see MiFID Connect Guideline on Investment Research);
- prepare, maintain, and implement an effective written Policy. Where the firm is a member of a group, the Policy must take into account circumstances of which it is or should be aware that may give rise to a conflict of interest arising out of the structure and business interests of other members of the group. In cases where a firm also produces or distributes investment research, the firm must include in its Policy specific measures to deal with possible conflicts of interest that may arise in that context (see MiFID Connect Guideline on Investment Research);
- provide retail clients or potential retail clients with a description of the Policy, which may be in summary form (note that further details of conflicts must be provided should the client request);
- disclose the general nature and/or the sources of conflicts with the interests of the client, where the arrangements to manage such conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to the interests of a client will be prevented (see section 3.8 below); and
- keep records of the services and activities performed by it in which a conflict has arisen or may arise. Such obligation may, in some circumstances, be discharged through compliance with the requirement to prepare, maintain, and implement an effective Policy (see section 3.9 below).

3.2 *Oversight of conflicts management*

SYSC 10.1.3R

A *common platform firm* must take all reasonable steps to identify conflicts of interest between:

(1) the *firm*, including its managers, employees, *appointed representatives* (or where applicable *tied agents*), or any *person* directly or indirectly linked to them by *control*, and a *client* of the *firm*; or

(2) one *client* of the *firm* and another *client*;

that arise in the course of the *firm* providing any service referred to in *SYSC* 10.1.1R.

[Note: Article 18(1) of *MiFID*]

SYSC 10.1.7R

A *common platform firm* must maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps to prevent conflicts of interest as defined in *SYSC* 10.1.3R from constituting or giving rise to a material risk of damage to the interests of its clients.

[Note: Article 13(3) of *MiFID*]

SYSC 10.1.10R

(1) A *common platform firm* must establish, implement and maintain an effective conflicts of interest policy set out in writing and appropriate to the size and organisation of the *firm* and the nature, scale and complexity of its business.

(2) Where the *common platform firm* is a member of a *group*, the policy must also take into account any circumstances, of which the *firm* is or should be aware, which may give rise to a conflict of interest arising as a result of the structure and business activities of other members of the *group*.

[Note: article 22(1) of *MiFID implementing Directive*]

SYSC 10.1.11R

(1) The *conflicts of interest policy* must include the following content:

> (a) it must identify in accordance with *SYSC* 10.1.3R and *SYSC* 10.1.4R, by reference to the specific services and activities carried out by or on behalf of the *common platform firm*, the circumstances which constitute or may give rise to a conflict of interest entailing a material risk of damage to the interests of one or more *clients*; and
>
> (b) it must specify procedures to be followed and measures to be adopted in order to manage such conflicts.

(2) The procedures and measures provided for in paragraph (1)(b) must:

> (a) be designed to ensure that *relevant persons* engaged in different business activities involving a conflict of interest of the kind specified in paragraph (1)(a) carry on those activities at a level of independence appropriate to the size and activities of the *common platform firm* and of the *group* to which it belongs, and to the materiality of the risk of damage to the interests of *clients*…..

[Note: article 22(2) and (3) of *MiFID implementing Directive*]

A firm is responsible for ensuring that its systems, controls, and procedures are robust and adequate to identify and manage any conflicts of interest that may arise, and to ensure, as far as practicable, that those arrangements operate effectively. In practice, this responsibility rests with the firm's senior management.

Whilst FSA Rules do not impose any specific requirements on senior management in relation to the identification and management of conflicts of interest, in complying with the general SYSC requirements in relation to senior management responsibility (e.g. see SYSC 4.3), firms might consider ensuring that senior management of a firm:

- are fully engaged in conflict identification and management;
- take an holistic view of conflicts risk and conflict mitigation within the full range of business activities for which they are responsible;
- have policies and procedures that aim to achieve a consistent treatment of conflicts of interest throughout their organisation; and
- receive management information on the extent of, and mitigation of, conflicts of interest in their business in order to assist them in controlling their business effectively.

3.3 ***Notion of Reasonableness***

See SYSC 10.1.3R above

The Obligation is not absolute. However, a firm is required to take "all reasonable" steps to identify conflicts of interest and to manage them (not just "some" reasonable steps). The requirements under the Implementing Rules do not prohibit firms from carrying on activities, which could by their very nature create conflicts of interest or activities that, when carried on together within the same legal entity or group, potentially create conflicts of interest.

Since the Obligation is not absolute and applies by reference to reasonableness, the way in which a firm is organised and the nature of the business it undertakes will impact on the type of conflicts that arise and, potentially, the scale and materiality of the conflicts of interest that arise, and this will in turn impact on the steps that it will be reasonable for the firm to take to manage conflicts of interest. A firm will be expected to disclose a conflict of interest if it is otherwise unable to manage the conflict effectively.

In determining what steps are reasonable to identify and manage conflicts of interest, firms may take into account:

- the level of risk that a conflict of interest may constitute or give rise to a material risk of damage to the interests of a client or clients;
- the nature of the conflicts in question;
- the way in which the firm is organised and the nature, scale and complexity of the firm's business in the UK and internationally; and
- the nature and range of products and services offered in the course of its business.

The requirement to identify and manage conflicts of interest applies equally to all types of clients (including clients who are classified as eligible counterparties).

3.3.1 *Nature, scale and complexity of the firm's business*

Firms carrying out a narrow range of services and activities may be less likely to encounter conflicts than firms carrying on a wide range of services and activities. Larger firms may carry on a wider range of business lines which have inherent between them the possibility of conflict, for example, corporate finance activities and research.

The policies and procedures for firms that are smaller and less complex may therefore be able to be less detailed than those of large or more complex firms.

However, depending on the services and activities that they carry on, firms that only carry on a limited range of services and activities may also be faced with conflicts situations regularly. For example, a firm conducting only corporate finance business may be regularly faced with situations where there is a conflict of interest between its clients and potential clients (e.g. potentially competing bid situations). Similarly, a firm conducting only investment management activity could regularly encounter conflicts of interest while allocating securities to different funds and different client portfolios. Also, a firm carrying out proprietary trading activities with clients is likely to face conflicts of interests on a regular basis.

3.3.2 *Nature and range of products/services*

Where the relevant services provided by a firm to its clients carry a high risk of those clients' interests being damaged by conflicts of interest a firm may need to apply proportionately greater resources to managing such conflicts. Examples of such services would include corporate finance and proprietary trading activities.

3.4 ***Identification of conflicts***

SYSC 10.1.4 R

For the purposes of identifying the types of conflict of interest that arise, or may arise, in the course of providing a service and whose existence may entail a material risk of damage to the interests of a *client*, a *common platform firm* must take into account, as a minimum, whether the *firm* or a *relevant person*, or a *person* directly or indirectly linked by *control* to the *firm*:

(1) is likely to make a financial gain, or avoid a financial loss, at the expense of the *client*;

(2) has an interest in the outcome of a service provided to the *client* or of a transaction carried out on behalf of the *client*, which is distinct from the *client*'s interest in that outcome;

(3) has a financial or other incentive to favour the interest of another *client* or group of *clients* over the interests of the *client*;

(4) carries on the same business as the *client*; or

(5) receives or will receive from a person other than the *client* an inducement in relation to a service provided to the *client*, in the form of monies, goods or services, other than the standard commission or fee for that service.

The conflict of interest may result from the *firm* or *person* providing a service referred to in *SYSC* 10.1.1R or engaging in any other activity.

[Note: Article 21 of *MiFID implementing Directive*]

SYSC 10.1.5 G

The circumstances which should be treated as giving rise to a conflict of interest should cover cases where there is a conflict between the interests of the *firm* or certain *persons* connected to the *firm* or the *firm*'s *group* and the duty the *firm* owes to a *client*; or between the differing interests of two or more of its *clients*, to whom the *firm* owes in each case a duty. It is not enough that the *firm* may gain a benefit if there is not also a possible disadvantage to a *client*, or that one *client* to whom the *firm* owes a duty may make a gain or avoid a loss without there being a concomitant possible loss to another such *client*.

[Note: Recital 24 of *MiFID implementing Directive*]

SYSC 10.1.12 G

In drawing up a *conflicts of interest policy* which identifies circumstances which constitute or may give rise to a conflict of interest, a *common platform firm* should pay special attention to the activities of investment research and advice, proprietary trading, portfolio management and corporate finance business, including underwriting or selling in an offering of securities and advising on mergers and acquisitions. In particular, such special attention is appropriate where the *firm* or a *person* directly or indirectly linked by *control* to the *firm* performs a combination of two or more of those activities.

[Note: Recital 26 of *MiFID implementing Directive*]

A firm should, on an ongoing basis, assess situations within all of its businesses (which includes other members of the same corporate group - see section 3.5 below) that could potentially give rise to conflicts of interest - either conflicts between the firm or a relevant person (see definition in Appendix 3) and its client or conflicts among its clients.

A firm should consider the services and activities carried out by each line of business in order to identify any conflicts that may arise between clients of the firm and that business line. Firms should also have in place processes that enable them to identify any new conflicts that may arise (e.g. as part of new business approval processes if a new activity is being carried out or a new client segment is being pursued by the business).

Each firm will have its own particular set of conflicts, relevant to its specific services and activities and will have to develop its own policy in relation to those conflicts. Set out below is a non-exhaustive list of typical examples of situations where conflicts may arise. The list has been divided between those conflicts that may arise between the interests of the firm and the interests of one or more clients and those that may arise between the interests of different clients of a firm. Some of the examples could sit in either category of conflict.

Firm vs. client conflicts

- Where a firm trades its proprietary positions in a security when at the same time it has information about future transactions with clients in relation to that security;
- Where one of the employees of a firm engages in personal account dealing in respect of securities and the firm has a client with an interest that potentially conflicts with such dealing;

- Where a firm is the syndicate agent for a financing arrangement for a client and the firm's corporate finance team is looking to advise another firm targeting that client;
- Where a firm has information in relation to distressed assets and the firm trades proprietary positions in those assets;
- Where a firm has provided corporate finance advice to one corporate client and subsequently, when that corporate client becomes a target of a bid, the firm also seeks to act for the bidder;
- Where a firm is providing advice to a corporate in relation to a debt issuance and is advising other clients as to the pros and cons of investing in the debt;
- Where one part of a multi-service financial institution is used by another part of the same institution which owes fiduciary obligations, e.g. an investment manager placing orders with affiliated broker dealers; and
- Where substantial gifts and entertainment (including non-monetary gifts) are received that may influence behaviour in a way that conflicts with the interests of the clients of the firm.

Client vs. client conflicts

- Where a firm provides corporate finance advice in relation to the same target to clients who are direct competitors of one another;
- Where a firm provides investment research in relation to an entity or group to which it also provides corporate finance advisory services;
- Where a firm provides advisory and financing services to one client in respect of a bid and seeks to provide financing services to another client in respect of the same bid;
- Where a firm is discretionary portfolio manager for more than one client or fund - in particular in respect of issues relating to allocation.

3.5 ***Meaning of "Firm"***

See SYSC 10.1.3R above.

When assessing conflicts of interests, a firm must consider not just its own conflicts but also conflicts which arise between: (i) relevant persons, or (ii) a person directly or indirectly linked by control to the firm, and the duty the firm owes to its clients.

For the purposes of the Obligation, the use of the word "firm" refers to the firm itself, a relevant person (see below), or a person directly or indirectly linked by control to the firm.

The broad definition of relevant person includes those individuals directly involved in the provision of services to a firm under an outsourcing arrangement for the purpose of the provision by the firm of regulated activities. Firms should therefore note that under SYSC 10.1.4R the interests of employees of service providers may be relevant to their conflicts management obligations, for example where an employee of a service provider has access to information that might allow them to make a profit at the expense of a client. (See also section 4.7 of the MiFID Connect Outsourcing Guideline).

The Policy of a firm that is part of a group should provide for measures to manage generic or specific conflicts that arise out of the activities of the group. Therefore, in relation to group members, for the purposes of conflicts identification and management, firms will need to take into account circumstances of which they have actual knowledge, or which are so obvious that the

firm should be aware, that give rise to conflicts of interest in a group context. So, for example, if: (i) the firm is expressly told of a generic or specific conflict by a member of its group; or (ii) relevant information that clearly identifies a conflict has, for example, been widely reported in the press (e.g. a high profile deal), the firm should take such steps to manage the relevant conflict, such as the use of information barriers, as are appropriate.

Arrangements are commonly put in place by firms to ensure that entities belonging to the same group operate independently of each other (e.g. they have in place systems and controls to ensure that there is no flow of information between firms (e.g. information barriers), the firms operate under independent management or there are appropriate controls on cross-board membership). Such arrangements may be an effective way of managing intra-group conflicts of interest. However, actual or potential conflicts of interest may still arise where such arrangements are in place and firms should monitor their effectiveness and appropriateness on an ongoing basis.

Firms must put in place policies that limit the possibility of conflicts arising between employees, officers and agents of the firm and the firm's clients. Such policies would include, for example, staff dealing policies and restrictions on outside interests such as directorships of other companies.

3.6 ***Managing Conflicts of Interest***

SYSC 10.1.11 R

(2) The procedures and measures provided for in paragraph (1)(b) must:

(a) be designed to ensure that *relevant persons* engaged in different business activities involving a conflict of interest of the kind specified in paragraph (1)(a) carry on those activities at a level of independence appropriate to the size and activities of the *common platform firm* and of the *group* to which it belongs, and to the materiality of the risk of damage to the interests of *clients*; and

(b) include such of the following as are necessary and appropriate for the *common platform firm* to ensure the requisite level of independence:

(i) effective procedures to prevent or control the exchange of information between *relevant persons* engaged in activities involving a risk of a conflict of interest where the exchange of that information may harm the interests of one or more *clients*;

(ii) the separate supervision of *relevant persons* whose principal functions involve carrying out activities on behalf of, or providing services to, *clients* whose interests may conflict, or who otherwise represent different interests that may conflict, including those of the *firm*;

(iii) the removal of any direct link between the remuneration of *relevant persons* principally engaged in one activity and the remuneration of, or revenues generated by, different *relevant persons* principally engaged in another activity, where a conflict of interest may arise in relation to those activities;

(iv) measures to prevent or limit any *person* from exercising inappropriate influence over the way in which a *relevant person* carries out services or activities;

(v) measures to prevent or control the simultaneous or sequential involvement of a *relevant person* in separate services or activities where such involvement may impair the proper management of conflicts of interest.

(3) If the adoption or the practice of one or more of those measures and procedures does not ensure the requisite level of independence, a *common platform firm* must adopt such alternative or additional measures and procedures as are necessary and appropriate for those purposes.

[Note: article 22(2) and (3) of the *MiFID implementing Directive*]

Firms should take care, in devising their organisational structures, to ensure that these do not incentivise behaviour that may lead to conflicts, e.g. through remuneration, appraisal or other management/control arrangements that reward or potentially reward behaviour that disadvantages the interests of clients in favour of the firm or other clients. However, permissible indirect links would include, for example, bonuses calculated according to the general performance of the firm.

When an effective information barrier is being operated within a firm, individuals on the other side of the wall will not be regarded as being in possession of knowledge denied to them as a result of the information barrier. Consequently, any conflict that may be considered to arise due to the possession within the firm of relevant knowledge can be considered as effectively managed to the extent that knowledge is behind an effective information barrier (assuming that an information barrier is an appropriate measure to ensure the requisite level of independence in the particular case).

A firm's choice of what measures/combination of measures to put in place for the purposes of managing its conflicts of interests is left to its discretion, provided that the firm takes all reasonable steps to manage its conflicts of interest.

3.7 ***Management of conflicts involving investment research***

Please refer to the MiFID Connect Investment Research Guideline.

3.8 ***Disclosure***

SYSC 10.1.8 R

(1) If arrangements made by a *common platform firm* under *SYSC* 10.1.7R to manage conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to the interests of a *client* will be prevented, the *firm* must clearly disclose the general nature and/or sources of conflicts of interest to the *client* before undertaking business for the *client*.

(2) The disclosure must:

(a) be made in a *durable medium*; and

(b) include sufficient detail, taking into account the nature of the *client*, to enable that *client* to take an informed decision with respect to the service in the context of which the conflict of interest arises.

[Note: article 18(2) of *MiFID* and article 22(4) of *MiFID implementing Directive*]

SYSC 10.1.9 G

Common platform firms should aim to identify and manage the conflicts of interest arising in relation to their various business lines and their *group*'s activities under a comprehensive *conflicts of interest policy*. In particular, the disclosure of conflicts of interest by a *firm* should not exempt it from the obligation to maintain and operate the effective organisational and administrative arrangements under *SYSC* 10.1.7R. While disclosure of specific conflicts of interest is required by *SYSC* 10.1.8R, an over-reliance on disclosure without adequate consideration as to how conflicts may appropriately be managed is not permitted.

[Note: Recital 27 of *MiFID implementing Directive*]

In contrast to the position under the pre-MiFID FSA Rules, disclosure should not be seen as a method by which firms can manage a conflict of interest. Instead, disclosure should only be used where all reasonable steps to manage a particular conflict of interest are not sufficient to ensure, with reasonable confidence, that the risk of damage to the interests of a client will be prevented.

In these circumstances, a firm should consider whether disclosure is appropriate or whether, bearing in mind the risks involved, it should refrain from acting for the client. Where the client is a professional client or an eligible counterparty it is likely to be in a better position to understand the disclosure made to it and to understand the risks involved if it continues to deal with the firm.

Although disclosure alone will not normally be an appropriate course of action, if a conflict cannot otherwise be managed it may be the only option in certain circumstances. For example, a firm may have multiple interests in the success of a private equity transaction; if its clients also wish to participate in the transaction, disclosure alone may be appropriate where it is clear to clients in what respects they are unable to rely on the firm to act in their interests.

Firms may wish to use disclosure even where they have employed other measures to manage conflicts and those measures, such as functional independence or information barriers, have the effect that the risk of damage to clients' interests is low.

Disclosure should, like all other communications to the client, be clear, fair and not misleading irrespective of the categorisation of the client. A disclosure should contain sufficient detail about the relevant conflict of interest to enable the client in question to make an informed decision.

Therefore, whilst firms can make general disclosure of conflicts of interest in, for example, their terms of business (e.g. "there may be circumstances in which we act for two clients….etc"), where there is something specific that a client will need to know in order to make an informed decision in relation to a particular service, activity or transaction, this must be disclosed in specific terms. In the case of retail clients, it may be necessary to provide greater detail than in the context of disclosure to professional clients.

3.9 ***Record keeping***

SYSC 10.1.6 R

A *common platform firm* must keep and regularly update a record of the kinds of service or activity carried out by or on behalf of the *firm* in which a conflict of interest entailing a material risk of damage to the interests of one or more *clients* has arisen or, in the case of an ongoing service or activity, may arise.

[Note: article 23 of *MiFID implementing Directive*]

Provided that a record of a firm's Policy (and any changes to it) is kept by the firm for a period of five years, implementation and regular update of a Policy ensures compliance with the record-keeping requirement set out above. This is because the obligation to implement and update a Policy requires firms, *inter alia*, to identify the circumstances which constitute or may give rise to a conflict of interest entailing a material risk of damage to the interests of one or more clients.

Appendix 1

Conflicts of Interest under MiFID - Level 1 and Level 2 Text

BCD

Article 22(1)

Home Member State competent authorities shall require that every credit institution have robust governance arrangements, which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, and adequate internal control mechanisms, including sound administrative and accounting procedures.

Annex V paragraph 1

Arrangements shall be defined by the management body described in Article 11 concerning the segregation of duties in the organisation and the prevention of conflicts of interest.

MiFID

Recital 26

In order to protect an investor's ownership and other similar rights in respect of securities and his rights in respect of funds entrusted to a firm those rights should in particular be kept distinct from those of the firm. This principle should not, however, prevent a firm from doing business in its name but on behalf of the investor, where that is required by the very nature of the transaction and the investor is in agreement, for example stock lending.

Recital 29

The expanding range of activities that many investment firms undertake simultaneously has increased potential for conflicts of interest between those different activities and the interests of their clients. It is therefore necessary to provide for rules to ensure that such conflicts do not adversely affect the interests of their clients.

Article 13 (3)

An investment firm shall maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest as defined in Article 18 from adversely affecting the interests of its clients.

Article 18

1. Member States shall require investment firms to take all reasonable steps to identify conflicts of interest between themselves, including their managers, employees and tied agents, or any person directly or indirectly linked to them by control and their clients or between one client and another that arise in the course of providing any investment and ancillary services, or combinations thereof.

2. Where organisational or administrative arrangements made by the investment firm in accordance with Article 13(3) to manage conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to client interests will be prevented, the investment firm shall clearly disclose the general nature and/or sources of conflicts of interest to the client before undertaking business on its behalf.

3. In order to take account of technical developments on financial markets and to ensure uniform application of paragraphs 1 and 2, the Commission shall adopt, in accordance with the procedure

referred to in Article 64(2), implementing measures to:

(a) define the steps that investment firms might reasonably be expected to take to identify, prevent, manage and/or disclose conflicts of interest when providing various investment and ancillary services and combinations thereof;

(b) establish appropriate criteria for determining the types of conflict of interest whose existence may damage the interests of the clients or potential clients of the investment firm.

MiFID implementing Directive

Recital 24

The circumstances which should be treated as giving rise to a conflict of interest should cover cases where there is a conflict between the interests of the firm or certain persons connected to the firm or the firm's group and the duty the firm owes to a client; or between the differing interests of two or more of its clients, to whom the firm owes in each case a duty. It is not enough that the firm may gain a benefit if there is not also a possible disadvantage to a client, or that one client to whom the firm owes a duty may make a gain or avoid a loss without there being a concomitant possible loss to another such client.

Recital 25

Conflicts of interest should be regulated only where an investment service or ancillary service is provided by an investment firm. The status of the client to whom the service is provided — as either retail, professional or eligible counterparty — is irrelevant for this purpose.

Recital 26

In complying with its obligation to draw up a conflict of interest policy under Directive 2004/39/EC which identifies circumstances which constitute or may give rise to a conflict of interest, the investment firm should pay special attention to the activities of investment research and advice, proprietary trading, portfolio management and corporate finance business, including underwriting or selling in an offering of securities and advising on mergers and acquisitions. In particular, such special attention is appropriate where the firm or a person directly or indirectly linked by control to the firm performs a combination of two or more of those activities.

Recital 27

Investment firms should aim to identify and manage the conflicts of interest arising in relation to their various business lines and their group's activities under a comprehensive conflicts of interest policy. In particular, the disclosure of conflicts of interest by an investment firm should not exempt it from the obligation to maintain and operate the effective organisational and administrative arrangements required under Article 13(3) of Directive 2004/39/EC. While disclosure of specific conflicts of interest is required by Article 18(2) of Directive 2004/39/EC, an over-reliance on disclosure without adequate consideration as to how conflicts may appropriately be managed is not permitted.

Article 21

(Articles 13(3) and 18 of Directive 2004/39/EC) Conflicts of interest potentially detrimental to a client

Member States shall ensure that, for the purposes of identifying the types of conflict of interest that arise in the course of providing investment and ancillary services or a combination thereof and whose existence may damage the interests of a client, investment firms take into account, by way of minimum criteria, the question of whether the investment firm or a relevant person, or a person directly or indirectly linked by control to the firm, is in any of the following situations, whether as a result of

providing investment or ancillary services or investment activities or otherwise:

(a) the firm or that person is likely to make a financial gain, or avoid a financial loss, at the expense of the client;

(b) the firm or that person has an interest in the outcome of a service provided to the client or of a transaction carried out on behalf of the client, which is distinct from the client's interest in that outcome;

(c) the firm or that person has a financial or other incentive to favour the interest of another client or group of clients over the interests of the client;

(d) the firm or that person carries on the same business as the client;

(e) the firm or that person receives or will receive from a person other than the client an inducement in relation to a service provided to the client, in the form of monies, goods or services, other than the standard commission or fee for that service.

Article 22

(Articles 13(3) and 18(1) of Directive 2004/39/EC) Conflicts of interest policy

1. Member States shall require investment firms to establish, implement and maintain an effective conflicts of interest policy set out in writing and appropriate to the size and organisation of the firm and the nature, scale and complexity of its business.

Where the firm is a member of a group, the policy must also take into account any circumstances, of which the firm is or should be aware, which may give rise to a conflict of interest arising as a result of the structure and business activities of other members of the group.

2. The conflicts of interest policy established in accordance with paragraph 1 shall include the following content:

(a) it must identify, with reference to the specific investment services and activities and ancillary services carried out by or on behalf of the investment firm, the circumstances which constitute or may give rise to a conflict of interest entailing a material risk of damage to the interests of one or more clients;

(b) it must specify procedures to be followed and measures to be adopted in order to manage such conflicts.

3. Member States shall ensure that the procedures and measures provided for in paragraph 2(b) are designed to ensure that relevant persons engaged in different business activities involving a conflict of interest of the kind specified in paragraph 2(a) carry on those activities at a level of independence appropriate to the size and activities of the investment firm and of the group to which it belongs, and to the materiality of the risk of damage to the interests of clients.

For the purposes of paragraph 2(b), the procedures to be followed and measures to be adopted shall include such of the following as are necessary and appropriate for the firm to ensure the requisite degree of independence:

(a) effective procedures to prevent or control the exchange of information between relevant persons engaged in activities involving a risk of a conflict of interest where the exchange of that information may harm the interests of one or more clients;

(b) the separate supervision of relevant persons whose principal functions involve carrying out activities on behalf of, or providing services to, clients whose interests may conflict, or who otherwise represent

different interests that may conflict, including those of the firm;

(c) the removal of any direct link between the remuneration of relevant persons principally engaged in one activity and the remuneration of, or revenues generated by, different relevant persons principally engaged in another activity, where a conflict of interest may arise in relation to those activities;

(d) measures to prevent or limit any person from exercising inappropriate influence over the way in which a relevant person carries out investment or ancillary services or activities;

(e) measures to prevent or control the simultaneous or sequential involvement of a relevant person in separate investment or ancillary services or activities where such involvement may impair the proper management of conflicts of interest.

If the adoption or the practice of one or more of those measures and procedures does not ensure the requisite degree of independence, Member States shall require investment firms to adopt such alternative or additional measures and procedures as are necessary and appropriate for those purposes.

4. Member States shall ensure that disclosure to clients, pursuant to Article 18(2) of Directive 2004/39/EC, is made in a durable medium and includes sufficient detail, taking into account the nature of the client, to enable that client to take an informed decision with respect to the investment or ancillary service in the context of which the conflict of interest arises.

Article 23

(Article 13(6) of Directive 2004/39/EC) Record of services or activities giving rise to detrimental conflict of interest

Member States shall require investment firms to keep and regularly to update a record of the kinds of investment or ancillary service or investment activity carried out by or on behalf of the firm in which a conflict of interest entailing a material risk of damage to the interests of one or more clients has arisen or, in the case of an ongoing service or activity, may arise.

Article 30

(first indent of Article 19(3) of Directive 2004/39/EC)Information about the investment firm and its services for retail clients and potential retail clients

1. Member States shall require investment firms to provide retail clients or potential retail clients with the following general information, where relevant: ….

(h) a description, which may be provided in summary form, of the conflicts of interest policy maintained by the firm in accordance with Article 22;

(i) at any time that the client requests it, further details of that conflicts of interest policy in a durable medium or by means of a website (where that does not constitute a durable medium) provided that the conditions specified in Article 3(2) are satisfied.

Appendix 2

LIST OF SERVICES AND ACTIVITIES AND FINANCIAL INSTRUMENTS UNDER MIFID
Annex 1 of MiFID

INVESTMENT SERVICES AND ACTIVITIES

1. Reception and transmission of orders in relation to one or more financial instruments.

2. Execution of orders on behalf of clients.

3. Dealing on own account.

4. Portfolio management.

5. Investment advice.

6. Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis.

7. Placing of financial instruments without a firm commitment basis.

8. Operation of Multilateral Trading Facilities.

ANCILLARY SERVICES

1. Safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management.

2. Granting credits or loans to an investor to allow him to carry out a transaction in one or more financial instruments, where the firm granting the credit or loan is involved in the transaction.

3. Advice to undertakings on capital structure, industrial strategy and related matters and advice and services relating to mergers and the purchase of undertakings;

4. Foreign exchange services where these are connected to the provision of investment services.

5. Investment research and financial analysis or other forms of general recommendation relating to transactions in financial instruments.

6. Services related to underwriting.

7. Investment services and activities as well an ancillary services of the type included under Section A or B of Annex 1 related to the underlying of the derivatives included under Section C - 5, 6, 7 and 10 - where these are connected to the provision of investment or ancillary services.

FINANCIAL INSTRUMENTS

1. Transferable securities;

2. Money-market instruments;

3. Units in collective investment undertakings;

4. Options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash;

5. Options, futures, swaps, forward rate agreements and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event);

6. Options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market and/or a multi-lateral trading facility ("**MTF**");

7. Options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in C.6 and not being for commercial purposes, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are cleared and settled through recognised clearing houses or are subject to regular margin calls;

8. Derivative instruments for the transfer of credit risk;

9. Financial contracts for differences.

10. Options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates, emission allowances or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event), as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in this Section, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market or an MTF, are cleared and settled through recognised clearing houses or are subject to regular margin calls.

Appendix 3

GLOSSARY

Ancillary activity: an activity which is not a regulated activity but which is: (a) carried on in connection with a regulated activity; or (b) held out as being for the purposes of a regulated activity.

Ancillary service: means any of the services listed in Section B of Annex I to MiFID, that is:

(a) safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management;

(b) granting credits or loans to an investor to allow him to carry out a transaction in one or more financial instruments, where the firm granting the credit or loan is involved in the transaction;

(c) advice to undertakings on capital structure, industrial strategy and related matters and advice and services relating to mergers and the purchase of undertakings;

(d) foreign exchange services where these are connected to the provision of investment services;

(e) investment research and financial analysis or other forms of general recommendation relating to transactions in financial instruments;

(f) services related to underwriting; and

(g) investment services and activities as well as ancillary services within (a) to (f), above, related to the underlying of the derivatives included under Section C – 5, 6, 7 and 10, that is (in accordance with that Annex and Recital 21 to, and Article 39 of, the MiFID Regulation):

(i) commodities;

(ii) climatic variables;

(iii) freight rates;

(iv) emission allowances;

(v) inflation rates or other official economic statistics;

(vi) telecommunications bandwidth;

(vii) commodity storage capacity;

(viii) transmission or transportation capacity relating to commodities, where cable, pipeline or other means;

(ix) an allowance, credit, permit, right or similar asset which is directly linked to the supply, distribution or consumption of energy derived from renewable resources;

(x) a geological, environmental or other physical variable;

(xi) any other asset or right of a fungible nature, other than a right to receive a service, that is capable of being transferred;

(xii) an index or measure related to the price or value of, or volume of transactions in any asset, right, service or obligation;

where these are connected to the provision of investment services or ancillary services.

[Note: article 4(1)(3) of MiFID]

Appointed representative: in accordance with section 39 of the Act (other than an authorised person) who: (a) is a party to a contract with an authorised person (his principal) which: (i) permits or requires him to carry on business of a description prescribed in the Appointed Representatives Regulations; and (ii) complies with such requirements as are prescribed in those Regulations; and (b) is someone for whose activities in carrying on the whole or part of that business his principal has accepted responsibility in writing; and who is therefore an exempt person in relation to any regulated activity comprised in the carrying on of that business for which his principal has accepted responsibility.

Client: means a person to whom a firm provides, intends to provide or has provided: (a) a service in the course of carrying on a regulated activity; or (b) in the case of MiFID business or the equivalent business of a third country investment firm, an ancillary service. See COBS 3.2 for further details.

Common platform firm: means a firm that is (a) a BIPRU firm; or (b) an exempt CAD firm; or (c) a UK MiFID investment firm which falls within the definition of 'local firm' in article 3.1P of the Banking Consolidation Directive.

Conflicts of interest policy: means the policy established and maintained in accordance with SYSC 10.1.10R.

Control: (for a common platform firm) control as defined in article 1 of Directive 83/349/EEC.

Durable medium: means (a) paper; or (b) any instrument which enables the recipient to store information addressed personally to him in a way accessible for future reference for a period of time adequate for the purposes of the information and which allows the unchanged reproduction of the information stored. In particular, durable medium covers floppy disks, CD-ROMs, DVDs and hard drives of personal computers on which electronic mail is stored, but it excludes internet sites, unless such sites meet the criteria specified in the first sentence of this paragraph. (in relation to MiFID business or equivalent business of a third country investment firm, if the relevant rule implements the MiFID implementing Directive) the instrument used must be: (i) appropriate to the context in which the business is to be carried on; and (ii) chosen by the consumer when offered the choice between that instrument and paper. For the purposes of this definition, the provision of information by means of electronic communications shall be treated as appropriate to the context in which the business between the firm and the client is, or is to be, carried on if there is evidence that the client has regular access to the internet. The provision by the client of an e-mail address for the purposes of the carrying on of that business is sufficient. [Note: article 2(f) and Recital 20 of the Distance Marketing Directive, article 2(12) of the Insurance Mediation Directive and articles 2(2), 3(1) and 3(3) 23, of the MiFID implementing Directive].

Eligible counterparty: (in accordance with COBS 3.6.1R) a client that is either a per se eligible counterparty or an elective eligible counterparty.

Firm: means an authorised person, but not a professional firm unless it is an authorised professional firm. (see also GEN 2.2.18 R for the position of an authorised partnership or unincorporated association which is dissolved.).

Group: (in relation to a common platform firm) means the group of which the firm forms a part, consisting of a parent undertaking, its subsidiaries and the entities in which the parent undertaking or its subsidiaries hold a participation, as well as undertakings linked to each other by a relationship within the meaning of article 12(1) of Directive 83/349/EEC on consolidated accounts.

MiFID: means Directive 2004/39/EC of the European Parliament and the Council of 21 April 2004 on markets in financial instruments.

MiFID business: means investment services and activities and, where relevant, ancillary services carried on by a MiFID investment firm.

MiFID implementing Directive: means Commission Directive No. 2006/73/EC implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisation requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

Person: means (in accordance with the Interpretation Act 1978) any person, including a body of persons corporate or unincorporate (that is, a natural person, a legal person and, for example, a partnership).

Professional client: means (in accordance with COBS 3.5.1R) a client that is either a per se professional client or an elective professional client. [Note: article 4(1)(12) of MiFID]

Regulated activity: (in accordance with section 22 of the Act (The classes of activity and categories of investment)) any of the following activities specified in Part II of the Regulated Activities Order (Specified Activities): (a) accepting deposits (article 5); (aa) issuing electronic money (article 9B); (b) effecting contracts of insurance (article 10(1)); (c) carrying out contracts of insurance (article 10(2)); (d) dealing in investments as principal (article 14); (e) dealing in investments as agent (article 21); (f) arranging (bringing about) deals in investments (article 25(1)); (g) making arrangements with a view to transactions in investments (article 25(2)); (ga) arranging (bringing about) regulated mortgage contracts (article 25A(1)); (gb) making arrangements with a view to regulated mortgage contracts (article 25A(2)); (h) managing investments (article 37); (ha) assisting in the administration and performance of a contract of insurance (article 39A); (i) safeguarding and administering investments (article 40); for the purposes of the permission regime, this is sub-divided into: (i) safeguarding and administration of assets (without arranging); (ii) arranging safeguarding and administration of assets; (j) sending dematerialised instructions (article 45(1)); (k) causing dematerialised instructions to be sent (article 45(2)); (l) establishing, operating or winding up a collective investment scheme (article 51(1)(a)); for the purposes of the permission regime, this is sub-divided into: (i) establishing, operating or winding up a regulated collective investment scheme; (ii) establishing, operating or winding up an unregulated collective investment scheme; (m) acting as trustee of an authorised unit trust scheme (article 51(1)(b)); (n) acting as the depositary or sole director of an open-ended investment company (article 51(1)(c)); (o) establishing, operating or winding up a stakeholder pension scheme (article 52); (oa) providing basic advice on a stakeholder product (article 52B); (ob) establishing, operating or winding-up a personal pension scheme (article 52(b)); (p) advising on investments (article 53); for the purposes of the permission regime, this is sub-divided into: (i) advising on investments (except pension transfers and pension opt-outs); (ii) advising on pension transfers and pension opt-outs; (pa) advising on regulated mortgage contracts (article 53A); (q) advising on syndicate participation at Lloyd's (article 56); (r) managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's (article 57); (s) arranging deals in contracts of insurance written at Lloyd's (article 58); (sa) entering into a regulated mortgage contract (article 61(1)); (sb) administering a regulated mortgage contract (article 61(2)); (t) entering as provider into a funeral plan contract (article 59); (u) agreeing to carry on a regulated activity (article 64); which is carried on by way of business and relates to a specified investment applicable to that activity or, in the case of (l), (m), (n) and (o), is carried on in relation to property of any kind.

Relevant person: means any of the following: (a) a director, partner or equivalent, manager or appointed representative (or where applicable, tied agent)of the firm; (b) a director, partner or equivalent, or manager of any appointed representative (or where applicable, tied agent)of the firm; (c) an employee of the firm or of an appointed representative (or where applicable, tied agent) of the firm; as well as any other natural person whose services are placed at the disposal and under the control of the firm or a tied agent of the firm and who is involved in the provision by the firm of regulated activities; (d) a natural person who is directly involved in the provision of services to the firm or its appointed representative (or where applicable, tied agent) under an outsourcing arrangement for the purpose of the provision by the firm of regulated activities. [Note: article 2(3) of the MiFID implementing Directive]

Retail client: means in accordance with COBS 3.4.1R, a client who is neither a professional client or an eligible counterparty [Note: article 4(1)(12) of MiFID].

Tied agent: means a person who, under the full and unconditional responsibility of only one MiFID investment firm on whose behalf it acts, promotes investment services and/or ancillary services to clients or prospective clients, receives and transmits instructions or orders from the client in respect of investment services or financial instruments, places financial instruments and/or provides investment advice to clients or prospective clients in respect of those financial instruments or investment services. [Note: article 4(1)(25) of MiFID]