Market Intermediary Management of Conflicts that Arise in Securities Offerings

Final Report

TECHNICAL COMMITTEE
OF THE
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

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Part 1: Background

A. Purpose of this report

This report sets out guidelines for regulators and market participants when considering how to address conflicts of interest that may arise when market intermediaries are involved in securities offerings, and, in particular, how to address the management of information flows in conflicted situations.

These guidelines have been developed pursuant to IOSCO Core Principle 23, which recommends:

> *Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.*[1]

IOSCO has also released *Principles for Addressing Sell-side Securities Analyst Conflicts of Interest*[2], which address conflicts arising from the individual capacity of the analyst.

It is important to note at the outset that the purpose of this report is to set out general guidelines to be taken into account by market participants and regulators when dealing with the issue of conflicts or possible conflicts in securities offerings. The purpose of this paper is not to impose prescriptive or inflexible rules. The examples that are given are for illustrative purposes only.

The guidelines in this report must be placed in the context of the regulatory regime applicable in each individual jurisdiction. It is also important to recognise the differences between wholesale and retail investors and between debt and equity markets. Approaches to addressing conflicts should take these differences into account.

B. Rationale for this report

The drafting of this report was prompted by the report of the IOSCO Technical Committee entitled "Strengthening Capital Markets Against Financial Fraud," dated February 2005.[3] That report referred to a series of high profile financial scandals that appeared to raise doubts in the minds of investors about the integrity of global capital markets and highlighted areas of securities market regulation requiring review.

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1 Under section 12.5 of the IOSCO Objectives and Principles of Securities Regulation (May 2003)(http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf), it is stated that "[a] firm should try to avoid any conflict of interest arising but, where the potential for conflicts arise, should ensure fair treatment of all its customers by proper disclosure, internal rules of confidentiality or declining to act where conflict cannot be avoided." "A firm should not place its interests above those of its customers."

2 <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD150.pdf>

3 <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD192.pdf>

Market intermediaries were involved in the transactions referred to in the report. Some of them were investment banks that acted as underwriters for public equity and debt issuances and brokered private loan arrangements, while others were broker-dealers who marketed securities to institutional and retail investors. In some cases, market intermediaries that arranged loans or other transactions were accused of misusing material non-public information about the issuer.

Among other action items for priority work, the report recommended that the Technical Committee examine the role of market intermediaries in the offering process. The Technical Committee mandated its Standing Committee on Intermediaries (SC3) to undertake some work on this area and that it focus on:

(a) Information flows within market intermediaries as well as between them and issuers and investors to identify (1) potential conflicts of interest; (2) how information is managed within market intermediaries involved in securities offerings; and (3) the possible inappropriate use or withholding of relevant information related to those conflicts; and

(b) How inappropriate uses of information and possible conflicts of interest related to a securities offering could be addressed by information management arrangements within the market intermediary.

It is essential that investors have confidence that market intermediaries act with integrity and with appropriate regard to their interests, whether they are clients of the market intermediary or invest in a securities offering that is underwritten or facilitated by the market intermediary. Where a market intermediary has more than one client and/or where it has a proprietary interest in the outcome of a transaction, both of which may lead to conflicts of interest, investors and regulators rightly expect the intermediary to identify and address those conflicts appropriately.

There are potential benefits to clients in dealing with a market intermediary offering a range of financial services, as clients obtain an integrated approach to their financial needs. However, the offering of a range of financial services increases the potential for conflict issues to arise and gives rise to a need to properly address such potential conflicts.

C. Consultation

This report was developed following an extensive consultation process with a range of individual market participants, industry bodies and regulators. The IOSCO Technical Committee issued a consultation report in February 2007, inviting comment on a number of issues and proposed approaches for dealing with conflicts in the context of securities offerings. The consultation report was prepared primarily on the basis of responses from SC 3 member regulators[4] to a survey on the regulation and practices of market intermediaries involved in securities offerings. As part of the drafting

[4] SC3 member regulators are: OSC Ontario Canada, ASIC Australia, AMF Quebec Canada, AMF France , Bafin Germany, SFC Hong Kong, Consob Italy, FSA Japan, CNBV Mexico, AFM the Netherlands, SEC Pakistan, MAS Singapore, CNMV Spain, EBK Switzerland, FSA UK, SEC US, CFTC US.

process, SC 3 members also held informal consultations with a limited number of market intermediaries and self-regulatory organisations.

The Committee was pleased to receive detailed and helpful comments on the consultation report from a wide range of organisations, and these comments have been taken into account in the development of this final report.

D. Scope of this report

This report is divided into three parts:

(a) Part 1 outlines the background and purpose of the report and discusses what is meant by the term "conflicts of interest".

(b) Part 2 describes proposed general approaches for addressing conflicts and means for their implementation. .

(c) Part 3 outlines examples of circumstances in which market intermediaries involved in securities offerings may face potential conflicts of interest, and discusses possible ways to deal with them.

What is included within the scope of this report?

The focus of this report is on the conduct of market intermediaries in securities offerings where:

- the market intermediary (either alone or together with its related entities) is generally in the business of offering a number of services to individual clients (such as underwriting, lending, advising); and

- the market intermediary (either alone or together with its related entities) has more than one commercial relationship with an issuer (or its related entities) or has a relationship with other clients of the market intermediary that may be relevant to its involvement in a particular securities offering (such as an adviser to a merger or acquisition, a lender, a private equity fund, a counterparty to a credit derivative, or an adviser to retail clients); and

- the market intermediary is directly involved in a securities offering by the issuer. The market intermediary may act as arranger to the offer (either on a firm commitment[5] or best efforts[6] basis), placing agent, adviser to the offer or dealer

[5] "Firm commitment" underwriting (as understood in North America) involves guaranteeing the sale of an issue of securities by purchasing it at stated price from the issuing corporation. It devolves upon the underwriter to dispose of the securities to the investing public at a price sufficiently attractive to ensure their sale and yet yield the underwriters a profit. The underwriter is required to take the balance of securities that it cannot dispose. There may also be "standby underwriting" where the underwriter simply agrees to take any balance of securities unsubscribed in an offering. "Standby underwriting" is understood as "firm commitment" underwriting in Australia (The definition above is derived from the definition of "firm commitment" in Charles Woelfel Encyclopedia of Banking and Finance 10th Edn (1994) Probus Publishing Company).

in the securities offering. The market intermediary may also be indirectly involved as part of a syndicate jointly distributing the securities; and

- the securities offering is either a public or private offering; and

- the securities offering is either of equity or debt.

The Appendix to this report provides an example in flowchart form of typical steps involved in an equity fundraising.

What is not included within the scope of this report?

Conflicts other than those described above are not covered in this report. For example, the report does not address:

- Conflicts faced by sell-side research analysts employed by a market intermediary. These are already dealt with in IOSCO's *Principles for Addressing Sell-side Securities Analyst Conflicts of Interest.*[7]

- Services related to the entry into derivatives contracts as a 'securities offering'. By a derivative contract we mean a financial instrument (other than a security) the value of which is dependent upon the value of an underlying instrument or asset.[8]

- The required content of offering documents, e.g., prospectuses (typically regulated by specific statute or law) used in the securities offering, or due diligence arrangements under the offering.

E. Conflicts – Description and Importance

What are conflicts of interest?

Conflicts of interest are common in the activities of market intermediaries because of the different roles that an intermediary or companies within the same financial group as the market intermediary play. A conflict arises where the interests of a market intermediary may be inconsistent with, or diverge from, those of its clients, investors, or others. There may also be a conflict between the interests of one group of clients and those of another group. Conflicts of interest take various forms, i.e., they may be actual, apparent or potential (future). It is common for a market intermediary to have conflicts of interest in connection with securities offerings because the market intermediary often plays more than one role.

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6 "Best efforts" underwriting means that the underwriter makes no firm commitment but agrees to use its best efforts to sell as much of the offering as possible. (Charles Woelfel Encyclopedia of Banking and Finance 10th Edn (1994) Probus Publishing Company).

7 See footnote 2 for the relevant citation.

8 This approach is not intended to exclude some structured products, such as collateralized debt obligations and other synthetic products that are debt instruments.

In addition, a market intermediary may be part of a group of companies or business units (the group), where different entities within the group undertake different services or activities for a range of clients. Although the market intermediary may be involved only in the offering of the securities, other entities in the group may perform other functions that are relevant to the market intermediary's role. These other members of the group and their functions can create conflicts of interest between them and other members.

The above definition of conflicts is intentionally broad to assist market intermediaries to identify all possible conflicts and give careful consideration as to what action, if any, is necessary to address the conflict. A classic example of a conflict of interest in a securities offering is where the offering is arranged by means of a book building. In such an offering, the market intermediary acts for the issuer in arranging the sale of securities to its own investment clients. These investment clients use the services of the market intermediary to trade securities. In this case, there may be a conflict in terms of the offering price between the interests of the issuer and the interests of the investment clients. Another example of the type of conflict that may arise is a conflict between an entity or business unit that is the market intermediary responsible for the offering of securities and an entity or business unit of the same group that is responsible for lending activities. In this case, the conflict may arise if the funds being raised will be used for repayment of the loans.

Market intermediaries that are involved in a securities offering could have conflicts of interest if they or a company within the same financial group also provide services to clients other than the issuer, e.g., if they are advising potential investors about the offering. Another conflict may arise if the market intermediary or a company within the same financial group conducts business activities in which they have a proprietary interest that is not the same as the issuer's, such as where the market intermediary (or a company within the same financial group) is a commercial lender to the issuer.

In many cases, the potential conflict of interest becomes a real conflict because the market intermediary (or a company within the same financial group) acquires information about the issuer (for example, information on its prospects) for one purpose and this information may be relevant to the provisions of services in a separate context or to the market intermediary's own business.

The use of syndicates in securities offerings made up of unrelated market intermediaries, such as joint managers, may also give rise to potential conflicts of interest. For example, some members of a syndicate may possess information about the issuer that other syndicate members do not have, such as information obtained from separate business activities it conducts with the issuer.

While the focus of this report is on the activities of market intermediaries, there can be group activities or interaction between the market intermediary and other group members which have an impact on the market intermediary and its clients. Approaches to conflicts need to deal with these issues. This report identifies some of the circumstances when there are conflicts between different group members and some proposed approaches for dealing with them.

Why addressing all types of conflicts of interest is important

Addressing conflicts helps promote consumer protection and maintain market integrity. Without adequate arrangements to address conflicts, market intermediaries whose interests conflict with those of a client or investors may have an incentive to put its own interests first in a way that may harm the client or investors and may diminish confidence in the market intermediary or in the market in general.

Surveys in a number of jurisdictions[9] have shown a possible link between conflicts management and consumer protection and market integrity outcomes. Poor conflicts management tends to be associated with poor consumer protection and market integrity outcomes.

While not all conflicts of interest may result in harm to particular clients or diminish market integrity, all conflicts increase the risk of these outcomes (both in terms of the likelihood and the impact of such outcomes). Conflicts of interest can have a biasing or distorting effect – they may create incentives for the market intermediary to put its own interests ahead of those of its clients, such as investment clients of the market intermediary, the issuer and/or the market as a whole.

In light of the above, in some jurisdictions, market intermediaries may have a specific legal obligation to address (or there may be prohibitions against) certain conflicts of interest. These obligations may arise under statute, regulations, rules, common law, or industry standards. In other jurisdictions, the obligations may be is derived from the statutory obligations on market intermediaries to operate honestly and fairly, or from their duties under the general law (*e.g.*, fiduciary duties, the law of tort and contract).

F. Addressing Conflicts

Prudent market intermediaries take steps to address the conflicts of interest they are exposed to in their day-to-day operations. The adequacy of those steps will depend on the nature, scale and complexity of the market intermediary's business, as well as the specific legal obligations applying to them. When a market intermediary or other entities within the market intermediary's group are engaged in a range of activities associated with a securities offering, conflicts may also arise within the market intermediary or between the market intermediary and other members of the same financial group engaged in such activities. For ease of reference, unless otherwise stated, references in this report to "market intermediary" will be taken to refer to the financial group of which the market intermediary forms a part.

[9] FSA, Consultation Paper 171 'Conflicts of Interest: Investment Research and Issues of Securities' (CP 171) May 2003
FSA Discussion paper 15 'Investment research – Conflicts and other issues' (DP 15) October 2002
ASIC 'Shadow shopping survey on superannuation advice – An ASIC report' April 2006

Part 2: Approaches for addressing conflicts

Approaches for addressing conflicts may involve establishing specific structures or procedures, disclosure, or, less commonly, refraining from engaging in the conduct.

This part of the report considers specific mechanisms that may be used by market intermediaries to address conflicts, and how these mechanisms assist in promoting the regulatory objectives of investor protection and market integrity. The level of investor sophistication may, of course, impact upon the effectiveness of each mechanism.

As a general rule, a market intermediary that provides a range of different financial services should have policies and procedures on a whole of firm or group basis that enable it to identify, assess and develop appropriate means of addressing conflicts or potential conflicts.[10] These could include refraining from participating in a transaction, establishing specific structures or processes, and disclosure. The mechanisms put in place should be appropriate to the size and organisation of the firm and the nature, scale and complexity of its business. The following topics are discussed below:

(a) whole of group approach;[11]
(b) decision process for addressing conflicts;
(c) information barriers and restrictions;
(d) disclosure of conflicts; and
(e) refraining from acting.

(A) Whole of group approach

A market intermediary and its senior management should be aware that there is the potential for a conflict of interest to arise if it participates in a securities offering and also provides financial services to other clients and/or has a proprietary interest in the transaction. They should be aware that the potential for conflicts can also arise because of services provided by other entities of the group of which it is a member. The market intermediary needs to identify and address those conflicts so that client interests are not impaired. This will call for addressing conflicts on a whole of group basis.

Large financial and other groups[12] operate in a complex environment. Business units within a large group operate often as discrete profit centres. Managers of business units focus on the particular conflicts that their business unit confronts. Conflicts

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10 IOSCO's report on the Compliance Function at Market Intermediaries (March 2006) (http://www.iosco.org/library/pubdocs/pdf/IOSCOPD214.pdf) sets out general principles for compliance that address how such policies and procedures should be developed.

11 This topic discusses the situation where conflicts arise because of activities performed by different business units or entities within a group as well as within a market intermediary.

12 While conflicts are more likely to occur between business units performing financial services, we use the more general term "group" to refer to any large business that includes a market intermediary as one of its business units or entities, even if it has business units or entities that provide non-financial services or products.

must not only be identified at the business unit level, but the group needs to consider the potential for conflicts outside that business unit and between different members of the group.

The group of which the market intermediary forms part should consider ways in which it can take a whole of group approach to the management of conflicts that arise in relation to or as a result of a securities offering managed by the market intermediary within the financial group. There is a greater probability that conflicts will be inadequately addressed in the absence of a whole of group approach.

An organisation's culture shapes the manner in which it deals with issues. A consistent "whole of group" approach that treats identification and management of conflicts with appropriate priority and importance is essential to address conflicts effectively. This is particularly so for organisations that operate through discrete business units that are members of the same group.

Compliance awareness training, effective information technology systems, a proactive compliance culture, comprehensive policies and appropriate recruitment and remuneration practices can also play an important role in achieving a whole of group approach.

The organisational structure of a group engaged in cross-border business may impact upon the implementation of a whole of group approach. In such a case, effective communication between a group's control committees in different jurisdictions is critical.

Means for implementation: Specific mechanisms that may be used to achieve a whole of group perspective to the management of conflicts that arise in relation to or as a result of a securities offering include:

(1) Putting in place policies that will enable a market intermediary and the group of which the market intermediary forms part, on an ongoing basis to:

(a) identify the conflicts of interest (including potential conflicts) relating to its involvement in arranging issues of securities;
(b) assess and evaluate those conflicts, and develop and implement an appropriate means to address those conflicts; and
(c) evaluate the effectiveness of the implemented response.

(2) The whole of group approach should be tailored to the nature, scale and complexity of the group's business.

(3) The senior management of the market intermediary and the group are responsible for setting and preserving the culture of the market intermediary. Conflicts may in some cases need to be considered, in addition to the assessment by the compliance function, at a management level above the individual business unit or entity that has the relevant conflict. This would help to ensure that an appropriate assessment is made of the nature of the conflict and the response to such conflict.

(4) Effective identification and addressing of conflicts are facilitated through policies and procedures endorsed and supported by senior management. Such policies and procedures might use one or more of the following mechanisms:

(a) ***Review, approval or central conflict management committees***[13]**:** One way for groups to identify and address conflicts that may arise between a market intermediary engaged in a securities offering and other entities in the group is to establish review, approval or central conflict management committees that comprise people with sufficient authority, autonomy and independence to take decisions uninfluenced by the commercial pressures of the relevant business units.

Some committees comprise senior management representatives of all relevant parts of the organisation. The committees should include personnel who are above the level of individual business entities, such as the chief compliance officer, head of internal audit, head of the legal division and independent board members if appropriate. If appropriate, the committee should also comprise senior representatives of those parts of the organisation that should be physically separated.

These committees may be established on a permanent basis or at the beginning of the market intermediary's (or the individual business unit's) involvement in a proposal. Their remit should continue throughout the market intermediary's involvement. These committees should also focus on unusual aspects of transactions.

Matters may be referred to the committees by individual business units or by personnel who are above the individual business units. Procedures should be put in place to deal with potential conflicts of interest of individual members of the committee and to help ensure that the committee's consideration of conflicts is timely and appropriately recorded.

(b) ***Control rooms:*** Some groups establish control rooms. The control room, as part of the compliance function, is responsible for providing a "whole of group" overview of the operations of the group. In particular, the control room identifies conflicts that may arise between different business units and provides information to the relevant committee(s).

(c) ***Conflicts checks:*** Groups typically conduct conflicts checks prior to the commencement of their involvement in a transaction. Such a check helps the market intermediary identify dealings with a competitor of the issuer using the market intermediary's service. Checks of individual staff conflicts may also be conducted throughout the intermediary prior to the commencement of its

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[13] A central conflict management committee could be established with the charter of identifying areas where business units or entities have a relationship with the issuer or client and confirming that the business can be undertaken or whether particular measures need to be taken to manage the conflicts. The timely identification of issues that should be addressed other than at the business unit level or the individual entity level (where the entity is part of a group) and mechanisms for escalation of matters by the business unit or individual entity will be integral to the effective operation of any central conflict management committee.

involvement in a transaction. The conflicts focus is usually on arrangements that may affect the independence and objectivity of the staff member, for example, an employee has an interest in the outcome of a fundraising because he/she holds shares in the issuer that the market intermediary is advising.

(d) ***Internal controls:*** Groups have internal controls over the way in which the business is conducted. Internal controls seek to protect the market intermediary's financial position and business and assist in compliance and oversight of the staff of the market intermediary. Internal control procedures should therefore cover the management of conflicts to ensure that the market intermediary's conflict management process is followed. Examples of internal controls include the separation of roles and responsibilities, authorisation limits, review and reconciliation of information by other staff, internal audit and the development of policies and procedures for particular activities.

(B) **Decision process for addressing conflicts**

Market intermediaries or the group should address conflicts by employing the following process:

(a) First, if the conduct is prohibited by law, or if a conflict is so great that a management mechanism is unlikely to protect the interests of a client, then the market intermediary should refrain;
(b) Second, if (a) does not apply, the firm should consider and implement appropriate conflict management mechanisms (such as information barriers, dealing restrictions, and/or disclosure);[14]
(c) Third, the market intermediary should monitor the ongoing effectiveness of the chosen approach, and modify it if necessary;
(d) Fourth, if at any stage during (b) and (c) above, the market intermediary forms the view that the conflict cannot be adequately addressed by conflict management mechanisms, the intermediary should refrain from the activity.

Means for implementation: Market intermediaries should adopt policies and procedures to identify conflicts, take the appropriate measures to address the conflicts, and to monitor their effectiveness. Relevant matters that market intermediaries typically monitor and document as part of their approach to addressing conflicts include identifying:

(a) material interests in relation to a securities offering;
(b) the appropriate people to participate in committees concerning the identification and assessment of the conflicts;
(c) resources for implementing solutions; and
(d) mechanisms for monitoring compliance.

[14] Some jurisdictions may require some or all of these.

(C) Information barriers and restrictions

(1) Information barriers are a useful mechanism to manage information flows and possible conflicts that arise during a typical securities offering, such as:

- *(i) the period when a mandate for a securities offering is being explored between the corporate finance part of the firm and the potential issuer;*[15]
- *(ii) the due diligence period in drafting the issuer's prospectus;*[16]
- *(iii) the pricing period of issue (whether using a book building process*[17] *or not).*[18]

(2) Dealing restrictions should be considered to address conflicts where information may otherwise be used by the firm and/or its staff (and their family and other house members) to the detriment of the interests of clients of the market intermediary.

Information barriers will be effective only where there are clear procedures to ensure that only those persons who should have access to relevant information do so, such as those working on the issue in the relevant business unit. Procedures that provide for the authentication of the person accessing the information, particularly electronic information, can be useful although, with such procedures, it is important also to control the circumstances under which a person may be permitted to access information protected by a barrier to ensure the information is contained and protected.

A firm should understand the type of information and the sources of information that are used in a securities offering. Understanding the information flows helps when constructing information barriers and in monitoring the effectiveness of these barriers.

Information security is enhanced where there is an audit trail and appropriate records about the access and actions performed by a person who has been involved with preparing or using confidential information. Information security helps apply barriers to information. This may entail at least three components – physical barriers, document classification and security and computer protections. Information security measures are discussed in more detail below.

Means for implementation: The following list is not exhaustive and the appropriateness of each suggested means for implementation should be considered in the context of each market intermediary's specific operating environment.

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15 In this case the barrier will often allow the other parts of the intermediary's business to operate without restriction.

16 Like the example in paragraph (i), those parts of the intermediary's business should not be tainted by the knowledge of the issuer gained by the corporate finance part of the firm's business.

17 Book building is the process of establishing the pricing for an issue, by contacting institutional investors before the offering to ascertain at what price and at what quantity the institutional investor would be prepared to purchase securities subject to the offer.

18 During this period senior representatives across the intermediary (including the public broker/dealer side) may share information about the issuer, the market and likely interest of possible wholesale and retail investors. Even though engaged representatives may have their conduct restricted because of the information they are taken to know, barriers may help their business units to operate without restriction.

(1) Information barriers: Specific information barriers include:

(a) ***Physical barriers:*** Office design and office security arrangements are important ways in which confidential information may be protected from abuse within a market intermediary. The protection of confidential information within business units can be achieved where there are security measures to limit the access to business units that may be working on sensitive information about a securities offering. Records of who may have accessed an area where sensitive information may be stored should be maintained.

(b) ***Document classification and security*****:** Arrangements to classify the security measures that should be applicable to documents can also be put into place as part of an information barrier. This can involve physical separation of documents and imposition of restrictions on access to the documents and copying of those documents.

(c) ***Computer protection*****:** Where information is stored electronically, specific measures to help ensure information security should be adopted. For example:

(i) labelling files with lists of authorised users;
(ii) shielding computers to prevent interception;
(iii) enciphering of information sent over telephone lines or other means;
(iv) erection of firewalls to restrict non-public information being accessed by other staff of the market intermediary; and
(v) placing different parts of the market intermediary on different network and email security arrangements that would protect certain information in emails.

(d) ***Confidentiality agreements:*** These are agreements between issuers and market intermediaries as well as between intermediaries and their employees, which require the parties to preserve the confidentiality of information, particularly in the absence of applicable legal or contractual obligations. Such agreements can protect clients by prohibiting the transfer of information that could give the firm, its employees or another client an advantage in conflict with the client's interests. In addition, individual staff of the market intermediary and other professionals associated with the securities offering may be under an obligation (usually contained in employment contracts or in legal requirements) to keep information confidential.

(2) Restrictions on dealing can be used to address conflicts where information may otherwise be used by the firm or its employees to the detriment of the interest of the clients of the market intermediaries. Restrictions within a market intermediary include:

(a) ***'Watch' trading lists:*** An issuer is typically added to a "Watch" list when the role of the market intermediary in an offering is a possibility but has not been confirmed (*i.e.*, pre execution of the mandate). These lists are compiled to

facilitate monitoring of trading in the entity's securities by the organisation and its employees[19];

(b) ***Restricted dealing lists:*** An issuer is typically added to this list once the mandate has been signed and announced. Staff of the market intermediary are made aware that trading in the securities (on their own behalf or for the market intermediary) of an entity on the restricted list requires prior approval.

(D) Disclosure of conflicts

(1) Where disclosure is used to address conflicts, such disclosure should be sufficiently complete and timely so that it is meaningful and comprehensible to the client.

(2) A market intermediary should consider making disclosures to its clients supplemental to the information required to be in the issuer's prospectus in order to address conflicts adequately.

Additional disclosures concerning conflicts may need to be made to those persons who may make a decision about a securities offering (for example, the issuer and/or the firm's clients[20]). For example, the disclosure may include a description by the market intermediary of financial benefits that it will receive as a result of the securities offering or of the multiple roles it and/or its affiliates are playing. The information disclosed should allow the person who is relying on the market intermediary to assess the services of the market intermediary with an understanding of any fact that may affect the independence and objectivity of the market intermediary. Completeness and timeliness of the disclosure are key elements to making this an effective mechanism for dealing with conflicts.

The effectiveness of disclosure as a tool for addressing conflicts of interest may also depend upon the level of sophistication of the client and the extent to which they are able to understand and act upon the information given to them. In this context, it is relevant to consider the level of the investor's sophistication.

Means for implementation:

(1) To be effective, a disclosure should describe the specific conflict, its impact, and the underlying facts. Unless the form, content and impact of the disclosure can be understood and acted on by the recipient, it will not be effective as a tool for addressing conflicts.

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19 The term for a "watch trading list" may differ across jurisdictions. Watch trading lists may also be used in contexts other than securities offerings.

20 The term "client" includes an issuer for whom the market intermediary is acting, and an investor (whether retail or institutional) who purchases securities from the intermediary as part of the initial offering. It does not refer to investors that may purchase securities in the secondary marketplace.

(2) Disclosure alone may not be enough to effectively address a conflict of interest, and other approaches may be necessary or required. [21]

(3) The market intermediary should consider whether to amend or withdraw earlier research reports that are inconsistent with its current knowledge of the issuer.

(E) Refraining from acting

(1) The market intermediary should refrain if the conduct (which creates or is likely to create a conflict) is prohibited by law, or where it is contrary to the interests of a client and is unlikely to be adequately managed by conflict management mechanisms.

(2) Policies and procedures should give clear guidance as to the process and the circumstances in which a conflict is unlikely to be able to be effectively managed and where the market intermediary or other group entity should refrain from acting, including as and when circumstances change.

When deciding whether to refrain, relevant factors include the size and structure of the relevant market and the intermediary, fiduciary or statutory obligations, and the probability and impact of harm.

Means for implementation: The market intermediary's policies and procedures should give clear guidance as to the circumstances in which the market intermediary should specifically consider refraining from acting. These circumstances could include:

(a) The market intermediary is involved at the same time, in more than one corporate finance transaction, for directly competing entities;
(b) The distribution remuneration incentives for a securities offering are materially out of step with industry practices;
(c) The employees would have access to material confidential information at or about the time of a securities offering involving the market intermediary; and
(d) The issuer is facing financial distress and has outstanding loans to a member of the group at the same time that the market intermediary would undertake to underwrite an offering of securities on behalf of the issuer.

[21] In some jurisdictions, disclosure alone, as a matter of regulatory policy, is not considered sufficient to address the conflict.

Part 3: Examples of using mechanisms to address conflicts

This part of the report outlines some types of conflicts that may arise when a market intermediary is involved in a securities offering. It sets out the behaviour that may be caused by the conflict of interest, the impact of the market intermediary acting in a conflicted manner and the reasons the market intermediary might be motivated to act in that manner. Proposed methods of addressing the types of conflict described in the fact case are also discussed. The purpose of this part of the report is not to set out prescriptive rules for dealing with particular fact situations, but to discuss possible methods for dealing with such situations, for the purposes of illustration and guidance.

In general, the number of potential conflicts that a market intermediary will need to address is greater where there is a large number of different products and services that the market intermediary and its affiliates provide to the issuer. The conflicts of interest policy of the market intermediary and its group should be appropriate to the size of the organisation, and to the nature, scale and complexity of the services that the group provides to the issuers.

In many jurisdictions, market intermediaries may have a specific legal obligation to address conflicts of interest, which may arise under statute, regulations, rules, general law, or industry standards. Also, current regulatory restrictions may already preclude the behaviour that would lead to the market intermediary acting in a conflicted manner (for example, insider trading laws).

We set forth below examples of fact situations in which a particular conflict may arise. These appear in shaded boxes. After each example, we suggest mechanisms that the market intermediary could employ to address the conflict appropriately (having regard to the approaches and mechanisms set out in more detail in Part 2 of this Report).

A. Advising to undertake a securities offering

Conflicts of interest could cause a market intermediary to advise an issuer to raise capital in circumstances where another form of financing may be more appropriate. The conflict arises where the market intermediary will have a role in the fundraising and would earn more fees and face less risk in participating in the securities offering as underwriter compared to what a lender faces. The advice would be of detriment to the issuer if an alternative form of funding would be cheaper and more commercially suitable (*e.g.*, from the perspective of debt/equity ratios on its balance sheet).

Example 1 – Advising to undertake a securities offering
Company A is a leading goods manufacturer. It is an established and profitable company. Bank X is a commercial bank. Company A is a longstanding client of Bank X.

Company A becomes aware of a competitor which will shortly be entering its market. Company A is advised that the product being offered by the competitor is so superior

to its own, that without improving its technology its operations would be at a significant commercial disadvantage.

Company A approaches Bank X seeking advice on how it could fund its looming cash flow difficulties and the purchase of its new technology. Bank X is Company A's largest creditor, having provided it with a number of credit and loan facilities over the years.

Bank X refers Company A to its affiliated market intermediary, Infosec, for funding advice. Bank X and Infosec are subsidiaries of Holding Company H. Infosec recommends that Company A raise the funds by way of a securities offering to the public. It recommends that it advise on the offering and act as arranger (best efforts).

Infosec may benefit from this recommendation because raising funds from the securities offering could alleviate Bank X's existing credit exposure.

A conflict arises if raising funds through a securities offering is not in the best interests of Company A because, for example, debt funding may have been cheaper and more practicable because all that Company A required was short-term funding.

Proposed Approaches

- Whole of group
- Disclosure

In this case, Infosec should have in place mechanisms to identify, assess and decide how to address any conflicts arising out of the transaction. This conflict may be adequately addressed by a whole of group approach that puts in place processes that will support the recommendation of funding that is most suitable to Company A. Specific restrictions on form and conditions for remuneration may also be appropriate. In evaluating this conflict scenario, market intermediaries may wish to consider the following factors:

- The ultimate funding decision, both whether to proceed with funding and the type of funding rests with the issuer, Company A.

- Existing disclosure obligations for offering documents in some jurisdictions may appropriately address the conflict of interest.

- The extent of the market intermediary's mandate with the issuer, and the possibility for the parties to amend the mandate, may reduce the conflict.

- The issuer can obtain second opinions on the funding decision, and can seek advice from competing market intermediaries.

B. Pricing

In many securities offerings, the process of book building is used to ascertain the likely pricing and demand for the securities to be offered.[22] As part of the book building, the market intermediary will frequently consult with institutional investors and elicit from them a pricing indication. Information may be made available to the institutional investors for them to make their assessment of the pricing of the offer.[23]

The issuer will be involved in the pricing process, since no offering will occur without the issuer's agreement. The issuer may have goals in addition to obtaining the best possible price. For example, the issuer may be interested in having a diverse investor base, and may be prepared to obtain a lower price to achieve that goal.

As described below, there are a number of potential conflicts that may be faced by an intermediary as part of the pricing process, which may create incentives for underpricing or overpricing an offering.

Underpricing

Some possible incentives for a market intermediary to underprice securities include[24]:

(a) to increase the demand for those securities. This could occur where the market intermediary is arranging the offer on a "best efforts" basis, with the fee being calculated by reference to the *value* of securities purchased, and the market intermediary may believe that a lower per share price will lead to a larger total number (and value) of shares sold, thus increasing the net fee amount. Moreover, a lower priced but better sold offering could be beneficial to the reputation of the market intermediary;

(b) to reward and retain the clients of its distribution/selling (equities) operation. Ensuring their participation in an offering that provides these clients with a profitable transaction ("stag" profits[25]) might have this effect;

(c) to obtain a lower price when its proprietary trading desk wishes to purchase the securities itself;

(d) if the market intermediary is also acting in a market making capacity, and the market maker is aware that a discounted issue is imminent, to obtain benefits by quoting to sell securities at market prior to the capital raising and purchase

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22 See footnote 17 for a definition of book building.

23 It has been observed that on average the offering price under a book build is 15-20% less than the price at which the share begin trading in the secondary market. See W.I. Wilhelm *Book building, Auctions and the Future of the IPO Process* Vol 17(1) Journal of Applied Corporate Finance 2-13 at pg 3.

24 In some jurisdictions, market misconduct provisions (including insider trading regulations) may also prohibit certain pricing practices.

25 A stag is a person who purchases new shares expecting their price to rise. Thus, stag profit is the financial gain accumulated by the person resulting from the value of the shares rising.

cheaper securities following the offering or by entering into short sales based on its anticipation of demand following the offer[26].

The incentive to underprice may, however, be limited in cases where the market intermediary's fee is contingent on a successful issue and placement. In secondary sales of existing securities, it is not uncommon for the vendor to pay a fee based on the excess of the sale price over a minimum price. This mechanism provides a tangible incentive to the market intermediary to maximise the sale proceeds. Also, when the issue price is determined by way of a book build, the level and quality of consultation with the issuer may reduce the incentive to underprice as may the extent of the issuer's oversight of the process.

Overpricing

Some possible incentives for a market intermediary to overprice securities include:

(a) where the market intermediary or other group entities (such as funds management, proprietary trading or private equity) are existing owners and possibly sellers of the securities, to protect the value of those investments;

(b) where the market intermediary or its related entity has lent money to the issuer, and it is seeking to retire the maximum amount of debt with the proceeds of the offer; and

(c) where the pricing of a debt issue would enable the market intermediary to revalue other holdings of the issuer's debt securities and possibly liquidate the holdings at inflated prices.

[26] However, existing regulatory measures in many jurisdictions against insider trading may deter the conduct in this scenario. Other jurisdictions may also prevent such conduct through existing regulatory measures. For example, 'Designated sponsoring' market making is regulated in Germany by the Frankfurt Stock Exchange's rules.

Example 2 – Pricing

Infosec has undertaken enquiries of a number of its major clients and other broker-dealers as part of the book build process for an initial public offering of securities in a mid-sized Company A. During this process, some of its major clients criticize Infosec for overpricing a recent securities offering which had performed very unsatisfactorily. They infer that they will reduce the amount of business they will give to Infosec if the price of the offering is not more favourable this time. Infosec has a range of prices which vary by 30%. Infosec decides that the final price for the offering will be at the bottom of the range of the prices suggested by the book build process. Infosec has taken this view as a result of the road show and book build (including feedback from investment client-facing staff), which indicate the possibility of less demand for securities at higher potential prices. Infosec's view is that the market concerns arise from there being other equity fundraisings that may come to market in the near future and the general conditions of the economy, following a recent series of interest rate increases.

Proposed approach for underpricing

- Whole of group

In this case Infosec should have in place mechanisms to identify, assess and decide how to address any conflicts arising out of the transaction. This conflict may be appropriately addressed by a whole of group approach that puts in place agreed processes for setting the price that are transparent to Company A. Infosec should also monitor and evaluate the effectiveness of the processes implemented.

In evaluating this conflict scenario, market intermediaries may wish to consider the following factors:

- Where the book building process is used, the ability of the underwriter can be constrained by the issuer demanding to see the books on which the book building price was arrived at.

- In some jurisdictions there are existing rules in place that address pricing.

- Some fee structures may provide the intermediary with an incentive to maximise rather than minimise the price.

- The ramifications for underpricing, including reputation risk, and legal/regulatory action may limit the incidence of underpricing.

- If sub-underwriters are involved in the pricing process, both the intermediary and the sub-underwriters should ensure that appropriate conflicts management mechanisms are in place.

- Price is not always the only objective for the issuer. Thus, the possibility of underpricing may be more likely to occur where the issuer's aim in undertaking a securities offering is to increase the number of security holders of the stock.

C. Allocation

Oversubscribed issue

Where a market intermediary has discretion in the allocation of securities, conflicts of interest may cause the market intermediary to prefer certain subscribers in an oversubscribed issue. This could be to the detriment of other clients of the market intermediary, who may have an interest in purchasing the securities, or be contrary to the issuer's interests, *e.g.*, the issuer may wish to minimise "short-term" holders of the securities offered.

Some reasons (although they may be illegal in some jurisdictions) why a market intermediary may prefer certain subscribers include the[27]:

(a) promise of future business by the subscriber, if it is allocated securities;

(b) payment of an additional commission to the market intermediary or a related entity of the intermediary (or the entitlement to other benefits such as priority subscription to an offer managed by the subscriber or a related entity of the subscriber) by the subscriber, if it is allocated securities;

(c) promise by a person to provide liquidity and support for trading of the securities in the secondary market, if it is allocated securities. Maintenance of a high "aftermarket" price is of reputational benefit to market intermediaries.

These conflicts would arise where the market intermediary has the ultimate discretion in placing the securities that are the subject of the issue, whether on a "firm commitment" or a "best efforts" basis.

Offer with low demand

Where there is anticipated low demand for securities in an offering, conflicts of interest may cause a market intermediary to allocate securities to those of its clients over whose accounts it has discretionary authority. If the reason for the lack of demand is that the securities are overpriced, this allocation would particularly disadvantage those clients.

Some reasons why a market intermediary may effect this kind of allocation include:

(a) where the market intermediary has underwritten the offer, the allocation reduces the number of securities it may have to acquire in the event of a "shortfall." This reduces its financial exposure to an unsuccessful offering;

(b) where the market intermediary is acting in a "best efforts" capacity, the greater number of securities purchased under the offer would be of reputational benefit to the market intermediary.

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[27] In some jurisdictions conduct of business and market misconduct rules may prohibit certain allocation practices.

Example 3- Allocation

The offering for the securities of Company A is oversubscribed. In allocating the securities, Infosec intends to identify criteria for the allocation. It would like to reward certain of its clients that frequently use its broker-dealer services.

Proposed approach

- Whole of group

In this case Infosec should have in place mechanisms to identify, assess and decide how to address any conflicts arising out of the transaction.

The market intermediary should establish in written form the principles and process which it intends to follow in determining the allocation. The process should include a system documenting the allocation processes applied, the key allocation decision-makers, the assumptions applied and objective factors taken into account by the decision-makers. The market intermediary could also have an independent underwriting committee to review the criteria. This conflict may be appropriately addressed by a whole of group approach that separates the allocation decisions from trading and sales staff that manage relationships with clients. Infosec should also monitor and evaluate the effectiveness of the processes implemented.

In evaluating this conflict scenario, market intermediaries may wish to consider the following factors[28]:

- Transparent allocation processes including discussion with the issuer of allocation criteria - in considering the range of matters that should be disclosed to the issuer, intermediaries should give particular consideration to the disclosure of issues such as the intermediary's allocation preferences and any conflicts affecting the issuer.

- Risk to reputation may be influential in ensuring the market intermediary acts fairly when allocating the issue.

D. Retail Advice/Distribution

A conflict of interest may arise where the members of the distribution side of a market intermediary sell to or advise their retail clients to acquire the securities, in circumstances where the market intermediary is also paid a commission arising out of the underwriting of the securities being offered. This may influence the market intermediary to provide advice that is not in the best interests of the retail client because of the market intermediary's or group's interest in a successful underwriting (selling all of the securities that are available under the offering).

[28] Some jurisdictions may have existing rules on allocation that must be followed including required disclosure in the offering documents.

Example 4 – Retail advice/distribution

A retail adviser is paid a commission for advice that it provides to a retail client about the offering of the securities of Company A. The retail adviser is an employee of an entity related to Infosec, which is the underwriter for the offering. The commission being offered to the adviser for recommending securities in Company A is higher than that the adviser would receive for other products, such as those available in the secondary market or other primary market products. The adviser is also able to receive volume bonuses for the sale of large volumes of the Company A offering.

Proposed approaches

- Whole of group
- Disclosure

In this case, Infosec should have in place mechanisms to identify, assess and decide how to address any conflicts arising out of the transaction. We believe that this conflict may be adequately addressed by a whole of group approach that puts in place processes that seek to ensure that the client receives advice that is suitable. For example, remuneration could be based on the provision of suitable advice and client retention. The market intermediary involved in the sales activity should also disclose all fees and commissions paid to any member of the group. Infosec should also monitor and evaluate the effectiveness of the processes implemented.

In evaluating this conflict scenario, market intermediaries may wish to consider the following factors:

- Existing disclosure obligations relating to the provision of advice in some jurisdictions may help to address the conflict, particularly if such obligations relate to inducements offered to advisers to recommend certain products.

- Existing obligations in some jurisdictions on salespersons (sometimes referred to as advisers) to conduct, among other things, suitability and appropriateness tests may adequately address the conflict.

- Contractual arrangements between the intermediary and the client may, in some cases, specify that a certain proportion of the client's assets may be invested in issues with which the intermediary is involved, subject to suitability of the investment and appropriate disclosure.

- The degree to which robust oversight mechanisms are in place to help ensure disclosure of all conflicts (including information about commissions) and the provision of suitable advice to clients.

- The degree to which the market intermediary is structured so as to help ensure that the wealth management/client advisory business is independent of the institutional arm.

E. Lending

Conflicts of interest may create an incentive for advisers employed by a market intermediary, who has lent money to an issuer but is also arranging a securities offering for that issuer, to fail to provide complete information to their clients subscribing under the offer. The omission of the information could adversely affect the investment decision made by the subscribing clients of the market intermediary. The responsibility for the content of the disclosure (e.g., the offering prospectus) generally lies with the issuer of securities, and the market intermediary may seek assurances from the issuer that all relevant information has been provided by the issuer.

There may be an incentive for a market intermediary to condone or ignore the failure by an issuer to disclose extensive details of relevant facts concerning the issuer's financial situation. In addition, the market intermediary might make less robust inquiries of the issuer or its related entities, both of which may lead to a decreased demand for the issuer's securities (although this may be illegal in some jurisdictions), for the following reasons:

(a) the market intermediary may need to acquire shortfall securities;
(b) the market intermediary's remuneration could be affected;
(c) the reputation of the market intermediary could be adversely affected; and/or
(d) if the purpose of the fundraising is to relieve debt owed to the market intermediary (or to the lending business unit within the group owning the market intermediary) and thereby reduce the credit risk to which the market intermediary is exposed, the decrease in demand would reduce the amount of funds raised for that purpose.

Example 5 – Lending

Company A is in a precarious financial situation. Bank X is aware of this because it is a major lender to Company A. Indeed, Bank X is unsure whether its loans to Company A will ever be repaid. Infosec is underwriting an offering of Company A securities. Bank X and Infosec are subsidiaries of Holding Company H. The proceeds of the offering will be available to Company A for repayment of the loans to Bank X. Infosec staff are generally unaware of the seriousness of Company A's deteriorating financial situation both because of an information barrier set up between Bank X and Infosec, and because, notwithstanding Infosec's best "due diligence"[29] efforts (which have met the legal standards for a due diligence defense in Infosec's jurisdiction), Company A has not directly described a deteriorating picture of itself to Infosec staff. Company A's communications with Infosec, however, do not meet the legal definition of fraud. Company A's offering prospectus contains some very general language that any investment in its securities is highly risky and that an investor might lose the full amount of his or her investment, thus arguably meeting its legal obligations to disclose all material information.

Proposed approaches

[29] The concept of "due diligence" may, depending on the applicable jurisdiction, encompass both an underwriter's affirmative responsibilities and the defense that it may assert to avoid liability for any material misrepresentations or omissions contained in a registration statement or prospectus.

- Whole of group
- Disclosure or refrain from acting

Bank X (and indirectly Infosec as part of Holding Company H) has an interest in seeing the underwriting go forward (to the detriment of clients), which creates a conflict as this may well enhance the likelihood that Company A will have monies available to repay loans. The investment clients of Infosec would likely take a different view of the attractiveness of the securities if they were aware of the information about the financial situation of the issuer and loans held by Bank X. Also, Infosec would be interested in the information regarding the issuer's financial condition and ability to repay the loans as its participation in the offering could be damaging for its reputation.

As part of the analysis of this example, consideration was given as to whether current disclosure requirements (for example, requirements arising through material change reporting requirements, prospectus requirements, and contractual and fiduciary obligations) might adequately address the conflicts. Another issue however, is whether the conflict between Bank X's and Infosec's interests and those of Infosec's clients requires Infosec to refrain from acting as an underwriter or distributor of the securities, whether or not the issuer has met its legal disclosure requirements. In this example, effective management of conflicts may require the Holding Company H to be concerned about activities being undertaken within the group – through a whole of group approach. In any case, investment clients of the market intermediary would expect conflicts to be identified and addressed.

Under the whole of group approach, mechanisms should be in place to identify, assess and decide how to address any conflicts arising out of the transactions. In particular, Holding Company H could have in place a process that would enable it to observe the activities taking place on each side of any information barrier or across group entities[30]. This would allow Holding Company H to see clearly that Infosec would be underwriting a company that may soon fail and where the proceeds would benefit a group company, Bank X (thus creating a conflict of interest between clients who are investors in the offering and Infosec and Bank X). This process may lead Holding Company H to form the view that conflict management structures, and even additional disclosures are unlikely to address this conflict adequately and to cause Infosec to refrain from acting as arranger for the securities offering.

In evaluating this conflict scenario, market intermediaries may wish to consider the following factors:

- The absence of additional disclosure by the market intermediary regarding the conflicts (i.e., in addition to the information contained in the issuer's prospectus or other offering documents) may lead investors to make investment decisions that are unsuitable for them.

- Confidentiality of information (and any relevant agreements) and the possible need for an issuer to authorize the sharing of confidential information between

[30] In some jurisdictions, the sharing of information across separate legal entities is not permitted.

entities that are subsidiaries of Holding Company H in order for Infosec to go forward with the underwriting.

Appendix

Activities associated with an Equity Fundraising

The table relates to the scenario where there is a financial group that has the following members each of which is a separate legal entity (although the broker-dealer may be a division of the Market Intermediary):

- Bank – responsible for ordinary commercial lending and other financing arrangements
- Market Intermediary – an investment bank responsible for equity fundraising
- Broker dealer – trades securities both on behalf of others and on its own behalf

Activity	Description
BANK **Long term relationships with client** ↓	The bank provides ongoing banking services, including the provisions of fixed terms loans and working capital finance for the client.
Referral by Bank to related Market Intermediary to identify appropriate method of fundraising and negotiate mandate ↓	The Market Intermediary has expertise in corporate finance and uses its expertise to advise the client on the most appropriate approach to fundraising.
MARKET INTERMEDIARY **Parties accept terms of mandate for fundraising** ↓	In many cases an agreement between the client and the Market Intermediary is entered into, in which the scope of the activities that the Market Intermediary will undertake are agreed and the fees and costs are also settled.
Due diligence and preparation of offering documents ↓	As the offer is to be made to retail investors, ordinarily a document containing relevant information about the equity fundraising is prepared. The Market Intermediary is involved in assisting in the preparation of the offering document. Part of the process will involve the Market Intermediary undertaking enquiries of the entity raising the funds to ensure that the content of the offering document is correct.
Marketing/roadshows ↓	This process is to raise interest in the equity fundraising, particularly with non-retail investors. There may also be some marketing of the offer to retail investors.

Assessment of pricing and sizing of offer ↓	Market Intermediary makes enquiries both within the firm and with third parties to make an assessment of the likely demand for securities and whether there are significant matters that may affect the pricing of the issue. The broker-dealer may provide some opinion on the pricing and demand for the offering.
Book build ↓	The book build is often interrelated with roadshows. A book build is undertaken by the Market Intermediary to ascertain from institutional investors the likely demand for the securities and pricing for the offer. Book building is the process of establishing the pricing for an issue, by contacting institutional investors before the offering to ascertain at what price and the quantity the institutional investor would be prepared to take securities that are the subject of the offer.
Final price determination ↓	The Market Intermediary, using the information from the book build process determines the price at which the securities will be issued to the market. Once pricing is agreed with the issuer, the Market Intermediary will get their investment clients to confirm their interest at the issue price. Then, once interest is confirmed the underwriting agreement will be signed.
Allocation/issue ↓	This activity involves the Market Intermediary determining who will be entitled to shares at the close of the fundraising.
Market Stabilisation	The Broker dealer may engage in trading securities to try to minimise price movements in the securities during the early phase of the securities being listed on a market on which the securities are traded.

ANNEX: FEEDBACK STATEMENT

Consultation Report on Market Intermediary Management of Conflicts that Arise in Securities Offerings, February 2007

PART A: Short summary of comments and proposed amendments to paper

Question	Summary of comments	Response
General comments	The report deals with theoretical issues and the case has not been made out as to why IOSCO principles are necessary.	We have added further information about the rationale for this report.
	If principles are issued, they should be high level and general – they should not be detailed or prescriptive.	This report outlines high level guidance and is not prescriptive.
	Any principles should distinguish between retail and wholesale investors.	We have made further endeavours to distinguish between wholesale and retail investors.
	The report should recognise the reality that there are benefits to a client in dealing with an intermediary offering a range of financial services, as clients obtain an integrated approach to their financial needs.	We have specifically recognised that there may be benefits to a client in dealing with an intermediary offering a range of financial services.
Question 1: Description of conflicts	The definition of conflicts is too broad and should be restricted to circumstances where, for example, the intermediary has a duty of care to the client, there is a material divergence of interests between	We have not changed the definition of conflicts. The definition of conflicts is intentionally broad to assist market intermediaries to identify all possible conflicts and give careful consideration

	the intermediary and the client and the divergence may result in a material disadvantage to the client.	as to what action, if any, is required to address the conflict.
Question 2: Methods to identify conflicts – whole of group approach	Points 1 (b) and (c) could be combined. The aim is to manage specific and defined circumstances and to supplement the compliance function. Further consideration is required re the proposal to include independent directors in conflict management committees as it is not appropriate for directors to be actively involved in day-to-day operations.	We have not combined points 1(b) and (c). These are separate steps. We have qualified the reference to independent board members.
Question 3: Whole of group approach in a cross-border context	The whole of group approach may not be possible where there are cross border differences in standards to address conflicts or where the organisation is loosely organised.	We have recognised that cross border differences and the organisational structure of a group may impact the whole of group approach.
Question 4: Decision process to address conflicts	Refraining from acting may lead to unintended consequences such as alerting the market to an impending transaction. The decision process should be flexible, as the same type of conflict can be managed differently, according to circumstances. The notion of refraining should be replaced by avoidance, and, unless an action is prohibited by law, should only be considered as a last resort. The term "the interests of a client" is ambiguous.	*ave made some amendments to the decision guidelines however we did not agree with all of the points made here. Paragraph (d) makes clear that a market intermediary should only refrain from acting if other measures are not able to adequately address the conflict.*
Question 5: Determining effectiveness of conflict	An audit or inspection based process was suggested.	We did not modify the report in response to this submission.

management processes		
Question 6: Circumstance where an intermediary should refrain from acting	The submissions were not supportive of the examples in the report of situations where an intermediary should refrain. It was suggested that the examples could be dealt with by other conflict management mechanisms.	We make clear that a market intermediary should only refrain from acting if other measures are not able to adequately address the conflict.
Question 7: Circumstances where firms are likely to refrain from acting	These include insider trading, market manipulation, fraudulent statements, handling the offering of a competing intermediary.	We have not changed the report in response – these are either prohibited by law or already covered in the report.
Question 8: Circumstances where information barriers should be used	One submission agreed with the statements in the report. Two submissions were of the view that the checklist approach is not effective and the listed mechanism may not always be appropriate in all cases.	We make it clear that listed means for implementation is not exhaustive and their appropriateness should be considered in the context of each intermediary's specific operating environment.
Question 9: Other information barriers that are or should be used	No specific suggestions made. The importance of customised solutions was mentioned.	We have not changed the report in response.
Question 10: Other restrictive mechanisms that should be used	One submission stated that physical barriers should also be considered at an additional level – ie to keep a transaction separate within a business unit by putting up barriers to separate dedicated teams within the unit.	We have not changed the report in response. The general principles in the report applicable to business units can also be applied to teams within units.
Question 11: Circumstances	Opinion was divided – a number of submissions put the view	We have given examples of the kind of additional disclosures that might be required in addition to those made in a prospectus.

where the intermediary should supplement disclosures in the issuer's prospectus	that disclosure as required by law is sufficient and no additional disclosure is required. Others put the view that disclosure required by law may not be sufficient and additional disclosure should be made if the intermediary thinks it is necessary or if it is required by contract.	
Question 12: Determining effective disclosure	One submission suggested that the distinction between retail and wholesale investors be specifically referred to in this section of the report.	We have emphasised that an investor's level of sophistication is a relevant consideration.
Question 13: Circumstances where an intermediary's research about the issuer should be withdrawn or amended	Most submissions put the view that there should be no need to withdraw or update research – it is self evident that research reports have a short shelf life. One of these submissions placed a condition on this view – that the report was prepared before the relationship with the issuer began and without knowledge of the future relationship. One submission out the view that factually inaccurate research should be withdrawn, but effective Chinese walls should enable continued coverage by research units.	We have not changed the report in response.
Question 14: Factors re conflicts in funding advice	The example does not reflect general practice and is unlikely to occur. General law or regulatory provisions may address the issue.	We have amended the example to more clearly identify the conflict.
Question 15: Funding advice-remuneration or other restrictions	The case for price regulation has not been established. However, reference is made to the detailed framework for managing conflicts of interest in Europe under the MiFID.	We have removed references to remuneration in this example as reference to remuneration appeared to obscure the principal conflict sought to be identified – namely the potential for a securities offering to alleviate Bank X's existing credit exposure.
Question 16: Funding advice – refraining from	Some responses said the intermediary should refrain where debt is to be issued by the bank with which the company has existing credit or if there is reason to suspect fraud against	We have not changed the report in response.

acting	clients. Another said that the example is not useful and has been confused with inappropriate advice to a client – the only relevant conflict in the example is the dual capacity of adviser and creditor that can be managed by disclosure and Chinese walls. Another said that it is difficult to establish standard cases where an intermediary should refrain and if procedures are complied with, it will be clear where refraining is required.	We have not changed the report in response. Inappropriate advice may be a consequence of a conflict of interest that is not properly addressed. We make clear that a market intermediary should only refrain from acting if other measures are not able to adequately address the conflict.
Question 17: Approach to underpricing	Mispricing occurs only where there is market failure, and the potential for conflicts is not high. Pricing is inherently difficult and so long as bona fide processes are used, the underwriter should not be liable. Underpricing may not be a conflict if the issuer values objectives other than price. Disclosure to the issuer is important. Fee structures that give an incentive to maximise the price are inappropriate.	We have not changed the report in response.
Question 18: Who should and should not be involved in price setting?	The following should be involved: • the intermediary's operating staff, management, compliance officer and supervisory body • issuer • underwriting syndicate members The following should not be involved • the intermediary's proprietary trading desks , sales teams, research analysts, market makers, investor clients and affiliated owners	We have not changed the report in response.

	• group companies • regulators	
Question 19: Effect re sub-underwriters, best efforts basis and allocation to existing clients	The responses were inconsistent. Effect of involvement of sub-underwriters in the offering – one submission out the view that their involvement would not have an impact on conflicts. Another stated that if sub-underwriters are involved in price setting, conflicts are a greater concern. The third said that sub-underwriters should be able to make recommendations so long as conflicts are disclosed.	We have stated if sub-underwriters are involved in the pricing process, the intermediary and the sub underwriters should ensure that appropriate conflicts management processes are in place.
	Effect of the intermediary underwriting on a best efforts basis - two submissions put the view that it should not have an impact on conflicts management. The third stated that this limits direct negative financial consequences, leaving damage to reputation as a risk.	We have not changed the report in response.
	Effect of intermediary allocating a significant number of shares to clients – one submission said this would increase the probability of conflicts. Another said it should not influence pricing. The third said that it does not affect pricing in France as allocation occurs after pricing.	We have not changed the report in response.
Question 20: Determining underpricing and post issue compliance	One submission suggested that best practice would be to follow the trading price for a few days to determine excessive underpricing. Two submissions stated that trading price does not necessarily indicate underpricing as there may be other factors involved. One of these submissions suggested 6 months as an appropriate monitoring timeframe.	We have not changed the report in response.
Question 21:	Only one response - it is impossible to foresee all eventualities, and many factors are involved in pricing.	We have not changed the report in response.

Determining overpricing and preventative processes		
General comments on pricing	Conflicts rarely occur due to pressures exerted by market processes, issuers and investors.	We have not changed the report in response.
Question 22: Allocation of securities – appropriate conflict management mechanisms	Two submissions put the view that information barriers are not needed or possible. Two submissions were supportive of the role of disclosure in managing conflicts, but a further submission stated that apart from the rules to protect investors there is no need for specific disclosure. Other mechanisms mentioned include approval of allocations by the issuer, whole of group approach, monitoring of the process by the issuer, and electronic book builds.	We have not changed the report in response.
Question 23: **Allocation of securities – agreements with the issuer**	The two submissions on this question were inconsistent – one submission stated that the issuer would drive the key elements of any agreement and the other stated that the matter must be left in the syndication's hands, with the issuer receiving daily updates. Three submissions on question 24 stated that allocation preferences should either be cleared or agreed with the intermediary, or the intermediary should have the final say.	We have not changed the report in response. The report refers to discussions with the issuer.
Question 24: Allocation of securities – disclosure to the issuer	The submissions stated that the following should be disclosed – the intermediary's preferences re allocation, any conflicts that affect the issuer, and whether any affiliates of the intermediary are part of the	We have included specific examples of disclosures that may be made to make allocation processes transparent.

	book.	
Question 25: Allocation of securities – review arrangements	One submission on this question stated that review by the compliance area of the intermediary is sufficient. Another submission said that the risk management area should also be involved.	We have not changed the report in response as it already mentions monitoring of the process by the intermediary.
Question 26: Allocation of securities – identity of decision maker	Responses to this question varied as follows: • It should be agreed between the intermediary and the issuer • It should be agreed between a panel of all relevant areas in the intermediary • It should be left to the intermediary to determine • It should be left to the syndication agent.	We have not changed the report in response.
Question 27: Retail adviser, an employee of an entity related to the underwriter, recommends securities to client and receives high commissions – relevant factors	A number of responses stated that the approach in the paper was appropriate. Others mentioned comprehensive and appropriately pitched disclosure, and adequate training for advisers. One submission mentioned that the contractual arrangement with the client may specify that a certain share of the client's assets may be invested in issues in which the intermediary is involved, provided the investment is otherwise suitable and subject to appropriate disclosure.	We have included mention that the contractual arrangement with the client may specify that a certain share of the client's assets may be invested in issues in which the intermediary is involved, provided the investment is otherwise suitable and subject to appropriate disclosure.
Question 28: Ways to protect the interests of the client	A number of responses referred to the design of the adviser's remuneration structure. In particular, there was a suggestion that there should be an appropriate balance between fixed payments and performance incentives, and that the structure should be subject to oversight by an independent committee.	Appropriately designed remuneration structures for advisers may be one of the tools that assist a whole of group approach to addressing conflicts of interest.
Question 29: Disclosures to the client	Responses referred to a range of disclosures that could be made to ensure that the client makes an informed decision. For example, there could be disclosure that the intermediary is involved in the offering, an explanation of the nature of the offering, the nature and	Appropriate disclosures of any inducements to advisers to recommend certain products may be one of the tools that assists addressing conflicts of interest.

	relative size of the remuneration, the impact of distribution and sales on such remuneration, the nature and size of remuneration, of the sales force compared to other products and the potential lack of objectivity of the investment recommendation. Under the MiFID there should be disclosure of any inducement granted to the investment firm by a third party.	
Question 30: Appropriate monitoring arrangements	Responses referred to internal control and compliance review, and the oversight of an adviser's remuneration structure by an independent committee. One response said that there was no need for specific monitoring so long as there is a consistent policy of disclosure.	We have not changed the report in response as it already mentions robust compliance and advice oversight.
Question 31: Intermediary (or related body) lends to an issuer – appropriate conflict management mechanism	Two submissions stated that the intermediary must refrain in these circumstances. A further submission stated that if there are no effective information barriers the intermediary must refrain, but if there are such barriers, the intermediary should only refrain if it doubts that the issuer has properly informed it of its financial position. Another submission said that Bank X would be obliged to disclose the facts to the intermediary and the intermediary should refrain, unless the deal is specifically structured as distress relief and properly disclosed as such. A further submission favoured disclosure as the preferred mechanism.	We have amended the report to ensure that it is understood that the whole of group approach: • Contemplates having in place mechanisms that allow a designated person/committee/entity to see each side of an information barrier. • Does not contemplate a person/entity on one side of the information barrier crossing that barrier.
Question 32: **Intermediary (or related body)**	Submissions referred to disclosure, information barriers, and penalties for non-disclosure. One submission stated that prospectus disclosure requirements may not be sufficient – there may also be contractual or fiduciary duties of disclosure to clients. Another submission pointed out that insider dealing requirements prevent the intermediary giving privileged information to selected clients – there is a need to disclose to	We have refined some of the drafting around disclosure in addition to prospectus disclosure.

lends to an issuer – further conflict management mechanism	all purchasers – even purchasers who use the services of another intermediary.	
Question 33: Intermediary (or related body) lends to an issuer – crossing the information barrier	The two submissions on this point are inconsistent. One stated that there should be no requirement for crossing of information barriers, as this jeopardises the whole concept of such barriers and creates uncertainty as to when crossings should occur. The other stated that, although crossings impair the effectiveness of information barriers, wall crossings should be made regularly where there are insurmountable conflicts.	We have amended the report to ensure that it is understood that the whole of group approach: • Contemplates having in place mechanisms that allow a designated person/committee/entity to see each side of an information barrier. • Does not contemplate a person/entity on one side of the information barrier crossing that barrier.

PART B: Detailed summary of comments

Question	Name of Respondent	Summary of Response	Comments
General comments	Investment Industry Association Canada	The paper has an academic perspective and deals with theoretical issues that may not exist. IOSCO should not recommend regulatory intervention unless there are actual significant market problems and all other solutions have been ruled out. The paper's recommendations will add to costs and inefficiencies for no clear benefit.	We have added further information about the rationale for this report.
General comments		Undue burdens should not be placed on intermediaries to identify and manage conflicts and potential conflicts. Client sophistication and market forces mitigate the potential for intermediaries to take unfair advantage of clients.	This report outlines high level guidance and is not prescriptive.
General comments	The Japan Securities Dealers Association	Intermediaries are engaged in many other activities such as mergers and acquisitions and investment banking - IOSCO should study the broader context.	We have added further information about the rationale for this report.
General comments	British Bankers' Association	It would be more appropriate to develop high-level principles rather than a detailed set of rules. A code of guidance should be developed, and firms should establish procedures, validated by national regulators.	This report outlines high level guidance and is not prescriptive.
General	Australian	It is not clear why IOSCO principles are required - they	We have added further information about the rationale for this

comments	Financial Markets Association	are unlikely to add value in Australia, given the existing regulatory regime.	report.
General comments		If principles are issued, there should be a separate consultation process. Any principles should be general and distinguish between wholesale and retail clients and the institutional and structural differences between markets. The application of information barriers is not suitable for prescriptive guidance by IOSCO.	This report outlines high level guidance and is not prescriptive.
General comments	Zentraler Kreditausschuss	It makes sense for IOSCO to promote internationally consistency in this area. However, IOSCO should restrict itself to high-level principles. Part 3 of the paper gives good examples of the proper management of conflicts but they are too prescriptive due to their case specific nature.	This report outlines high level guidance and is not prescriptive.
General comments	Max Planck Institute for Comparative and International Private Law	Conflicts have cross-border and global implications. IOSCO principles will provide important guidance for intermediaries. Consequences of conflicts can be dire in terms of misallocation of resources and concern the entire market. Intermediaries usually have an informational advantage over their clients. Market forces are insufficient to manage all conflicts and regulation is necessary.	No comment.
General comments	International Council of Securities	The report promotes an overly prescriptive, rules based approach. Any IOSCO principles in this area should be general to cater for differences in each jurisdiction and	This report outlines high level guidance and is not prescriptive.

	Associations	distinguish between debt and equity markets and retail and wholesale clients. The application of information barriers is not a matter that warrants prescriptive IOSCO guidance.	
General comments		The report does not explain why such principles are required as an alternative to regulation within individual jurisdictions. It has a narrow focus on conflicts in the IPO context, and there is concern that this may be a precursor to further detailed rules about other activities.	We have added further information about the rationale for this report.
General comments		The analysis should also consider the effect of brand or reputational risk that can assist the regulatory process.	Reputational issues are mentioned in the report.
General comments	Association française des enterprises d'investissement	It is not clear why the report is limited to conflicts in securities offerings. While it purports to be limited in this way, in fact the report deals with conflicts in general. The report should take account of the differences between debt and equity markets. It would be more appropriate to have a paper dealing with conflicts in general (which comprises 80% of the current report) and a further paper dealing with conflicts in securities offerings.	We have added further information about the rationale for this report.
General comments		French principles and rules already deal with conflicts that intermediaries may face in general and in the context of IPOs. If the report is directed at jurisdictions with less developed rules, it should state this. Several of the report's propositions are inconsistent with European	This report outlines high level guidance and is not prescriptive and will allow individual jurisdictions to adapt this guidance to their own regulatory framework.

		legislation – each jurisdiction should be able to adapt the principles to their own regulatory framework.	
General comments		Bank secrecy and personal data protection rules impair the flow of information between entities in a group – efficient management of conflicts requires access to relevant information.	We recognise the potential impact of the laws of different jurisdictions in this report.
General comments		Refraining from acting should be a last resort in conflict management. Flexibility should be maintained in dealing with conflicts. The same type of conflict can be managed in different ways with different lines of the same business adopting different strategies.	The report recognises this.
General comments		It is difficult to separate genuine conflicts from commercial issues. A fair price cannot be achieved through internal procedures or policies – it is established through supply and demand.	We did not modify the report in response to this submission.
General comments	National Association of Financial Market Institutions	Financial institutions identify conflicts but mitigation methods vary. Larger institutions are more concerned about addressing conflicts. Foreign banks have more formal processes to address conflicts than national banks, but formal mechanisms are no guarantee of their efficacy. The size of the Brazilian market results in a reduced number of institutions acting as underwriters in public offerings and often there is a long and broad relationship between the intermediary and the issuer. These factors increase the potential for conflicts. Intermediaries want to comply with regulatory	We did not modify the report in response to this submission. The report outlines high level guidance and is not prescriptive.

		requirements and to avoid reputational damage through badly resolved conflicts. Reforms to prospectus requirements have strengthened relevant disclosure requirements The ANDIMA Code of Ethics and Market Operational Code and the ANBID Code of Self-Regulation are also relevant.	
Question 1: Description of conflicts			
Q1	Investment Industry Association Canada	The paper refers to potential conflicts where an intermediary offers different services. This is not a conflict or a potential conflict and ignores business reality. Clients often choose an intermediary offering a range of financial services to obtain an integrated approach to their financial needs.	We have specifically recognised that there may be benefits to a client in dealing with an intermediary offering a range of financial services.
Q1	The Japan Securities Dealers Association	Part D of Part 1 of the report, dealing with the description of conflicts, should address asymmetry of information between intermediaries, issuers and clients.	We have not changed the definition of conflicts. The definition of conflicts is intentionally broad to assist market intermediaries to identify all possible conflicts and give careful consideration as to what action, if any, is required to address the conflict.
Q1	Australian Financial Markets Association	The description of conflicts is too wide to have a meaningful application. It should be refined to conflicts where an intermediary has a duty of care to a client, and there is a material divergence of interest between the intermediary and its client or between two or more of its clients to whom it owes a duty of care.	We have not changed the definition of conflicts. The definition of conflicts is intentionally broad to assist market intermediaries to identify all possible conflicts and give careful consideration as to what action, if any, is required to address the conflict.
Q1		A business structure that offers a wide range of services and properly managed conflicts of interest may better serve the client than using a number of services from independent firms.	We have specifically recognised that there may be benefits to a client in dealing with an intermediary offering a range of financial services.

Q1		Reputational issues and market discipline promote market integrity, but will not always prevent dishonest or careless behaviour. There is a role for regulation but it is costly and must be applied efficiently.	We refer to reputational issues in the report.
Q1	European Federation of Financial Analysts Societies	The description is correct but should explicitly state that the paper deals with conflicts of **financial** interests. Political, cultural and macroeconomic conflicts are only relevant if they lead to financial conflicts.	We have not changed the definition of conflicts.
Q1		The conflict arising through the intermediary's remuneration should be explicitly excluded. The service provider wants to maximise the remuneration and the service receiver wishes to minimise it. This is a matter for market forces.	We have not changed the definition of conflicts. We did not see the need for the explicit exclusion of this issue.
Q1		However, remuneration issues may provide circumstantial evidence for other conflicts – while the paper considers underpricing the issue of overpricing is often overlooked. An intermediary receiving a percentage of the issue price may have an incentive to set the price as high as possible.	No comment.
Q1	Zentraler Kreditausschuss	Agree, no further comments.	No comment.
Q1	Max Planck Institute for Comparative and International Private Law	There is no comprehensive definition of conflicts of interest in European rules or IOSCO statements. A definition is needed. The regulatory material does, however, point to core features that are necessary when drafting a definition and to a narrowing of the definition in the report.	We have not changed the definition of conflicts.

Q1		A potential definition could be: "A conflict of interest occurs when an interest of a person interferes with the ability of that person to decide how to act in the interest of another party when that person has an ethical or legal duty to act in that other party's interest whereby interest means any influence, concern, emotion, loyalty, or other factor, that could affect the decision of that person. These interests can arise for example due to financial ties, employment, business relationships, or family bonds."	We have not changed the definition of conflicts.
Q1	International Council of Securities Associations	The definition in the report is incomplete as it omits potential prejudice to the client arising from a conflict of interest between the client and the market intermediary. It should reflect material conflicts of interest where a registrant has a duty of care to the client under its regulatory or common law obligations.	We have not changed the definition of conflicts.

Q1		MiFID level 2 Directive (2006/73/EC), Recital 24 states: "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 the 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 loss to another such client."	We have not changed the definition of conflicts.
Q1	Association française des enterprises d'investissement	AFEI requests clarification of the proposed definition, which is not in italics.	We have not changed the definition of conflicts.
Q1		MiFID provides a solution - see MiFID Level 2 Directive (2006/73/EC) Recital 24 (see above). An additional definition would apply specifically to conflicts in securities offerings: "A market intermediary could have conflicts of interests in connection with securities offerings because the market intermediary often plays more than one role".	We have not changed the definition of conflicts.
Q1		The proposed definition is too wide and would apply every time an intermediary deals with a client. It should apply where there are material conflicts and the intermediary has a duty of care to the client.	We have not changed the definition of conflicts.
Q1		The meaning of the term "the same financial group" needs clarification. The group concept assumes	Footnote 14 of the report refers to what we mean when we use the term "group".

		information flow between the parent and subsidiaries, conflicts are dealt with at a group level, and companies in which the parent holds a small interest are excluded from the group.	
Q1		Offering multiple services does not automatically create a conflict. Some services complement each other.	We have specifically recognised that there may be benefits to a client in dealing with an intermediary offering a range of financial services.
Q1	National Association of Financial Market Institutions	There is agreement with the report's definition.	No comment.
Question 2: Methods to identify conflicts – whole of group approach	Australian Financial Markets Association	The suggestion that central conflict management committees should include independent directors may require further consideration or clarification. Conflict management committees should have a strong compliance component, but should not be involved in day-to-day business activities.	We have qualified the reference to independent board members.
Q2	Association française des enterprises d'investissement	The proposed procedures match those put in place by leading financial institutions. Policies b and c could be grouped together, and the phrase	We have not combined points 1(b) and (c). These are separate

		"develop appropriate means" added since the aim is to assess and manage a specific and clearly identified set of circumstances. It would also be appropriate to specify that the assessment by senior management is intended to supplement the procedure established by the compliance function.	steps.
Question 3: Issues in using a whole of group approach in a cross-border context	Australian Financial Markets Association	A consistent global policy regarding the whole group approach may not be possible due to the variety of cross border differences.	We have recognised that cross border differences and the organisational structure of a group may impact the whole of group approach.
Q3	European Federation of Financial Analysts Societies	Use of the whole group approach depends how the group is organized. If the group organization is loose, than the group approach should not be used. If the group is organization integrated, than the group approach should be used.	We have recognised that cross border differences and the organisational structure of a group may impact the whole of group approach.
Q3	Max Planck Institute; Association française des enterprises d'investissement	There are obvious practical and legal difficulties in the cross border context, and so communication and conflict of law resolution will be important. The international principles discussed by IOSCO will be a useful guidance for regulators, authorities and intermediaries.	We have recognised that cross border differences and the organisational structure of a group may impact the whole of group approach.
Q3	ANDIMA-National Association of Financial Market	The fact that the "whole of group approach" frequently occurs in the Brazilian market can be pointed out in the adoption of this approach in the Brazilian context, in comparison with the international context.	We have recognised that cross border differences and the organisational structure of a group may impact the whole of group approach.

	Institutions		
Question 4: Decision process to address conflicts	Australian Financial Markets Association	It may not always be possible to simply refrain from an activity without creating business or regulatory complications, such as tipping the market that your firm will soon be working on a particular deal.	This report outlines high level guidance and is not prescriptive.
Q4	Association française des enterprises d'investissement	In the description of the decision process, the term "the interest of a client" should be deleted because it is ambiguous and replaced by "if the interests of a client cannot be properly protected (among others by disclosure)". It also does not make sense to place *refraining* at **a**, given that refraining from acting is only one possibility and the last resort when it comes to resolving a conflict (with the exception when acting is prohibited by law). This extreme solution should be replaced by the notion of avoidance, since the basic idea is to avoid acting against the interests of the client and/or to make disclosures. Further, **a** and **b** should be switched to show the order in which solutions should be considered. Great flexibility should generally be maintained regarding the choice of the approach. It should also be pointed out that the same type of conflict of interest can be managed in very different ways depending on the circumstances. (see letter for suggested edits)	We have made some amendments to the decision guidelines however we did not agree with all of the points made here.
Q4	ANDIMA-National Association of Financial Market	The "decision process" was the type of approach that most distanced itself from the procedures adopted by Brazilian institutions to address conflicts of interest, especially due to the absence of mechanisms capable of determining and guarantying if, at the end of the evaluation, the treatment	No comment.

	Institutions	applied to the conflict was effective.	
Question 5: Determining effectiveness of conflict management processes	Association française des enterprises d'investissement	An audit/inspection-based process is used to ensure compliance effectiveness. The proposed approach should be adjusted to reflect the stage of the client relationship and the urgency of obtaining a response from the client. Convening committee meetings is not realistic in all cases. Point **d** should be modified to make it clear that case-specific, not general, monitoring is required.	We did not modify the report in response to this submission. We have made some amendments to the decision guidelines however we did not agree with all of the points made here.
Q5	National Association of Financial Market Institutions	No mechanism is used.	No comment.
Question 6: Circumstance where an intermediary should refrain from acting	The Japan Securities Dealers Association	Doubt that the examples of when to refrain from acting are all pertinent as example (a) seems to need information barriers; example (b) should be addressed through disclosure of conflicts; example (c) is a case where the intermediary should establish an appropriate firewall rather than refrain from acting; and example (d) can be responded to with rigorous examination and disclosure.	This report outlines high level guidance and is not prescriptive.
Q6	Australian Financial Markets Association; European Federation of	The examples given lack sufficient context given the vast possibility of different business circumstances under which they might arise. Therefore, general principles of conflict avoidance are preferred to unequivocal requirements to refrain from acting in these situations.	This report outlines high level guidance and is not prescriptive.

	Financial Analysts Societies; Zentraler Kreditausschuss Association française des enterprises d'investissement		
Q6	ANDIMA-National Association of Financial Market Institutions	The "refraining from acting" approach has proven to be less common in Brazil.	No comment.
Question 7: Circumstances where firms are likely to refrain from acting	Australian Financial Markets Association	Client order priority, insider trading, as well as fraudulent statements, conduct, and market manipulation are all situations where the conflict cannot effectively be managed and the firm should restrain from acting.	No comment.
Q7	Max Planck Institute	Handling the offering of a competing intermediary is a situation where the conflict cannot effectively be managed and the firm should restrain from acting.	No comment.
Q7	Association française des enterprises	The refraining from acting approach is not necessarily in the client's interest and goes well beyond the principles established by MiFID. Should combine Topics 2 and 3 to	This report outlines high level guidance and is not prescriptive.

	d'investissement	avoid overemphasizing the idea of refraining from acting, which is the last resort in conflict management. The proposed examples are general, unspecific examples whose response might differ depending on the circumstances. Thus, a case-by-case assessment will always be needed. These examples can and should be used as an additional warning level, but the solution should not be to refrain from acting in every instance.	
Question 8: Circumstances where information barriers should be used	Australian Financial Markets Association	A checklist of information barriers is not an effective means of conflicts management, and could lead to a misunderstanding about the nature of conflicts management.	This report outlines high level guidance and is not prescriptive.
Q8	Association française des enterprises d'investissement`	The mechanisms described in the Report may only be appropriate in certain circumstances. Clarification should be provided on circumstances in which it is acceptable to cross Chinese walls.	This report outlines high level guidance and is not prescriptive.
Q8	Zentraler Kreditausschuss	Agrees with IOSCO that the information barriers stated should be used under the circumstances in question.	No comment.
Question 9: Other information barriers that are or should be used	Australian Financial Markets Association	An intermediary should have a general framework of conflicts management and vary the circumstances depending on the particular facts of the situation. Customized conflicts management procedures are the most effective.	No comment.

Q9	Max Planck Institute	A client should be able to waive his right to a Chinese wall, a Chinese wall may not be appropriate in all situations, and a Chinese wall should not apply to the board of directors.	No comment.
Q9	Zentraler Kreditausschuss	No, believes the information barriers stated to be comprehensive and customary.	No comment.
Q9	ANDIMA-National Association of Financial Market Institutions	The "information barriers and restrictions" were among the most mentioned mechanisms in Brazil. There is some concern with confidentiality and with the flow of information within an institution. The observance lists and restrictions lists for transactions are quite common in institutions; however, the not so rooted cultural question can comprise the efficiency of the mechanism.	No comment.
Question 10: Other restrictive mechanisms that should be used	Association française des enterprises d'investissement	In addition to the physical barriers described in the proposal, another level of physical barriers should be added that would consist of specific barriers to keep a given transaction separate within a business unit. (see letter for specific edits)	No comment.
Question 11: Circumstances where the intermediary should supplement disclosures in the issuer's prospectus	Australian Financial Markets Association; Zentraler Kreditausschuss Association française des enterprises d'investissement	Supplemental disclosures are not needed as required legal disclosures are sufficient to avoid conflicts of interest.	We do not agree and have not amended the report.

Q11	European Federation of Financial Analysts Societies	If the market intermediary considers the prospectus insufficient to disclose conflicts of interest, it should disclose separately from the issuer.	No comment.
Q11	Max Planck Institute	Contractual obligations may require an intermediary to make additional disclosure beyond the legal requirements of prospectus disclosure.	No comment.
Q11	National Association of Financial Market Institutions	Legal disclosure requirements in the Brazilian market are not always sufficient to disclose conflicts of interest, especially for retail clients.	No comment.
Question 12: Determining effective disclosure	Association française des enterprises d'investissement	In Europe, effective disclosure must provide clients with precise information and facts about potential conflicts. The IOSCO Report seems to reflect a US based view of more generalized disclosure.	This report outlines high level guidance and is not prescriptive.
Q12	Australian Financial Markets Association	Agrees with the proposition that the disclosure needs of retail and wholesale clients are different and the recommendation that this should be factored into the intermediary's assessment of its disclosure obligations.	We have emphasised that an investor's level of sophistication is a relevant consideration.
Q12	Zentraler Kreditausschuss	Considers the criteria for an "effective disclosure" stated on page 16 of the Consultation Report to be appropriate and comprehensive.	No comment.
Question 13: Circumstances where an	Australian Financial Markets	The disclosure document required by law should take precedence over previous research reports. It is self evident that research reports have only a short 'shelf life,' so there	No comment.

intermediary's research about the issuer should be withdrawn or amended	Association	should be no requirement to update research, and withdrawal of research should be kept to the minimums prescribed by law.	
Q13	European Federation of Financial Analysts Societies	Research that is no longer factually accurate should be withdrawn. If an effective Chinese wall is in place, the research unit should be allowed to continue coverage during the issue.	No comment.
Q13	Zentraler Kreditausschuss	As long as the research report was prepared by the intermediary before the relationship with the issuer began and without any knowledge of that future relationship, there is no need to withdraw research.	No comment.
Q13	Max Planck Institute; Association française des enterprises d'investissement	There is no provision in German or French securities law requiring the withdrawal of research.	No comment.
General comment	British Bankers Association	The BBA argued that a principles based approach is necessary without commenting in particular on the questions.	No comment.
Question 14: Factors re conflicts in funding	AFMA	The example is not reflective of general practice and therefore not a sound basis for developing policy. Any potential conflict of interest would be mitigated by the fact that:	The example is broadly reflective of known factual situations.

advice		- funding rates in debt securities markets are transparent; - bank divisions operate independently at the client level and compete internally; - as a sophisticated client, the company would be able to assess the quality of advice; and - commercial reality means that a dissatisfied company will change advisors From the investor perspective, proper disclosure, mandated through the listing rules or contained in a prospectus, would deal with conflicts in most situations. The example should make clear that it is not intended to shift the disclosure responsibility from the issuer to the intermediary.	
Q14	EFFAS	The respondent is not comfortable with the approach suggested in this example. The bank is obliged to determine whether loan or equity financing is the better solution. If the bank is not willing to take on the additional credit risk it should advise the client accordingly. The advising subsidiary is obliged to make a similar determination and must give proper advice, including appropriate disclosures.	We have amended the example to more clearly identify the conflict. We have not otherwise changed the example.
Q14	Max Planck Institute	In this example the bank has a legitimate interest in seeking to reduce its credit exposure and the client is free to consult any advisor. Provided the bank does not abuse its market power in a manner contrary to good faith there should not be any legal intervention into the duties of the bank. Inaccurate advice given by a bank should be treated in the same way as any inaccurate advice given by an expert under	We have amended the example to more clearly identify the conflict. We have not otherwise changed the example.

		national law, for example a claim for damages. The bank is obliged according to contractual and pre-contractual duties to give proper advice regarding the financing decision. In this example the conflicting interests are known to the parties and therefore disclosure of a conflict has no purpose. Disclosure should only apply if it is not apparent to the client that the bank and advisor are members of the same group. (German law requires further disclosure if the bank receives an inducement to advise against the client's best interests).	
Q14	AFEI	This example addresses problems that would not occur in France due to regulatory and organisational safeguards. Intermediaries must comply with formalised client disclosure obligations and the principle to act in the client's interest (the latter established under MiFID).	This report outlines high level guidance and is not prescriptive. We have recognised that cross border differences and the organisational structure of a group may impact the whole of group approach.
Q14	ANDIMA	Conflicts of this sort are rare due to: - a close relationship and intense involvement between issuer and intermediary; and - a guarantee by the intermediary may be given to the client so that some of the client's credit risk remains with the intermediary.	We have amended the example to more clearly identify the conflict. We have not otherwise changed the example.
Question 15: Funding advice-remuneration or other restrictions	AFMA	None. Remuneration should be based on negotiation between the parties. The discussion paper has not presented a basis for regulation.	We have removed references to remuneration in this example as reference to remuneration appeared to obscure the principal conflict sought to be identified – namely the potential for a securities offering to alleviate Bank X's existing credit exposure.

Q15	EFFAS	The ideal structure would be a separate fee for advice with offsetting remuneration for the financing element. Alternatively an intercompany fee could be charged on the services resulting from the advice. Such an internal remuneration system should be disclosed to the client.	We have removed references to remuneration in this example as reference to remuneration appeared to obscure the principal conflict sought to be identified – namely the potential for a securities offering to alleviate Bank X's existing credit exposure.
Q15	AFEI	In Europe the MAD and MiFID establish a detailed framework for managing conflicts of interest.	This report outlines high level guidance and is not prescriptive. We have recognised that cross border differences and the organisational structure of a group may impact the whole of group approach.
Question 16: Funding advice – refraining from acting	EFFAS	If proper advice is given to the company, the market intermediary would need to refrain from participating in the offering where loan financing is the preferable financing method. The intermediary would also need to refrain from participation if the company is not willing to disclose such information in the prospectus.	We have not changed the report in response.
Q16	ZKA	This example is not useful to the discussion of conflicts of interest and has been confused with inappropriate advice to a client. The only relevant conflict here is the dual capacity of a creditor and advisor. This can be managed by Chinese Walls and disclosure in the prospectus, but withdrawal from consultation is not necessary.	We have removed references to remuneration in this example as reference to remuneration appeared to obscure the principal conflict sought to be identified – namely the potential for a securities offering to alleviate Bank X's existing credit exposure.
Q16	Max Planck Institute	The intermediary should only refrain from participating if it has reasonable cause to suspect fraud against retail clients.	We have not changed the report in response.

Q16	AFEI	It is not possible to establish standard cases for where an intermediary should refrain, since intermediaries must make an individual assessment of where the client's interests lie. If the procedures to prevent conflicts are complied with, it will become clear to the intermediary whether to refrain from acting.	This report outlines high level guidance and is not prescriptive.
Question 17: Approach to underpricing	AFMA	Market processes determine pricing; market practices such as industry and sector benchmarking provide comparisons for the purpose of trading. In practice, there can be under- or over pricing only if there is a market failure, and it is not clear that exists here. The issue typically determines the final price at the offer.	We have not changed the report in response.
Q17	EFFAS	Pricing of an IPO can only be through a bona fide determination by those determining the offering price as IPO pricing does not have the benefit of a secondary market evaluation of a company's value. Fair pricing, over- and underpricing are only terms which bear a relation to such bona fide determination. As long as a market intermediary uses a bona fide evaluation approach, they would not be blamed for over- or underpricing, regardless of what the subsequent prices in the secondary market trading are. Over- and underpricing must be disclosed and contain the reasons and effect of such pricing.	We have not changed the report in response.
Q17	Max Planck	The proposed whole of group approach is an appropriate	No comment.

		instrument to manage conflicts of interest arising during the pricing process. Also, it would be helpful to have a disclosure of the obligation of the intermediary towards the issuer. Disclosure to the issuer will put the intermediary under pressure to justify the price arrived at. The reputation damage due to underpricing may be of less importance to the issuer, and could be a gain for the intermediary as long as potential future issuers do not become aware of a consistent approach to underprice shares in IPOs. If the issuer values objectives other than a good price, the underpricing could be in the interest of the issuer, which would not be a conflict of interest.	

Q17	AFEI	Setting the right price is a question of balancing the needs of the issuer/seller with those of investors. One of the key questions is whether establishing a price is a conflict of interest or commercial issue. Placing emphasis on underpricing risk can be misleading, because overpricing has been the major source of risk in recent years. One of the proposed approaches to underpricing is unsuitable (fee structure that provides the intermediary with an incentive to maximize rather than minimize the price). This approach can be dangerous and end up being bad for the aftermarket; • incentive fees based on final valuation should be crossed out; • discretionary fees put pressure on underwriters to achieve a high price.	We have not changed the report in response.
Question 18: Who should and should not be involved in price setting?	EFFAS	(a) Involved: Infosec's operating staff, management, responsible supervisory body & compliance officer. Also the issuer and underwriting syndicate members, if any. (b) Not Involved: Infosec's proprietary dealing unit, sales unit, any other group companies and investor clients.	We have not changed the report in response.

Q18	Max Planck	(a) Involved: Intermediary (financial knowledge and resources), issuer, potential buyers (guide; not to directly influence finally determined price). (b) Not Involved: Other market actors and regulators.	We have not changed the report in response.
Q18	AFEI	(a) Involved: Origination and Syndication (b) Not Involved: research analysts, sales teams, proprietary trading desks, market makers, existing owners affiliated with the intermediary.	We have not changed the report in response.
Question 19: Effect re sub underwriters, best efforts basis and allocation to existing clients	EFFAS	(a) Sub-underwriters – Sub-underwriters should be able to make recommendations as long as they disclose any conflicts of interest. (b) Best-efforts – Opinion is that it should not influence the appropriate pricing process. (c) Clients of Intermediary – Should not influence pricing.	We have not changed the report in response.
Q19	Max Planck	(a) Sub-underwriters – Conflicts of interest become a greater concern when sub-underwriters participate in the actual price setting, rather than just acting as a sales force. (b) Best-efforts – Acting on a best-efforts basis limits direct negative financial consequences, leaving damage to reputation as a potential risk. (c) Clients of Intermediary – Probability of conflict of interest increases for the intermediary with each additional client buying shares in the IPO.	We have not changed the report in response.

Q19	AFEI	(a) Sub-underwriters – Would not appear in and of itself to have an impact in terms of conflict management. (b) Best-efforts –Would not appear to have an impact in terms of conflict management. (c) Clients of Intermediary – In France, allocation takes place after the pricing stage and does not affect the price.	We have not changed the report in response.
Question 20: Determining underpricing and post issue compliance	EFFAS	Discrepancy of the trading price is not governing. Post-issue compliance would determine the reasons for discrepancies (negligence vs. intention)	No comment.

Q20	Max Planck	Best practice would be to follow the prices during the first trading day(s) to determine whether the offering has been excessively underpriced. Alternatively, analyse the "grey market", though setting a certain percentage for overpricing may prove difficult.	No comment.
Q20	AFEI	If the securities trade 20% higher in the first week, this indicates the securities could have been priced higher, but does not necessarily mean they were underpriced. Sharp moves can be caused by other factors as well. A longer time frame (*e.g.*, six months) should be used. The question of pricing cannot be dealt with at the level of compliance.	No comment.
Question 21: Determining overpricing and preventative processes	AFEI	Whether the issue is over- or underpricing, it is impossible to foresee every eventuality, and many factors are involved in market moves.	No comment.
General comments on	JSDA	Pressures from issuers can be factors in overpricing.	No comment.

pricing			
General comments on pricing	ANDIMA	Pricing is the most difficult means of occurrence of conflicts of interest. Market processes are efficient in determining the price of an asset, and conflicts of interest rarely occur, even in extreme cases of over- and underpricing. The pressures exerted by the issuers on one hand, and the investors on the other balance out to the point of finding a fair price.	No comment.
Question 22: **Allocation of securities – appropriate conflict management mechanisms**	Japan Securities Dealers Association	Disclosure should be included in the example. In Japan, intermediaries must distribute 10% of securities by lot and publicise allocation procedures. They may reward their frequent clients to the extent that it is not unfair or excessive.	We have not changed the report in response.
Q22	Australian Financial Markets Association	Allocations are typically based on criteria agreed by the syndicate banks and the issuer – such as diversity in the shareholder base, price and quantity of investors' interest etc. The final allocations are typically determined and approved by the issuer.	We have not changed the report in response.
Q22	European Federation of Financial Analysts Societies	Allocation principles should be determined in writing before subscription. They should preclude arbitrary decisions. The reward motive is legitimate so long as it does not conflict with the issuer's interests. Information barriers are neither possible nor necessary in the allocation process.	We have not changed the report in response.

Q22	Max Planck Institute	The whole of group approach should help to deal with the conflict. Disclosure will help protect the issuer's interests. The issuer should be able to monitor the allocation process, as it will be much more affected by the allocation process than the intermediary, given that investors will become shareholders of the issuer. Information barriers would hinder the smooth and easy allocation of shares.	No comment.
Q22	Association française des enterprises d'investissement	France has stringent rules to protect retail and professional customers. Where there is low demand, it is not possible to "dump" securities into discretionary account, and if the price drops, investors will be unhappy. The intermediary must be able to explain the allocation criteria. The involvement of several intermediaries in the process means that the process is self-regulated. Apart from the rules to protect investors, there is no need to make specific disclosure given the allocation is managed as part of a Chinese wall system. Bond and equity market practices differ in this area.	No comment.
Q22	National Association of Financial Market Institutions	In Brazil, there is effective participation by the issuer in the allocation process – but the joint process by itself does not seem sufficient to deal with the conflicts issues. Electronic book builds give greater degrees of transparency and equity to investors – but their use is limited. Use of discretion in allocation takes place more often in share offerings rather than debt security offerings. This is because the discretion may be exercised with the objective of creating dynamism in the secondary market, and most holders of debt securities hold their interest until maturity. As foreign investors in Brazil tend to be more volatile, intermediaries may seek to limit their participation in the public offering process.	No comment..

Question 23: **Allocation of securities – agreements with the issuer**	Australian Financial Markets Association	A general framework may be agreed but this is often refined during the process. The key elements are more likely to be driven by the client rather than the intermediary.	No comment.
Q23	Association française des enterprises d'investissement	Issuers may want the highest price, but this cannot be the sole or main criterion for allotments. The syndicate desks must devise allocation criteria that manage conflicting interests, and the issuer is informed of the book daily. The final decision should be in the syndication's hands, independent of other business lines.	No comment.
Question 24: Allocation of securities – disclosure to the issuer	Australian Financial Markets Association	Allocation preferences are normally agreed between the intermediary and the issuer (the client).	No comment.
Q24	European Federation of Financial Analysts Societies	The allocation principles should be cleared with the issuer. The issuer may have preferences such as wanting a balance between retail and institutional investors. The intermediary may have a contractual or fiduciary duty to take the issuer's interests into account.	No comment.
Q24	Max Planck Institute	The issuer has to have the final word on who should become its future shareholders, so the intermediary should disclose to the issuer its preferences re allocation and any conflicts that affect the issuer.	No comment.
Q24	Association	If affiliates of the intermediary are part of the book, this	No comment.

	française des enterprises d'investissement	should be disclosed to the issuer.	
Question 25: Allocation of securities – review arrangements	Australian Financial Markets Association	Allocation preferences are normally agreed between the intermediary and the issuer (the client).	No comment.
Q25	European Federation of Financial Analysts Societies	The compliance function should be involved in the allocation process to prevent market manipulation. Depending on the nature of the intermediary's involvement, the risk management function must also be involved to evaluate the allocation on the intermediary's risk exposure.	No comment.
Q25	Max Planck Institute	Review by the compliance officer is sufficient. An extensive review process is unnecessary – the issuer's interests can be protected by ensuring that it has the last word on allocation and through disclosure by the intermediary of its allocation preferences.	No comment.
Q25	Association française des enterprises d'investissement	No need for specific disclosure in this case.	No comment.
Question 26: Allocation of securities – identity of decision	Australian Financial Markets Association	Allocation preferences are normally agreed between the intermediary and the issuer (the client).	No comment.

maker			
Q26	European Federation of Financial Analysts Societies	A panel or committee consisting of all functions affected by the allocation – eg sales, trading, treasury, legal and compliance.	No comment.
Q26	Max Planck Institute	If the intermediary has established a viable control mechanism, this matter should be left to the intermediary to determine.	No comment.
Q26	Association française des enterprises d'investissement	The allocation decision should be made by the syndication agent, never by sales personnel.	No comment.
Question 27: Retail adviser, an employee of an entity related to the underwriter, recommends securities to client and receives high commissions –relevant factors	Australian Financial markets Association	Comprehensive disclosure properly pitched to retail investors is important and should be supplemented by other regulatory checks such as adequate training and support arrangements for retail client advisers.	No comment.

Q27	European Federation of Financial Analysts Societies	The intermediary may stipulate in the contract that a certain share of the client's assets may be invested in issues in which the intermediary is involved, provided the investment meets suitability requirements and other investment guidelines. This must be accompanied by proper disclosure of the conflicts arising. In the absence of such an arrangement, the intermediary should specifically clear the investment with the client before investment, and provide appropriate disclosure.	We have included mention that the contractual arrangement with the client may specify that a certain share of the client's assets may be invested in issues in which the intermediary is involved, provided the investment is otherwise suitable and subject to appropriate disclosure.
Q27	Zentraler Kreditausschuss	The IOSCO proposals to handle conflicts are appropriate and we see no need for the intermediary to refrain.	No comment.
Q27	Max Planck Institute	The proposed approaches are in line with the Commission Directive implementing the MiFID and thus accord to modern approaches.	No comment.
Q27	Association française des enterprises d'investissement	MiFID rules mean that the sort of unreasonable support seen in Parmalat would be impossible today. Also, the information required in prospectuses prevents "lending" banks from hiding information from investors. Client orders should not be accepted unless written – this makes monitoring easier.	No comment.
Q27	National Association of Financial Market Institutions	All intermediaries showed a high degree of concern about managing conflicts between the role of underwriter and advising for the sale of assets. There is a commitment for disclosure to clarify that the intermediary is also the underwriter. In relation to research reports, there is a large concern to ensure the independence of the analyst and the sole use of public information.	No comment.
Question 28: Ways to	European Federation of	Effective internal control and heightened compliance review. We also question the legitimacy of providing higher	No comment.

protect the interests of the client	Financial Analysts Societies	inducements for the relevant issue, as this will automatically bias the sales force.	
Q28	Zentraler Kreditausschuss	Intermediaries should ensure that commission payments have as little influence as possible on the advice given. This can mean, for example, that the consultant does not know the exact amount of the commission. However, this may conflict with the duty to disclose commission. .	Appropriately designed remuneration structures for advisers may be one of the tools that assist a whole of group approach to addressing conflicts of interest.
Q28	Max Planck Institute	The key element is to provide an adequate remuneration structure that balances fixed payments and performance related elements. An independent committee should determine whether remuneration schemes are optimal.	No comment.
Q28	Association française des enterprises d'investissement	See comments under question 27.	No comment.
Question 29: Disclosures to the client	European Federation of Financial Analysts Societies	If the recommendation is otherwise suitable for the client, disclosure is an effective means to manage the conflict. The disclosure should reveal that the intermediary is involved in the offering, an explanation of the nature of the offering (eg firm or best effort underwriting etc), the nature and relative size of the remuneration, the impact of distribution and sales on such remuneration, the nature and size of remuneration, of the sales force compared to other products and the potential lack of objectivity of the investment recommendation.	Appropriate disclosures of any inducements to advisers to recommend certain products may be one of the tools that assists addressing conflicts of interest.
Q29	Zentraler Kreditausschuss	The European Markets in Financial Instruments Directive (MiFID) provides that in such cases the inducement granted to	No comment.

		the investment firm by a third party (here - the issuer) is disclosed. The customer can be given a summary of the commission agreement and can receive details on request. This is an adequate monitoring concept.	
Q29	Max Planck Institute	Disclosure is only effective if it enables an informed decision to be made. This requires knowledge about the existence of the conflict and a basis to evaluate its consequences. The European Directive implementing the MiFID requires that conflicts be identified if a firm receives an inducement from someone other than the client. A recent German court decision held that in the absence of a contractual obligation, it is not a breach of disclosure requirements for an intermediary to recommend its own products without informing the client of alternative products. However, disclosure is required if the intermediary receives a commission that is linked to volume of sales of the specific product. It has been argued that this distinction is artificial. It is better to address only situations that are particularly likely to create a conflict. If the commission payments encourage recommendations that are contrary to the client's interests, this should be addressed by a cautiously shaped remuneration structure and by monitoring.	No comment.
Q29	Association française des enterprises d'investissement	See comments under question 27.	No comment.
Question 30: Appropriate monitoring arrangements	European Federation of Financial Analysts	Internal control and compliance review of all steps of the process, in particular, fair pricing and suitability of sales recommendation.	We have not changed the report in response as it already mentions robust compliance and advice oversight.

	Societies		
Q30	Zentraler Kreditausschuss	No specific monitoring arrangement is necessary so long as a consistent policy of disclosure to retail investors is pursued.	We have not changed the report in response as it already mentions robust compliance and advice oversight.
Q30	Max Planck Institute	An important aspect of monitoring should be the assessment of the remuneration structures of retail advisers by an independent remuneration committee.	We have not changed the report in response as it already mentions robust compliance and advice oversight.
Q30	Association française des enterprises d'investissement	See comments under question 27.	No comment.
Question 31: Intermediary (or related body) lends to an issuer – appropriate conflict	AFMA	AFMA expressed the view that the scenario in example 5 is unlikely because if the issuer's financial situation would not be properly disclosed in the prospectus there would be a breach of law or lack of due diligence. Furthermore, the association asserted that Bank X would want to consider the harm to its business reputation in the absence of proper disclosure. The AFMA felt that the likely scenario is that Bank X would be obliged to tell Infosec and it would have to refrain. In such a situation the offer can be structured only as distress relief and priced accordingly.	The example is broadly reflective of known fact situations.

management mechanisms			
Q31	EFFAS	The European Federation of Financial Analysts Societies agreed with the proposed factor relating to example 5. Furthermore, EFFAS asserted that the management of conflicts of interests depends on the information barriers set up within the intermediary and/or its group. The commenter believes that: a) if a strict information barrier exists between the lending unit and the underwriting or advising unit, the responsibility for the disclosure would rest exclusively with the issuer. Infosec should refrain from acting only if it doubts that the issuer properly informed it on its financial situation; b) if there is no effective information barrier between the two units, Infosec would not have other possibility than refrain because it may not be able legally to disclose the financial situation without the consent of the issuer.	We have amended the report to ensure that it is understood that the whole of group approach: • Contemplates having in place mechanisms that allow a designated person/committee/entity to see each side of an information barrier. • Does not contemplate a person/entity on one side of the information barrier crossing that barrier.
Q31	Max Planck	The German Institute argues that even though information barriers exist, in practice, as a result of a correct due diligence, the intermediary will know about the credit relationship between its group member and the issuer and will know that the repayment of the loans to a certain degree depend on the success of the securities offering. The conflict of interest thus appear hardly surmountable. Crossing of information barriers will be necessary and the	We have amended the report to ensure that it is understood that the whole of group approach: • Contemplates having in place mechanisms that allow a designated person/committee/entity to see each side of an information barrier. • Does not contemplate a person/entity on one side of the information barrier crossing that barrier.

		minimum informational exchange will likely encompass the information that a failure of the offering would materially impair the issuer's ability to repay the loans and also the dimension of the consequences upon the financial situation of the bank. In such a situation refrain from acting will be the only possible solution.	
Q31 - 33	AFEI	In general the French trade association indicated that if there is a failure risk, the market intermediary must refuse to carry out the transaction. Infosec should therefore refrain. Moreover, the image-related risk is seen as too great.	No comment.
Q31 - 33	ANDIMA	The association referrers that in order to address these conflicts of interest, most of the interviewed institutions pointed out the use of information barriers but it recognised that these barriers could not be sufficient. The mechanism that has proven to be quite efficient for addressing this type of conflict of interest is the disclosure of information. The association indicated also disclosure on voluntary bases by the intermediary and rating agencies activity as factors that might adequately address conflicts.	No comment.

Question 32: Intermediary (or related body) lends to an issuer – further conflict management mechanisms	JSDA	The Japanese association believes that the conflicts of interest in most of these cases can be managed through information barriers or appropriate penalties when failing to fulfil disclosure requirements, rather than by refraining from acting as an arranger. It seems, after all, too restrictive to limit the approaches to this case to the three that have been listed in the report.	No comment.
Q32	EFFAS	In EFFAS opinion, Infosec might have to disclose more than the mere prospectus information to its own clients. The legal requirement of prospectus disclosure must be distinguished from the contractual or fiduciary duties Infosec might have to its clients.	No comment.
Q32	Max Planck	The institute noticed that disclosure on the group would not be a feasible solution: retail clients would still not be able to assess the extent of the conflict of interests involved. Furthermore, commenter indicated the need of equal disclosure to all purchasers, as well, even if some of them might purchase the product through another intermediary. Finally, the respondent notice that according to insider dealing restrictions the intermediary is not allowed to grant privileged information access to selected clients even if without such information they would make a financially disadvantageous decision.	No comment.

Question 33: Intermediary (or related body) lends to an issuer – crossing the information barrier	EFFAS	EFFAS do not support any requirement for crossing or overriding barriers. In its opinion, such an approach discredits the institution of information barriers, it jeopardises the containment of insider knowledge and it creates an additional area of uncertainty of whether and when the threshold is reached which requires the crossing of the information barrier.	We have amended the report to ensure that it is understood that the whole of group approach: • Contemplates having in place mechanisms that allow a designated person/committee/entity to see each side of an information barrier. • Does not contemplate a person/entity on one side of the information barrier crossing that barrier.
Q33	Max Planck	Any wall crossing will impair the effectiveness of information barriers. As example 5 illustrates information barriers sometimes can cause more harm than benefit for retail clients and markets. Wall crossings should be made on a regular basis in situations where insurmountable conflicts may arise. A parallel lending relationship to a member of the group is an example where a wall crossing by the intermediary and by the other group member is advisable.	We have amended the report to ensure that it is understood that the whole of group approach: • Contemplates having in place mechanisms that allow a designated person/committee/entity to see each side of an information barrier. • Does not contemplate a person/entity on one side of the information barrier crossing that barrier.