

Senior arrangements, Systems and Controls

Chapter 10

Conflicts of interest

10.1 Application

Application to a common platform firm

10.1.-2 **G** For a *common platform firm*:

- (1) the *MiFID Org Regulation* applies, as summarised in ■ SYSC 1 Annex 1 3.2G, ■ SYSC 1 Annex 1 3.2-AR and ■ SYSC 1 Annex 1 3.2-BR; and
- (2) the *rules and guidance* in the table below apply:

Subject	Applicable rule or guidance
Provision of services	SYSC 10.1.2G
Identifying conflicts	SYSC 10.1.3R
Types of conflicts	SYSC 10.1.5G
Managing conflicts	SYSC 10.1.7R
Conflicts policy	SYSC 10.1.12G

Application to a MiFID optional exemption firm and to a third-country firm

10.1.-1 **G** For a *MiFID optional exemption firm* and a *third country firm*, the rules and guidance in this chapter apply to them as if they were *rules* or as *guidance* in accordance with ■ SYSC 1 Annex 1 3.2CR(1).

General application

10.1.1 **R** (1) This section applies to a *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*).

(2) This section also applies to a *management company*.

[**Note:** The provisions in ■ SYSC 10.1 also implement articles 74(1) and 88 of *CRD* and as applied under the discretion in the third paragraph of article 95(2) of the *EU CRR*, *BCD* article 22 and *BCD* Annex V paragraph 1]

10.1.1A **R** This section also applies to:

- (1) a *full-scope UK AIFM* of:
 - (a) a *UK AIF*;

- (b) an *EEA AIF* managed or *marketed* from an establishment in the *UK*; and
- (c) a *non-EEA AIF*; and

(2) an *incoming EEA AIFM branch* which manages or *markets* a *UK AIF* .

Requirements only apply if a service is provided

10.1.2

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The requirements in this section only apply where a service is provided by a *firm*. The status of the *client* to whom the service is provided (as a *retail client*, *professional client* or *eligible counterparty*) is irrelevant for this purpose.

[Note: recital 46 to the *MiFID Org Regulation*]

Identifying conflicts

10.1.3

R

A *firm* must take all appropriate steps to identify and to prevent or manage conflicts of interest between:

- (1) the *firm*, including its managers, employees and *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 or may arise in the course of the *firm* providing any service referred to in ■ SYSC 10.1.1R including those caused by the receipt of inducements from third parties or by the *firm's* own remuneration and other incentive structures.

[Note: article 23(1) of *MiFID*]

Types of conflicts

10.1.4

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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 damage the interests of a *client*, a *management company* 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;
- (2A) in the case of a *management company* providing *collective portfolio management services* for a *UCITS scheme*, (2) also applies where the service is provided to, or the transaction is carried out on behalf of, a *client* other than the *UCITS scheme*;
- (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 in the case of a *management company*, carries on the same activities for the *UCITS scheme* and for another *client* or *clients* which are not *UCITS schemes*; 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 10.1.1 R or engaging in any other activity or, in the case of a *management company*, whether as a result of providing *collective portfolio management services* or otherwise.

[Note: article 17(1) of the *UCITS implementing Directive*]

10.1.4A **G** Other *firms* (except *common platform firms* and *UCITS management companies*) should take account of the *rule* on the types of conflicts (see ■ SYSC 10.1.4 R) in accordance with ■ SYSC 1 Annex 1 3.3R.

10.1.4B **G**

10.1.5 **G** The circumstances which should be treated as giving rise to a conflict of interest 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 45 to the *MiFID Org Regulation*]

Record of conflicts

10.1.6 **R** A *management company* must keep and regularly update a record of the kinds of service or activity carried out by or on behalf of that *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 20(1) of the *UCITS implementing Directive*]

10.1.6A **G** Other *firms* (other than *common platform firms*) should also take account of the *rule* on records of conflicts (see ■ SYSC 10.1.6 R) in accordance with ■ SYSC 1 Annex 1 3.2BR, ■ SYSC 1 Annex 1 3.2CR and ■ SYSC 1 Annex 1 3.3R).

10.1.6B **G** A *firm* (other than a *common platform firm*) should ensure that its management body receives on a frequent basis, and at least annually, written reports on all situations referred to in ■ SYSC 10.1.6R.

Managing conflicts

- 10.1.7 **R** A *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 10.1.3 R from adversely affecting the interests of its *clients*.

[Note: article 16(3) of *MiFID*]

Disclosure of conflicts

- 10.1.8 **R**
- (1) If arrangements made by a *firm* under ■ SYSC 10.1.7 R 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 following to the *client* before undertaking business for the *client*:
 - (a) the general nature or sources of conflicts of interest, or both; and
 - (b) the steps taken to mitigate those risks.
 - (2) The disclosure must:
 - (a) be made in a *durable medium*;
 - (b) clearly state that the organisational and administrative arrangements established by the *firm* to prevent or manage that conflict are not sufficient to ensure, with reasonable confidence, that the risks of damage to the interests of the *client* will be prevented;
 - (c) include specific description of the conflicts of interest that arise in the provision of *investment services* or *ancillary services*;
 - (d) explain the risks to the *client* that arise as a result of the conflicts of interest; and
 - (e) 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.
 - (3) This *rule* does not apply to the extent that ■ SYSC 10.1.21 R applies.

[Note: 23(2) and (3) of *MiFID*]

- 10.1.8A **R** The obligation in ■ SYSC 10.1.8 R (2)(a) does not apply to a *firm* when carrying on *insurance mediation activity*.

- 10.1.9 **G** *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 10.1.7 R. While disclosure of specific conflicts of interest is required by ■ SYSC 10.1.8 R, an over-reliance on disclosure without adequate consideration as to how conflicts may appropriately be managed is not permitted.

- 10.1.9A **R** A *firm* must treat disclosure of conflicts pursuant to ■ SYSC 10.1.8R as a measure of last resort to be used only where the effective organisational and administrative arrangements established by the *firm* to prevent or manage its conflicts of interest in accordance with ■ SYSC 10.1.7R are not sufficient to ensure, with reasonable confidence, that risks of damage to the interests of the *client* will be prevented.

Conflicts policy

- 10.1.10 **R**
- (1) A *management company* must establish, implement and maintain an effective *conflicts of interest policy* that is set out in writing and is appropriate to the size and organisation of the *firm* and the nature, scale and complexity of its business.
 - (2) Where the *management company* 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 18(1) of the *UCITS implementing Directive*]

Contents of policy

- 10.1.11 **R**
- (1) The *conflicts of interest policy* must include the following content:
 - (a) it must identify in accordance with ■ SYSC 10.1.3 R and ■ SYSC 10.1.4 R, by reference to the specific services and activities carried out by or on behalf of the *management company*, 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 *management company* and of the *group* to which either of them respectively 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 *management company* to ensure the requisite degree 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; and
- (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 *management company* must adopt such alternative or additional measures and procedures as are necessary and appropriate for the purposes of paragraph (1)(b).

[Note: articles 18(2), 19(1) and 19(2) of the *UCITS implementing Directive*]

10.1.11A **G** Other *firms* (except *common platform firms* and *UCITS management companies*) should take account of the *rules* relating to *conflicts of interest policies* (see ■ SYSC 10.1.10 R and ■ SYSC 10.1.11 R) in accordance with ■ SYSC 1 Annex 1.3.2BR, ■ SYSC 1 Annex 1 3.2CR and ■ SYSC 1 Annex 1 3.3R.

10.1.11B **G** A *firm* (other than a *common platform firm*) should assess and periodically review, on an at least an annual basis, the *conflicts of interest policy* established in accordance with ■ SYSC 10.1.10R and ■ SYSC 10.1.11R and should take all appropriate measures to address any deficiencies (such as over reliance on disclosure of conflicts of interest).

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 *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 47 to the *MiFID Org Regulation*]

10.1.13 **G** [deleted]

10.1.14 **G** [deleted]

10.1.15 **G** [deleted]

Application of conflicts of interest rules to non-common platform firms when producing investment research or non-independent research

10.1.16

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The *rules* relating to:

- (1) types of conflict (see ■ SYSC 10.1.4 R);
- (2) records of conflicts (see ■ SYSC 10.1.6 R); and
- (3) *conflicts of interest policies* (see ■ SYSC 10.1.10 R and ■ SYSC 10.1.11 R);

also apply to a *firm* which is not a *common platform firm* when it produces, or arranges for the production of, *investment research* that is intended or likely to be subsequently disseminated to *clients* of the *firm* or to the public, and when it produces or disseminates *non-independent research*, in accordance with ■ COBS 12.2.

Additional requirements for a management company

10.1.17

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A *management company*, when identifying the types of conflict of interests for the purposes of ■ SYSC 10.1.4 R, must take into account:

- (1) the interests of the *firm*, including those deriving from its belonging to a *group* or from the performance of services and activities, the interests of the *clients* and the duty of the *firm* towards the *UCITS scheme* or *EEA UCITS scheme* it manages; and
- (2) where it manages two or more *UCITS schemes* or *EEA UCITS schemes*, the interests of all of them.

[**Note:** article 17(2) of the *UCITS implementing Directive*]

10.1.18

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For a *management company*, references to client in ■ SYSC 10.1.4 R and in the other *rules* in this section should be construed as referring to any *UCITS scheme* or *EEA UCITS scheme* managed by that *firm* or which it intends to manage, and with or for the benefit of which the relevant activity is to be carried on.

Structure and organisation of a management company

10.1.19

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A *management company* must be structured and organised in such a way as to minimise the risk of a *UCITS scheme's*, *EEA UCITS scheme's* or *client's* interests being prejudiced by conflicts of interest between the *management company* and its *clients*, between two of its *clients*, between one of its *clients* and a *UCITS scheme* or an *EEA UCITS scheme*, or between two such *schemes*.

[**Note:** articles 12(1)(b) and 14(1)(d) of the *UCITS Directive*]

Avoidance of conflicts of interest for a management company

10.1.20

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A *management company* must try to avoid conflicts of interest and, when they cannot be avoided, ensure that the *UCITS schemes* and *EEA UCITS schemes* it manages are fairly treated.

[**Note:** articles 12(1)(b) and 14(1)(d) of the *UCITS Directive*]

Disclosure of conflicts of interest for a management company

- 10.1.21 **R** (1) Where the organisational or administrative arrangements made by a *management company* for the management of conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to the interests of the *UCITS scheme* or *EEA UCITS scheme* it manages or of its *Unitholders* will be prevented, the *senior personnel* or other competent internal body of the *firm* must be promptly informed in order for them to take any necessary decision to ensure that in all cases the *firm* acts in the best interests of the *scheme* and of its *Unitholders*.
- (2) A *management company* must report situations referred to in (1) to the *Unitholders* of the *UCITS scheme* or *EEA UCITS scheme* it manages by any appropriate *durable medium* and give reasons for its decision.

[Note: articles 20(2) and 20(3) of the *UCITS implementing Directive*]

Collective portfolio management investment firms

- 10.1.22 **R** A *collective portfolio management investment firm* which manages investments other than for an *AIF* or *UCITS* for which it has been appointed as manager, must obtain approval from its *client* before it invests all or part of the *client's* portfolio in *units* or *shares* of an *AIF* or *UCITS* it manages.

[Note: article 12(2)(a) of the *UCITS Directive* and article 12(2)(a) of *AIFMD*]

Additional requirements for an AIFM

- 10.1.23 **R** An *AIFM* must take all reasonable steps to identify conflicts of interest that arise, in the course of managing *AIFs*, between:
- (1) the *AIFM*, including its managers, *employees* or any person directly or indirectly linked to the *AIFM* by *control*, and an *AIF* managed by the *AIFM* or the investors in that *AIF*; or
 - (2) an *AIF* or the investors in that *AIF*, and another *AIF* or the investors in that *AIF*; or
 - (3) an *AIF* or the investors in that *AIF*, and another *client* of the *AIFM*; or
 - (4) an *AIF* or the investors in that *AIF*, and a *UCITS* managed by the *AIFM* or the investors in that *UCITS*; or
 - (5) two *clients* of the *AIFM*.

[Note: article 14(1) first paragraph of *AIFMD*]

- 10.1.24 **R** An *AIFM* must take all reasonable steps to avoid conflicts of interest and, when they cannot be avoided, manage, monitor and (where applicable) disclose those conflicts of interest in order to prevent them from adversely affecting the interests of the *AIFs* and their investors, and to ensure that the *AIFs* it manages are fairly treated.

[Note: article 12(1)d of *AIFMD*]

10.1.25

RAn *AIFM* must:

- (1) maintain and operate effective organisational and administrative arrangements, with a view to taking all reasonable steps designed to identify, prevent, manage and monitor conflicts of interest in order to prevent them from adversely affecting the interests of the *AIFs* and their investors;
- (2) segregate, within its own operating environment, tasks and responsibilities which may be regarded as incompatible with each other or which may potentially generate systematic conflicts of interest; and
- (3) assess whether its operating conditions may involve any other material conflicts of interest and disclose them to the *AIFs* investors.

[Note: article 14(1) second and third paragraphs of *AIFMD*]

10.1.26

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If the organisational arrangements made by the *AIFM* to identify, prevent, manage and monitor conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to investors' interests will be prevented, the *AIFM* must:

- (1) clearly disclose the general nature or sources of conflicts of interest to the investors before undertaking business on their behalf; and
- (2) develop appropriate policies and procedures.

[Note: article 14(2) of *AIFMD*]

Subordinate measures for alternative investment fund managers

10.1.27

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Articles 30 to 37 of the *AIFMD level 2 regulation* provide detailed rules supplementing the provisions of article 14 of *AIFMD*.



10.2 Chinese walls

Application

10.2.1 **R** This section applies to any *firm*.

Control of information

10.2.2 **R** (1) When a *firm* establishes and maintains a *Chinese wall* (that is, an arrangement that requires information held by a *person* in the course of carrying on one part of the business to be withheld from, or not to be used for, *persons* with or for whom it acts in the course of carrying on another part of its business) it may:

- (a) withhold or not use the information held; and
- (b) for that purpose, permit *persons* employed in the first part of its business to withhold the information held from those employed in that other part of the business;

but only to the extent that the business of one of those parts involves the carrying on of *regulated activities, ancillary activities* or, in the case of *MiFID business*, the provision of *ancillary services*.

- (2) Information may also be withheld or not used by a *firm* when this is required by an established arrangement maintained between different parts of the business (of any kind) in the same *group*. This provision does not affect any requirement to transmit or use information that may arise apart from the *rules* in *COBS*.
- (3) For the purpose of this *rule*, "maintains" includes taking reasonable steps to ensure that the arrangements remain effective and are adequately monitored, and must be interpreted accordingly.
- (4) [deleted]

Effect of rules

10.2.3 **G** ■ SYSC 10.2.2 R is made under section 137P of the *Act* (Control of information rules). It has the following effect:

- (1) acting in conformity with ■ SYSC 10.2.2 R (1) provides a defence against proceedings brought under sections 89(2), 90(1) and 91(1) of the Financial Services Act 2012 (Misleading statements, Misleading impressions and Misleading statements etc. in relation to benchmarks) - see sections 89(3)(b), 90(9)(c) and 91(3)(b); and
- (2) [deleted]

- (3) acting in conformity with ■ SYSC 10.2.2 R (1) provides a defence for a firm against FCA enforcement action, or an action for damages under section 138D of the Act, based on a breach of a relevant requirement to disclose or use this information.

Attribution of knowledge

10.2.4 **R** When any of the *rules* of COBS or CASS apply to a *firm* that acts with knowledge, the *firm* will not be taken to act with knowledge for the purposes of that *rule* if none of the relevant individuals involved on behalf of the *firm* acts with that knowledge as a result of arrangements established under ■ SYSC 10.2.2 R.

10.2.5 **G** When a *firm* manages a conflict of interest using the arrangements in ■ SYSC 10.2.2 R which take the form of a *Chinese wall*, 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 *Chinese wall*.