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Dear Committee Secretary

AIMA Australia Submission
Proposed update to RG 181 Licensing: Managing conflicts of interest

1. About AIMA

AIMA, the Alternative Investment Management Association, is the global representative of the alternative investment industry, with more than 2,000 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2.5 trillion in assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. In addition, AIMA has over 150 local based corporate members including managers and key service providers. For further information, please visit AIMA's website, www.aima.org. AIMA's affiliate association, The Alterative Credit Council (ACC) deals specifically with non-bank and private credit.

2. Consultation

This submission has been prepared by members of AIMA's Regulatory Committee.

Set out below are the questions asked in the consultation paper and AIMA's respective responses.

3. Executive Summary

AIMA is supportive of updating the regulatory guidance in this area. However, AIMA considers that:

- many of the illustrative examples are unhelpful as the conflicts are not adequately explained and there is no guidance on how these conflicts could be adequately managed, this is one of our key concerns with the revised guidance in its current form. Rather than including a table seeking to categorise a broad range of conflicts, would revised examples sit better with the relevant topics set out in the specific considerations section in RG 181.35 onwards?

- the roadmap that is included at the back of the draft of RG 181 will inevitability become out of date very quickly. Accordingly, if ASIC considers that such a roadmap would be useful it would likely be more useful if it was a separate document or page on ASIC's website so that it could more easily updated.

- it is premature to finalise the amendments to RG 181 arising from ASIC's work in relation to private markets before it releases it roadmap in relation to private markets and without giving stakeholders the opportunity to provide feedback on such proposed changes.

4. Detailed Submission

1. We propose to include guidance clarifying that the conflicts management obligation is broad and is intended to apply to all conflicts of interest other than those wholly outside the financial services business of a licensee or its representatives.

B1Q1 Is our guidance clear?

Please see our response in B1Q2 below.

B1Q2 Do you suggest changes to our guidance? If so, please provide details.

The concept of a broad expression of the conflicts obligation as set out in draft RG 181.10 is understood. We do have some concerns regarding the approach to articulating this concept in RG 181.10 – 181.12 as set out below.

We would submit that the language used in RG 181.10, in particular the phrase "other than those wholly outside the financial services business of you or your representative" whilst reflecting the language of the EM is not a phrase which is commonly used or understood. In particular the use of the language "wholly outside". We would suggest rephrasing this concept using more readily understood language, such as by use of phrases such as "completely separate to" or "independently of".

Whilst on the same theme as discussed above, we note also the different, more commonly used language in RG 181.11 of "conflicts that arise between something within the financial services business and something outside it". Whilst this is an improvement on the language in RG 181.10, it is also a different phrasing than used in RG 181.12, which is the third and probably the most straightforward and easily understood articulation of the concept, being "conflicts that are unrelated to the financial services business".

In terms of the examples used in RG 181.11, we feel that these are too simplistic and do not adequately describe the conflict which makes the examples meaningful. For example, in paragraph (a) what exactly is the conflict between the financial services business and lending business? Similar comments apply to (b). We would submit that the examples in the EM at 5.599 (as extracted below) be used instead of those in the draft RG as they have a clearer articulation of the actual conflicts in each case. We would also suggest that the articulation of the conflicts obligation in the context of the categorisations of conflicts as category 1, 2 and 3 in the EM as extracted below is also helpful and ideally should be used in the revised regulatory guidance

Types of conflicts of interest that must be managed

5.599 There are three main types of conflicts of interest:

• conflicts within the financial services business (Category 1);

– examples are conflicts within one area of the financial services business, such as dealing on behalf of various clients, or across different areas of the business, such as between publishing research in a client newsletter and market making;

• conflicts between something within the financial services business and something outside the financial services business (Category 2);

– examples are where outside factors give rise to conflicts within the financial services business, such as a conflict of interest between the financial services licensee lending (as principal) to a particular enterprise and the financial services licensee underwriting a public offer for the same enterprise. Alternatively, a conflict may arise where the objectivity of research is compromised by the analyst's personal interests or relationships;

• conflicts outside the financial services business (Category 3);

– where a factor outside the financial services business gives rise to a conflict with another factor outside the same financial services business. Examples include where those conflicts might arise between two non-financial services businesses of a merchant bank (for example; corporate lending and dealing on the bank's own behalf). Such conflicts are unrelated to the financial services business.

5.600 The purpose of proposed paragraph 912A(1)(aa) is to specifically require licensees to have adequate arrangements for managing Category 1 and Category 2 conflicts of interest. Licensees will not be obliged under the Corporations Act to manage Category 3 conflicts of interest, which occur wholly outside their financial services business. They may have other obligations to manage such conflicts. The Corporations Act already includes a definition of financial services (see Division 4 of Part 7.1).

2. We propose to include guidance clarifying how the conflicts management obligation operates in connection with other legal obligations of an AFS licensee (including other AFS licensing obligations). This guidance is supported by a non-exhaustive list of legal obligations and information (a 'roadmap') that may relate to the conflicts management obligation.

B2Q1 Is our guidance clear in draft RG 181?

It is not clear to us as to why this roadmap is being included. As noted in the Consultation Paper, obligations change over time (paragraph 23 of CP 385) and so this roadmap will inevitably be out of date in due course.

B2Q2 Do you suggest changes to our guidance in draft RG 181? If so, please provide details.

We consider that RG 181 would be more useful to AFS licensees if ASIC provided some guidance as to what appropriate conflict management looks like for particular examples. Of course, this would be subject to individual circumstances but in the existing examples, it is not clear if ASIC considers that disclosure would be appropriate for certain conflicts or if those conflicts should be avoided.

We note that the roadmap contains a lot of obligations, many of which do not strictly relate to conflicts of interest, so we query why this regulatory guide is the correct place for them. Further, the roadmap will inevitably become out of date very quickly as there are always amendments and new obligations. If ASIC considers that such a roadmap (or signpost) would be useful for licensees it may as a standalone document or page on ASIC's website provided it is regularly updated. –Another concern is that such a roadmap being at the back of a regulatory guide is difficult to find which does not seem to be consistent with ASIC's simplification priority.

3. We propose to update our guidance on types of conflicts of interest that an AFS licensee should consider.

B3Q1 Is our guidance clear?

We refer to the above submission in relation to the types of conflicts of interest that AFS licensees should consider.

B3Q2 Do you suggest changes to our guidance? If so, please provide details.

4. We propose to include illustrative examples of the types of conflicts of interest that an AFS licensee may need to consider.

B4Q1 Is our guidance clear?

We have a number of concerns relating to the examples which have been provided as part of the illustrative examples in Table 1 of Draft RG 181. Please see our comments in relation to certain of the suggested illustrative examples below.

B4Q2 Do you suggest changes to our guidance? If so, please provide details

Yes, you will see from the comments below that some of the examples appear to be too general in nature and, as such, run the risk of not clearly illustrating the particular activity which should be the focus of the licensee's conflict management obligation. In other cases there are more than one potential conflict which may be relevant and if the examples are to be useful they should highlight particular conflicts rather than being expressed in broad terms which could result in some uncertainty as to which aspect the licensee should be focusing on in complying with the conflicts management obligation.

Type of conflict	Illustrative Example	Comments
Conflicts with clients or members	• A private capital advisory (advising and dealing in a class of shares) not disclosing to a client its economic relationships with other investors in an equity deal An insurance broker who receives commissions from product issuers recommending products with higher commissions to a client, resulting in the client receiving similar cover but at a higher price • A fund charging excessive or unnecessary fees to members, not in their best financial interests • An adviser encouraging clients to invest in inappropriate financial products from a related entity, then hedging against a client's interests and directly seeking to generate revenue from expected client losses • A broker excessively buying and selling securities in a client's account to generate commissions and obtain remuneration incentives inconsistent with the client's objectives • A fund charging fees to borrowers (such as loan origination or default fees) that are retained by the fund manager, rather than for the benefit of the fund	The first example is cast in very general terms. It is not clear if the point of the example is to indicate that the mere existence of the relationship with other investors is the conflict which needs to be managed or whether something more is required. The reference to economic relationship could be read as inferring an obligation to disclose the nature and or extent of those (presumably confidential relationships) or the fact that the relationships may be on different terms. The second example relating to fund fees does not appear to relate primarily to conflicts of interest. There is a more fundamental question in this example as to appropriate exercise of trustee or responsible entity duties on the one hand and general licensee duties, such as the obligation to act honestly, efficiently and fairly. There are separate design and distribution obligations for retail products which are also presumably more relevant to this particular situation. In any event, it is not clear who is determining what is excessive or unnecessary in the context of the conflicts obligation. This example may be more appropriately re-cast as an example similar to the "fee for no service" issues highlighted in the recent Royal Commission rather than an example that questions the commerciality of

		the fees. In the third example, there are two potential conflict situations, (i) the related entity financial product recommendation (ii) the hedging against the client's position. If the intention is to focus the reader's mind on potential conflicts then it may be preferable to break this into two separate examples. In the broker remuneration example, the language regarding commissions and benefits is somewhat vague. Would it be clearer to say "generate commissions and benefit from potential remuneration incentives in circumstances which are inconsistent with the client's investment objectives. " The last example is too specific and limited to issues which are alleged to have occurred in parts of the private credit industry. We doubt this example will stand the test of time and query if it appropriate to use an example which relates to an area of the market where ASIC is in the process of considering submissions made in relation to the public and private markets consultation. We would also suggest that: (i) the example should be expressed in more general terms so that it could be applied across asset classes (ii) it should relate to fund managers (rather than a "fund") receiving fees or benefits from third parties in a situation where those amounts relate to the manager's role in managing fund assets; and (iii) the fees or benefits are kept for the manager's own benefit and not passed on for the benefit of the fund.
Conflicts between clients, members, or classes of persons	• A fund providing preferential information and treatment to some investors over others • A conglomerate firm using information obtained from one client to benefit another client • A market maker (acting as both a buyer and seller in a market) providing preferential treatment to certain clients, such as offering	In the first example of a fund providing preferential treatment, we note that this does not apply in all circumstances. A fund is able to provide preferential treatment where there are separate classes of investors and that treatment is part of the rights of a class, which rights are disclosed. In the second example of a

	better pricing or execution priority • A corporate advisory advising and dealing in a 'take-private' equity deal, providing certain classes of persons (e.g. directors and management) with confidential information and preferential treatment over other shareholders or potential bidders	conglomerate firm, the example should exclude activity in a group where data is properly treated and quarantined from the AFSL entity. That is, the activity is non-financial services activity. In the final example of corporate advisory dealing we note that if management is considering a potential buyout, by its nature the executive properly has access to certain data in the day to day management of a company which is not (and should not) provided to shareholders in that capacity.
Structural conflicts	• A corporate advisory client's confidential information (from the sell-side of the business) being passed on to benefit clients in the buy-side of the business • A conglomerate firm underwriting a public offer of an entity, while a different business unit is lending (as principal) to the entity • A financial institution providing a mortgage to a consumer, and encouraging the consumer to get home insurance from a related entity at a premium price that is not in the consumer's interests • A superannuation trustee or responsible entity owning a financial advice business that recommends owners' products to members • Different business units in the same multi-disciplinary firm providing audit and financial services to the same client, compromising an auditor's objectivity and independence - for example, a firm's sell-side business publishing research in a client newsletter that is being compromised by information from the market-making side of the business	We find the example in relation to the multi-disciplinary firm unhelpful and confusing as it suggests that a firm can't provide audit and financial services to the same client whilst maintaining independence. This is inconsistent with the Code of Ethics for Professional Accountants (including Independence Standards). We are further confused by the example which is dealing with research and market making activities and not audit services.
Proprietary conflicts	• A financial institution having a conflict between its proprietary interests and the interests of its clients and counterparties in a market transaction • A financial institution hedging risks or obtaining a beneficial price in proprietary trading by using confidential information accessed at a client's issuance, to the client's detriment • A market maker prioritising its interests over clients by using confidential information from	In this example, the phrase 'better terms' lacks clarity and could potentially be confusing without a defined benchmark. For example, a loan at lower interest rates with lower credit risk and more repayment flexibility could still be 'better' and more strategically beneficial to investors in a fund than a loan with higher interest rates and a weaker security package. We suggest that

	client orders to benefit its proprietary trading - that is, by front-running a client order to take advantage of the anticipated price impact of the order • A fund lending to a related company on better terms than if the fund were lending to an unrelated company or investor in similar circumstances, not in the interests of investors	ASIC instead refer to arrangements that are 'not at arms' length'.
Conflicts relating to duties	• A director's affiliations with an outside organisation influencing decisions that the director makes about the financial services business, to the detriment of members • An auditor's long association with a financial services business client impairing the auditor's objectivity and independence, leading to a conflict of interest • A director's duties to a financial services business being compromised by and conflicting with the duties they hold as a director of another intra-group company • A financial market operator's neutrality being impaired if the entity also has an advisory arm and a broking arm, and its fiduciary duties towards a client compromising the market's obligation to operate a fair, orderly and transparent market	The first example is unclear. Who are the "members"? Does ASIC mean the members of the company (ie shareholders) or the members of a scheme, superannuation fund or similar? The second example is, we think, an auditor's obligation and goes to the heart of auditor independence. We don't find this a helpful example in the context of conflicts of interest to be managed by a financial services licensee. Given the relatively small number of market operators, and smaller number still of market operators who have an advisory arm and a broking arm, is this a common example that should be included in RG 181?
Third-party conflicts	• A third party used to outsource aspects of the financial services business (e.g. its responsible manager or compliance functions) having an economic relationship with another financial services business, interfering with a third party's ability to perform its outsourced role • A fund relying on a third-party valuation of an unlisted asset, where the third- party valuation is conflicted due to an economic relationship with the issuer of the unlisted asset • An expert's independence being compromised by material financial interests when providing an expert report on underlying assets commissioned by a corporate advisory for securities holders in a share buy-back • A sub-contractor of a market being conflicted by economic relationships with other market participants • A comparison website having commercial relationships with product issuers, resulting in the website prioritising and recommending products to consumers from issuers that provide it with the most commissions, benefits,	This fist example is not clear. For example, what is the economic relationship (could it be a commercial relationship with the right to earn fees) and how does it interfere with its ability to perform its outsourced role? The valuation example is one where some guidance on what ASIC considers would be an appropriate conflicts management approach would be helpful because it is common that a fund would need to rely on the value of an unlisted asset provided by a third party valuer engaged by the issuer of the unlisted asset through the fund having inadequate information to undertake its own valuation or engage its own valuer. Also, is this really a conflict for the fund (or, more correctly, the fund manager/trustee given the structure of Australian funds)? Regarding the third example, doesn't this more raise the issue of whether

	or advertising revenue, rather than products in the consumers' interests	the expert is independent (and so should not be appointed for the role or accept the appointment) rather than a conflict of interest? We do not understand the 4th example (sub-contractor of a market). We note the 5th example uses terminology (commercial relationships or material financial interest) which is different to other examples which refer to economic relationships. It would be helpful if the terminology is consistent across the examples
Individual conflicts	• A trader accessing confidential information about a client to pass on to the trader's spouse who works for the client • An adviser recommending a client invest in a company the adviser holds significant shares in • An adviser recommending a retail client invest in property as part of the client's financial advice strategy, where the adviser receives a commission from a property developer for the referral • An employee of a superannuation fund revealing information about members to an affiliated third-party organisation the employee is aligned with • A research analyst's report provided to clients being influenced and compromised by the analyst's personal interests • A director or executive of a fund using confidential information about fund transaction activity - such as price-sensitive information, confidential valuations of unlisted assets, or when investment strategies are switched—for personal gain	We refer to the first example, we believe this example is more akin to breaching confidentiality obligations under their employment contract and, potentially, depending on the facts and whether the information would be expected to have a material effect on the price or value of financial products, inside trading. With the second example, could ASIC explain what it considers to be significant in this context? Also, should it be made clearer that this (and the following example) relate to financial advisers/planners? We also consider that these two examples are ones where some guidance on what ASIC considers would be an appropriate conflicts management approach would be appropriate given the relevant audience. The third example appears to be focussed on conflicted remuneration, given it's a retail client. In relation to the fourth example, this example should make it clearer that the employee is an employee of a superannuation fund trustee. In any event, would the example be simpler and clearer if it just referenced the trustee and disclosure of member information (without permission) to third party organisations the trustee was associated with? In the fifth example, further context as to what is meant by personal interest should be provided and in what scenario (for eg materiality of personal interest) would disclosure not be adequate and the conflict need to be

		avoided. Similarly, the second example could also be improved by discussing whether i disclosure would be adequate and, if not, why. Similar to the first example, the last example looks to be Insider Trading and illegal. We consider that it sends the wrong message to include in conflict examples even though there might also be a conflict.

5. We propose to include additional guidance on what 'adequate arrangements' involve. That is, adequate arrangements:
(a) should identify, assess and respond to (i.e. effectively manage) conflicts of interest; and
(b) require an AFS licensee to implement, monitor, maintain, and review these arrangements.

B5Q2 Do you suggest changes to our guidance? If so, please provide details.

We find it unhelpful that ASIC doesn't provide guidance on what it considers to be adequate arrangements particularly in the context of the examples. We also find it unhelpful that some of the illustrative examples of conflicts cover prohibited conduct, such as insider trading. In our view such conduct should be covered in the licensee compliance arrangements covering trading and it is unnecessary to also have to address such prohibited conduct in your arrangements for managing conflicts of interest. As outlined above, we consider it would be helpful if ASIC provided further guidance on what as a minimum would be adequate management of the conflict. For instance, avoiding prohibited conduct.

We note that in table 2, item 4 "Implement" – it suggests that arrangements should be regularly reviewed (internally or by a third party such as an auditor). We think it would be helpful to clarify the reference to auditor is not the external auditor and suggest it may be clearer if you changed the reference from "by a third party such as an auditor" to "by a third party expert". It is unclear if the reference to the arrangements being regularly reviewed is intended to cover the end-to-end arrangements (i.e. a review of the conflicts framework, relevant policies, conflicts register, a review of the controls in place and how they are operating). If so, then we think it would be helpful to clarify that a regular review doesn't mean annually and for APRA regulated entities could be done in the context of a triennial review of the risk management framework given that such a review would encompass significant resources and time. We think it would be also useful to clarify that a conflict can be transaction or deal related, or circumstance related, and it ends when the deal ends, and there is no need to maintain the appropriate conflict management arrangement on an ongoing basis.

6. We propose to include guidance on a proportionate and risk-based approach to having and applying adequate arrangements.

B6Q1 Is our guidance clear?

Yes, your guidance on taking a proportionate and risk-based approach to conflicts management is clear. We welcome the clear acknowledgment that adequate arrangements will vary significantly between small and large organisations.

B6Q2 Do you suggest changes to our guidance? If so, please provide details.

No material changes are recommended to this section of draft RG 181.

7. We propose to update our guidance to outline a more holistic and nuanced approach that AFS licensees can adopt to effectively manage their conflicts, consistent with existing legal principles and policy.

B7Q2 Do you suggest changes to our guidance? If so, please provide details.

AIMA welcomes the certainty added in the additions to RG 181 through the use of examples; this is helpful.

However, we note that it is important that the adjustments we have detailed in our submission be made so as to prevent the updated RG 181 from being unable to be applied in practice.

Otherwise, RG 181 will have reduced practical application at best, and at worst, require licensees to adopt practices which do not align with market best and current practice.

As outlined above, we consider it would be more help if the examples provided more guidance on what might be adequate arrangements to address the conflicts. We also think it is unhelpful to provide examples that have been identified in current surveillance of particular segments of the market when ASIC has not competed the surveillance activity and has not reported on its findings in relation to such surveillance activities to the market.

* * *

AIMA would welcome the opportunity to meet with ASIC to discuss our submission further. We would also be happy to provide further input on how conflicts could be managed in practice if ASIC was minded to cover this in the examples.

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Yours faithfully