

Managing Conflicts of Interest

Michael Malone, Examination Manager, FINRA, Dallas District Office

Michael Malone is an examination manager in FINRA's Dallas District Office. He began his career with FINRA in 1994, and is currently responsible for managing a staff of six examiners who conduct field examinations of FINRA member firms. Mr. Malone holds a bachelor's of business administration in accounting from Baylor University, has a CRCP designation from the FINRA Institute at Wharton, and is currently studying to obtain a CAMS certification from the Association of Certified Anti-Money Laundering Specialists.

Laura Leigh Blackston, Senior Regional Counsel, Department of Enforcement, FINRA, New Orleans District Office

Ms. Blackston joined FINRA as an attorney in 2002. Prior to joining FINRA, she was an associate and partner with the General Litigation group of the law firm Jones Walker. As Senior Regional Counsel, Ms. Blackston has handled numerous enforcement actions involving conflicts of interest. Ms. Blackston graduated from the University of Mississippi in 1988 with honors and received her law degree from Washington and Lee University with honors in 1992. She is also a graduate of the FINRA Institute at Wharton and a member of FINRA's Anti-Money Laundering Regulatory Expert Group.

Bob Mooney, Managing Director and CCO Wells Fargo Advisors

Bob Mooney is a managing director and Chief Compliance Officer of Wells Fargo Advisors, where he is a member of the firm's Operating Committee and is responsible for the compliance, regulatory affairs and internal controls functions for Wells Fargo's retail broker-dealers. Mr. Mooney also chairs the firm's Governance Committee and Conflict of Interest Committee. He joined Wheat First in 1992 and during his 22 years with the company has held a variety of leadership positions, including Chief Governance Officer, Chief Administrative Officer, Chief Compliance Officer, Regional Director – Private Client Group and Assistant General Counsel. He has been in his current role since 2008. Prior to joining the firm, Mr. Mooney spent four years as a special assistant U.S. attorney for the Southern District of New York – Securities and Commodities Fraud Task Force, and three years as Senior Counsel for the SEC's Division of Enforcement. A 1981 graduate of Mary Washington College, Mr. Mooney received his law degree from the Columbus School of Law, the Catholic University of America in 1985. Mr. Mooney is a member of the FINRA Compliance Advisory Group.

Steven Polansky, Senior Director, Office of Regulatory Programs, FINRA

Steven Polansky is Senior Director in FINRA's Office of Regulatory Programs. Mr. Polansky is responsible for leading cross-firm reviews—including the recent conflicts and ongoing cybersecurity reviews—and special projects. Previously, Mr. Polansky worked in FINRA's International Department, where he was responsible for analyzing international regulatory developments and leading FINRA's relationships with select financial regulators in Europe and Asia as well as international financial institutions. In addition, Mr. Polansky led advisory projects in a number of jurisdictions related to, among other things, risk-based supervision (including associated training), prudential oversight and market surveillance. Prior to joining FINRA, Mr. Polansky was a management consultant with PricewaterhouseCoopers, and he served for seven years as a professional staff member on the Committee on Foreign Relations in the United States Senate. Mr. Polansky received his master's in business administration in finance from The Wharton School at the University of Pennsylvania, his

masters of public administration from the Kennedy School of Government at Harvard University, and his bachelor's degree in history from Colgate University.

South Region Compliance Seminar

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Panelists

- Moderator – Michael Malone, Examination Manager, FINRA Dallas District Office
- Panelist – Steven Polansky, Senior Director, Office of Regulatory Programs, FINRA
- Panelist – Laura Leigh Blackston, Senior Regional Counsel, Department of Enforcement, FINRA New Orleans District Office
- Panelist – Bob Mooney, Managing Director and Chief Compliance Officer, Wells Fargo Advisors



Definition: What is a conflict of interest?

- **There is no universal definition of conflict of interest; however, there are combinations of circumstances that are the breeding ground for conflicts:**
 - An explicit or implied duty by one party towards another (e.g., meeting a suitability or fiduciary obligation)
 - An incentive that may compromise, or appear to compromise, the ability of that party to fulfill its obligation
 - Frequently, an asymmetry of information

Conflicts categories

- **Some firms group conflicts into the following major buckets or categories:**
 - Firm vs. client conflicts
 - Client vs. client conflicts
 - Employee vs. client conflicts
 - Employee vs. firm conflicts
 - Vendor vs. client conflicts

Areas of focus

- **Three critical areas:**
 - Conflicts of Interest Framework
 - New Product Conflicts
 - Compensation Practices

Conflicts of Interest Framework

- **Conflicts of Interest Framework**
 - Defining conflicts of interest in a way that is relevant to a firm's business and which helps staff identify conflict situations.
 - Articulating employees' roles and responsibilities with respect to identifying and managing conflicts.
 - Establishing mechanisms to identify conflicts in a firm's business as it evolves.
 - Defining escalation procedures for conflicts of interest within and across business lines.
 - Avoiding severe conflicts, even if that avoidance means foregoing an otherwise attractive business opportunity.
 - Disclosing conflicts of interest to clients, taking into consideration the different needs of retail and institutional clients.

Conflicts of Interest Framework (cont.)

- Training staff to identify and manage conflicts in accordance with firm policies.
- Reporting on significant conflicts issues, including on a firm's own measures to identify and manage conflicts, to the Chief Executive Officer (CEO) and board.

New Products

■ New Products Conflicts

- New product review process to identify and mitigate conflicts.
- Disclosure of conflicts in plain English.
- Know-Your-Distributor policies and procedures.
- Post launch reviews of new products to identify potential problems.
- Carefully evaluate and decline to offer products when conflicts associated with new products are significant.

Compensation

■ Compensation Practices

- “Product agnostic” compensation grids (i.e., a flat percentage of the revenue generated regardless of product).
- Link surveillance of representatives’ recommendations to thresholds in a firm’s compensation structure.
- Enhancing supervision and surveillance of recommendations as a representative approaches compensation milestones.
- Enhancing surveillance around key liquidity events in investor’s lifecycle. (e.g., 401k rollovers, inheritance, insurance claims)
- Reduce the incentive for a representative to prefer one mutual fund or variable annuity family over another by capping the credit a representative may receive for a comparable product across providers.

Issues Surrounding RR Agreeing to Fiduciary Roles

■ Potential Roles

- Power of Attorney
- Beneficiary
- Trustee
- Executor

Issues Surrounding RR Agreeing to Fiduciary Roles

■ Common Fact Pattern

- RR befriends elderly customer with no close relatives
- RR runs errands for customer, involves customer with own family, keeps others away from customer
- RR is named as beneficiary in will
- RR does not tell firm until after inheritance
- Firm and RR become involved in dispute with relatives
- Disciplinary action by FINRA based upon Firm's procedures

Issues Surrounding RR Agreeing to Fiduciary Roles

■ Preventative Measures

- Require annual disclosure of acting as power-of-attorney, trustee, executor
- Require annual disclosure of being named as beneficiary, successor beneficiary, successor trustee, executor
- Require annual disclosure of immediate family being named or acting in these roles
- If there is approval of any of these roles, require transfer of account to a different representative
- Educate RRs that receipt of funds as a trustee or executor is an outside business activity

Issues Surrounding RR Agreeing to Fiduciary Roles

■ Case Studies

- *Ronald G. Klebba*, 20080149742 (Sept. 14, 2010)
- *Robert Gesdorf*, 20100231574 (Sept. 24, 2013)
- *Kent M. Houston*, Exchange Act Release No. 71589A (Feb. 20, 2014).

Resources

■ Report on Conflicts of Interest

- <http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p359971.pdf>

■ A few minutes with FINRA - Interview with Rick Ketchum and Chip Jones on Managing Conflicts of Interest

- <http://www.finra.org/industry/regulation/guidance/communicationstofirms/p369762>

Questions?



