



MiFID II & Conflicts of Interest

Conflicts of Interest is a theme that is – although a legal obligation for investment firms – often considered after the fact. It can easily be forgotten in the heat of the action and is not always easy to define; definitely not on top of mind for a commercial or sales team.

After MiFID II went live on January 3rd 2018, the rules on Conflicts of Interest required firms to examine their Compliance processes in much more detail. Under the previous MiFID regulations, firms were already obliged to properly manage conflicts that could arise between their clients and themselves, or between separate clients. This involves constructing a comprehensive policy, initiating conflict management processes and even disclosing any potential conflicts to clients. Many firms were of the belief that most elements would stay the same in terms of requirements for Conflicts of Interest under MiFID II, however the rules have become a lot stricter regarding the level of detail required.

Under MiFID II firms are required to assess ***all risks*** instead of just "material risks" as they were to do so under the first version of MiFID. It is also apparent that, to date, firms have been dependent on disclosing (potential) risks and not actual mitigation, as opposed to managing them or even managing the potential of arising conflicts. This is actually now legally required and will stretch resources especially in mid-sized firms as this requires documentation, recording and subsequent capabilities to demonstrate adequately.

In addition, a report on (potential) Conflicts of Interest must be provided to senior management at least annually, which is also when firms must consider and review their Conflict policies and processes. As the market knows, these reviews often lead to few, if any, changes and thus why they are often missed, delayed or forgotten. Since MiFID II requires firms to explain their actions on a much deeper level when they identify and manage (potential) Conflicts of Interest, those annual reviews will need to be done and catalogued properly with evidence of reasonable thought and consideration having been given to the issues of all conflicts affecting the firm. The exercise is probably going to involve asking various members of staff to assess as broadly as possible where conflicts lie or may arise. This can be done through regular questionnaires which staff can feed back to their manager and/or compliance advice team. The questionnaires captured in comprehensible reports will allow to feedback risks to senior management. This process should lead to more scrutiny of the firm's policies and a useful review and/or expansion of disclosures included in documentation. And what to think of the growing awareness throughout the organization? Your firm should be able to save substantial amounts on (individual) education and time spent during Compliance training.

In essence, to ensure that a firm is MiFID II-compliant, it must be certain that its current Conflicts of Interest procedures are robust enough and, if necessary, expand them. It is also important that firms review – and if necessary – expand their register of conflicts to not only include "material", but all potential risks. This involves not just adding words

into policies and forms but ensuring also that staff undergo conflicts training to strengthen their understanding on identifying and managing conflicts and what policies and procedures to follow.

Disclosure of conflicts should no longer be used as a default option, but instead only when absolutely inevitable, as a means of last resort. Disclosing a conflict of interest is not a way of managing that conflict properly and disclosure can only be used when the firm's administrative arrangements to manage conflicts are inadequate or have failed. Where a firm relies on disclosure, it is obliged to state clearly that the organizational and administrative arrangements put in place to prevent (or manage) conflicts are not sufficient to make certain – with reasonable confidence – that the risks of any possible damage to the client's interests can be prevented. Whenever conflicts are disclosed, these conflicts will be liable to additional obligatory requirements. If a disclosure is made, for example, it must be in a durable medium and entail sufficient detail to allow the client to make a well-informed decision concerning the service in the context of which the conflict arises. This, in itself, will probably add 20% more compliance work throughout the year to a mid-sized firm and more for a larger firm. In this regard, MiFID II should end up causing a change in culture, which is the aim of the regulators.

The combination of Market Abuse rules and MiFID II enables Regulators to view the market as a whole and be much more rigorous in identifying breaches of their rules. It will allow Regulators to detect serious conduct – especially suspected manipulation – much earlier than before. The number of investigations some Regulators currently have on their books is at an all-time high. There has been an increase of 75% in the probes taken by the FCA, also due to a new way of counting every individual instead of every case.

Have companies done enough to be MiFID II-proof? It is set out to create more transparency and lessen Conflicts of Interest. And while AML and KYC are top of the agenda in the financial industry today, Regulators have not taken their eyes off Conflicts of Interest. Firms that have shown no sincere attempt to be MiFID II-proof will be the first to get in trouble.

If you are reviewing Conflicts policies or establishing new processes in your firm based on the MiFID II requirements for this theme, Silvertown Technologies ([website](#)) can help you. We have 5+ years of international experience in this field and automated software solutions that relate to non-financial reporting, compliance processes and record keeping. We have an easy-to-implement solution available that really starts solving your problems starting at only €2.500 a month.

And don't forget. Having to put out the fire is always more painful than preventing one...!

Walter Hendriks

CEO Silvertown Technologies

