FSMA report on conflicts of interest relating to commissions and sales targets. November 2013.

The Financial Services and Markets Authority of Belgium (hereinafter FSMA) has directed its activities, after the reform of the monitoring system to adopt the model "Twin Peaks", to the enforcement of the rules of conduct. To that effect, the FSMA has created, in May 2011, an internal inspection service (*le service "contrôle des règles de conduite"*) and, in January 2012, has presented to the financial sector an action plan to be carried out by the inspection service to comply with the rules of conduct and, specially, with the rules on conflicts of interest.
This document provides the findings and the positions of the FSMA on various aspects of the management of conflicts of interest related to remunerations, incentives and sales targets issued in connection with a series of inspections conducted, between April 2012 and January 2013, on various Financial Institutions and Investment Firms (hereinafter Entities). The inspections resulted in the adoption by the FSMA of the following measures: 85 recommendations for strengthening the internal control of the Entities, and 24 requirements for adoption within a deadline set by the FSMA concrete rectification actions in cases of breaches of rules MiFID or faulty behavior organization.

1. Identification of conflicts of interest.

The methodology to identify conflicts of interest is flawed in many Entities. The list of potential conflicts of interest is of a general nature and usually involves collecting what is described in the legislation without reflecting their individual activities and real internal organization. Identifying potential conflicts is reduced to a theoretical exercise without real transfer to the concrete Entity which prevents employees of being aware of the need to avoid conflicts of interest.

Identification of conflicts of interest related to remunerations, incentives and business objectives.

The **variable remuneration** of employees is relatively low and, in most cases, is within a range of between 5% and 20 % of the annual compensation. It is calculated on the basis of all activities and is not tied to the achievement of objectives in the context of the sale of investment products. Increasingly qualitative criteria are used to calculate the variable part of the salary such as, for example, the fulfillment of MiFID rules of conduct.

Entities' agents' remuneration is generally variable being of importance that the kind of compensation des not incite to sell certain product for which is better paid with preference to others. The FSMA notes that some Entities link remunerations to respect for the rules of conduct MiFID. Employees of agents have a remuneration determined by the latter. The FSMA requests Entities to exercise proper control over the agents and monitor compliance with MiFID conduct of business rules.

Many institutions allow for **incentives** for employees of their sales departments if they obtain good results in their marketing campaigns to sell specific products. Despite its low monetary value, incentives constitute a risk of conflict of interest that should be monitored by the compliance department to avoid conflict with the client´s interests. If there is a financial advisory or portfolio management relation with the client, the incentives created for a product or category of products are not acceptable.

The FSMA admits that Entities could fix **sales targets** set to achieve a certain return but, in order to prevent adversely effects for the client´s interests, it is essential to formulate the sales objectives in a way that it is possible to offer clients a range of products or services broad enough to respond to their needs. If there is a financial advisory or portfolio management relation with the client, business objectives fixed for a product or category of products are not acceptable.

The **compliance department** is involved only with a limited role in determining the variable remuneration, incentives and business objectives whereas the FSMA considers of high relevance that the compliance department gets involved in this process.

Identification of conflicts of interest related to the selection, approval and marketing of investment products.

Many Entities have established a procedure for product approval but these procedures are likely to be improved for better customer protection. Therefore, the FSMA suggests that these processes contain the following elements: designation of a person (gatekeeper) to check whether the client's interests are respected in the decision to create the product and its conditions, definition of the responsibilities of all involved in the procedure, setting product selection criteria, evaluation of balance between the clients' and Entities' interests, obligation to retain documentation of the various stages of the process and ongoing evaluation of products including the decision to cease marketing. In some circumstances, employees in commercial departments offer their clients sell or exit a product to purchase another new and thus achieve business goals with real risk of a conflict of interest. In this regard, the FSMA has required the development of operational procedures and policies including arbitration between products.

2. Policies and procedures relating to conflicts of interests.

Entities of a certain size have policies on conflicts of interest but, in many cases, there is not a proper adaptation to the activities and organization of the Entity. The control of the rules about conflicts of interest in the first level, that is, in the operational and commercial departments, is not sufficient because these policies are not implemented in daily functioning . The FSMA considers that Entities should set clear boundaries within which gifts can be accepted from clients and the compliance department should actively monitor compliance with these limits.

3. Training of employees.

Employees should know the concept of "conflict of interest" as a condition to proceed to their identification and communication to the compliance department. Despite the efforts of certain Entities, employees do not currently have sufficient knowledge in the field of potential conflicts of interest. The FSMA insists that institutions should make an effort to increase employee training.

4. Record keeping of conflicts of interests.

Most institutions find it difficult to distinguish between conflicts of interest recorded and the list of potential conflicts of interest. The FSMA clarifies that the first covers conflicts of interest observed and recorded, while the second is a theoretical evaluation of conflicts likely to occur.

5. Information provided to clients.

The FSMA notes that the information provided is very general and limited.

6. Self-evaluation and monitoring of policy and procedures.

The FSMA considers the compliance department is responsible for the compliance with the rules of conflict of interest on the second level (outside de daily activity or first level control). In addition the compliance department monitors compliance with policies and procedures on conflicts of interest and informs the Board of Administrators and the Directors.

If you want to read the full text of the FSMA, please, click here: http://www.fsma.be/~/media/Files/fsmafiles/mifid/fr/inspec/conflitsdinteret.ashx