The heat is on

According to a recent Wall Street Journal article¹ and public comments by the Securities and Exchange Commission’s (SEC) Director of the Office of Compliance Inspections and Examinations,² the Financial Industry Regulatory Authority (FINRA) and the SEC are “keen[ly] focused on conflicts of interest” for firms in the financial services sector. Further emphasizing the importance of managing conflicts of interest (COIs), SEC Director di Florio stated that “conflicts of interest, when not eliminated or properly mitigated, are a leading indicator of significant regulatory issues for individual firms, and sometimes even systematic risk for the entire financial system.”³

Similarly, FINRA’s Chairman and Chief Executive Officer Richard Ketchum outlined his intentions with regard to COIs when he stated that his organization intends to have “focused conversation... about the conflicts... identified and the steps...taken to eliminate, mitigate or disclose each of them.”⁴ Mr. Ketchum further emphasized FINRA’s intention to make detailed reviews of a company’s conflicts part of “standard operating procedure.”⁵

Based on these and other comments, KPMG sees regulators focusing on whether the firm has:

- Defined and outlined scenarios, relationships, and situations that may create an actual or perceived COI
- Assessed all products, activities, and trading strategies
- Inventoried all known COIs and assessed the potential impact of each
- Identified emerging and potential COIs
- Mitigated as much as possible inherent COIs
- Established controls in place to regularly and periodically review and assess evolving business conditions and relationships that may create a COI
- Implemented entity-level controls in place to prevent, detect, deter, and report COIs, including the implementation of robust policies and procedures, codes of conduct, periodic employee attestation, and ethics and disclosure committees.

³ Id.
⁴ Supra, Note 1.
⁵ Id.
Are you ready?

With FINRA and most likely other regulators renewing their focus on COI as an area of interest, you may want to think about whether your firm has any actual, inherent, potential, or even apparent COIs. You should be considering whether those COIs may be problematic to a client, investor/shareholder, or regulator; may be improperly disclosed or undisclosed; and whether your firm has established appropriate controls to prevent, detect, and disclose these COIs. For example, you may want to ask yourself several questions including:

- Does the firm have an interest in the outcome of any situations or transactions that are discrete or depart from the interests of clients?
- Does the firm have any positions the outcome of which may benefit the firm or some clients over other clients?
- Does the firm use any vendors or service providers that may cause an actual or apparent conflict with other vendors, customers, or clients?
- Does the firm or its employees have outside business/personal relationships or engage in transactions that if identified could result in a severe reputational risk?
- Does the firm have a robust ethics and compliance program that specifically addresses COIs adequately and that includes an objective assessment of potentially problematic relationships?

How can we help?

KPMG has a comprehensive suite of services and industry specialists who work with our clients to tailor approaches based on your firm’s concerns and specific requirements. Our work includes:

- **Governance and compliance program development/assessment** – We assist our clients with evaluating their supervisory/governance frameworks and developing new and/or assessing existing compliance policies and procedures to ensure they address applicable statutes, inherent/actual/perceived conflicts of interests, and other key regulatory risks, such as, ethical walls/information barriers, monitoring access/use of material nonpublic information (MNPI), outside business activities/undisclosed compensation arrangements, and personal securities trading activities.

- **Training** – A powerful preventative control to deter fraud and prevent inadvertent breaches of policy is education and training. We work with clients to develop and deliver targeted regulatory compliance training programs that highlight key regulatory and business risks through scenario-based discussion, reviewing industry/peer group challenges, and evaluating regulatory exam focus areas.

- **Forensic testing** – With the ever-increasing velocity of business change and associated amount of data, more complex and far-reaching distribution arrangements and the reality of operating under multiple regulatory schemes and continuously changing regulations, the need for forensic testing has never been greater. We assist clients with developing forensic testing protocols, including the independent sourcing and validation of data, to allow them to monitor their organization’s compliance with applicable regulations and internal policies.

- **Corporate intelligence and compliance monitoring** – We assist clients with understanding and assessing their risks related to the integrity, reputation, and history of related entities, individuals, and situations, and work with them to mitigate the risks associated with doing business with people and entities with whom they may have little or no familiarity by disclosing potentially unknown relationships and COIs.

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6 See, “What Registration Means for Hedge Fund Advisers;” Norm Champ, Deputy Director, Office of Compliance Inspections and Examinations, U.S. Securities and Exchange Commission, May 15, 2012: “Hedge fund advisers should identify any conflicts presented by the type and structure of investments their funds typically make, and ensure that such conflicts are properly mitigated and disclosed. Advisers of pooled investment vehicles also have a duty to disclose material facts to investors and prospective investors and failure to do so may constitute fraud.”

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• **Fraud Risk Management** – We assist clients in their efforts to proactively prevent, detect, and respond appropriately to fraud and misconduct risks through the design, implementation, and evaluation of antifraud programs and controls.

• **Investigations and Dispute Advisory Services** – If the firm has identified potential COIs, has already been subject to regulatory scrutiny or an enforcement proceeding, or has identified potential bad actors within the organization, we can assist with performing an investigation (under attorney-client privilege, if needed), provide objective fact-finding services, and/or provide expert witness testimony.

• Using our tools, methodologies, and unique skill sets, KPMG can help you prevent, detect, and respond to issues related to COIs by:
  – Strengthening entity-level controls designed to prevent and detect COIs (e.g., ethics and disclosure committees, policies & procedures, ethics and compliance manuals, code of conduct, attestation questionnaires, etc.)
  – Performing detailed testing and inquiries to identify and research relationships for potential COIs
  – Inventorying, managing, and assessing known and possible COIs
  – Mitigating or eliminating potentially problematic COIs
  – Performing confidential and privileged investigations
  – Providing objective fact-finding services or expert witness testimony.
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- Fraud and misconduct risk assessment
- Code of conduct and related standards
- Employee and third-party due diligence
- Communication and training
- Process-specific fraud risk controls
- Proactive forensic data analysis
- Hotlines and whistleblower mechanisms
- Auditing and monitoring
- Retrospective forensic data analysis
- Internal investigation protocols
- Enforcement and accountability protocols
- Disclosure protocols
- Remedial action protocols

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