Customer Interest & Conflicts of Interest

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THE ASSOCIATION OF FOREIGN EXCHANGE AND PAYMENT COMPANIES

Contents

1. Introduction

In August 2018 the FCA opened consultation on applying the FCA's Principles for Businesses to payment services and e-money sectors, as well as applying communication rules to advertising and communication (CP18/21). The outcome of this consultation was issued on 1st February 2019 by the FCA as the 'General standards and communication rules for the payment services and e-money sectors' (PS19/3).

In preparation for this in late 2018, the AFEP Executive Committee began writing industry guidance on several key topics to act as good practice for our industry. As this good practice guidance has significant impact on how FX, e-money and payment services firms are encouraged to operate and how AFEP works with the FCA, AFEP worked with members to write this good guidance through working groups and Round Table sessions.

Good Practice Guidance documents have been written and issued to members on a variety of topics and these can be found on the member portal.

AFEP recognises the importance of members not only adhering to FCA and other legislation but also these Good Practice Guidance documents. Member firms are required, as a condition of membership, to confirm they are using the Good Practice Guidance and applying it to their business to ensure quality and compliance with the regulations.

This is high level guidance as it is for each firm to determine how to comply with the requirements as relevant to their business model. This guidance is intended for Authorised Payment Institutions (API's) and Authorised Electronic Money Institutions (AEMI's) who are full members of AFEP. This guidance is designed to assist members, and the FCA approach documentation and legislative requirements should always take priority. Members are encouraged to take their own independent advice to ensure they are meeting requirements.

2. Specific Legislative Background

The following guidance has taken into consideration the following:

a) Conduct of business requirements as set out in the FCA's 'Payment Services and Electronic Money – Our Approach' document;
b) Consumer protection from Unfair Trading Regulations (2008)

c) FCAs Principles for businesses, particularly:

1. Integrity – a firm must conduct its business with integrity;
2. Skill, care and diligence – a firm must conduct its business with due skill, care and diligence;
3. Management and control – a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems;
6. Customer's interests – affirm must pay due regard to the interests of its customers and treat them fairly;
8. Conflicts of Interest – a firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client; and,
9. Customers: relationships of trust – a firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgement.

d) Treating Customers Fairly

Outcome 1: Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture.

Outcome 2: Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.

Outcome 3: Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale.

Outcome 4: Where consumers receive advice, the advice is suitable and takes account of their circumstances.

Outcome 5: Consumers are provided with products that perform as firms have led them to expect, and the associated service is both of an acceptable standard and as they have been led to expect.

Outcome 6: Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint

PART A - CUSTOMER INTEREST

A1. Governance

Strong governance is key in ensuring that risks to customer interests are identified and protected. AFEP has issued separate guidance on Corporate Governance and we do not seek to duplicate this in this document but have set out below the key areas we believe may have an impact on customer interests and some of the considerations that should be applied by member firms.

Failure to ensure that strong governance structures are in place may result in customer detriment, therefore we expect all member firms to:

a) adhere to AFEP's Corporate Governance good practice guidance;
b) consider and document the risks to customer interests and potential conflicts of interest that may arise in each area of their business and assess the mitigation in place to ensure that it is / remains fit for purpose;
c) provide relevant MI to the Board to allow them to identify any areas where customer interests may be at risk;
d) ensure all Senior Managers have clear, documented, individual responsibilities and accountabilities;
e) be able to clearly evidence first, second and third lines of defence;
f) assess and manage the risk of all material outsourcing on a continuous basis ensuring that it takes reasonable steps to avoid undue additional operational risk and recognising that responsibility cannot be outsourced; and,
g) have a process in place to assess the risks of new and existing products which takes into consideration the target market.

	Good practice	Poor practice
1	Clearly documented governance framework commensurate with the size and nature of the business.	Lack of documented governance framework and/or one that is documented but not implemented in practice.
2	Member of the Board or senior management given explicit responsibility for protecting customer interests.	Lack of consideration of customer interests at senior level.
3	MI presented to the board regularly and which clearly highlights areas of potential customer detriment (such as customer retention rates, complaints, change in spreads etc).	Failure to provide MI allowing the board to understand risks to customer interests.
4	Clearly documented senior management responsibilities, signed by management confirming their understanding and acceptance of those responsibilities.	Lack of or ill-defined responsibilities and/or gaps / overlap in areas of responsibility
5	Clear risk assessments in place and ongoing monitoring of all outsourcing arrangements. Evidence of thorough due diligence on all outsource providers.	Lack of control or oversight of outsourced functions and limited or absent due diligence.
6	Clear product approval process in place using FCA handbook (PROD) as a guide to requirements and documenting risks to customers and how they are addressed.	Failure to consider risks to customers in the design or sale of products.

A2. Pricing, Charges and Fees

AFEP has issued separate guidance on Customer Communications and we do not seek to duplicate this in this document but have set out below the key areas we believe may have an impact on customer interests and some of the considerations that should be applied by member firms.

Key Risks

a) Customers are provided low(er) quotes at the point of sale to win business and then higher spreads are applied once the account is open, funds are received, and / or first trade is concluded;

b) Customers suffer detriment due to a firm onboarding at a low spread and subsequently widening spreads over time;
c) Customers do not understand how the pricing, charges and fees are calculated;
d) Vulnerable customers are over charged as they are not able to question or understand the charges.
e) Firms encourage customers to speculate on the market, or to potentially "hide" a loss by allowing customers to close out trades and draw "profit" or roll trades without a change in the underlying commercial circumstances of the customer. This may be exacerbated by reward structures in place at the firm or firm revenue targets; and
f) Non-compliant firms are able to operate at lower costs and therefore price products lower resulting in significant potential harm to customers (lack of resourcing resulting in failures in AML and fraud controls, safeguarding, liquidity management, monitoring etc).

We expect all member firms to adhere to Treating Customer Fairly principles across their businesses (regulated and unregulated business).

We acknowledge that treating customers fairly does **not** equate to treating them equally and that it is acceptable to alter pricing for particular customer sets or negotiate special terms with specific customers. We do however expect that:

a) AFEP members should comply with AFEP's Customer Communications Good Practice guidance;
b) Firms should be able to demonstrate rationale for different margins, fees or charges being given to different customers;
c) Firms do not increase their margins or otherwise discriminate due to higher acquisition costs through a particular distribution channel unless there is a difference in the service or product provided;
d) Where a quote is given, the pricing must be honoured should the trade subsequently be booked. For clarity "pricing" in this context means any fees, charges and spreads are demonstrably the same as those quoted. Where the amount, tenor, or currency pair has altered, and this has an impact on the pricing this should be clearly explained to the customer;
e) If a reduced introductory price is given to the customer, the customer should be informed of this so that they are aware that a similar price may not be achievable in future;
f) If a guaranteed spread or price is agreed with a customer any conditions (such as amount traded, currency pair etc) should be clearly communicated to the customer. Any change to the guaranteed spread must be notified to the customer in advance of any future trade. We note that due to timing differences between booking with the customer and booking with the counterparty bank may result in a small difference in actual spread as opposed to the guaranteed spread. In this event the firm

should be able to demonstrate the counterparty rate used (and hence the spread) at the time of booking the trade with the customer;

g) Firms should not allow customers to routinely roll or close out forward positions unless there is a clear underlying commercial rationale (such as cancellation of an underlying contract). Exceptions should be infrequent. This is to ensure that forwards fall within the MiFID exemption and that customers are not encouraged to speculate on the market with a view to making profit or to avoid crystallising losses. Remuneration schemes should be designed to ensure that staff are not rewarded for such rolls and close outs; and,

h) Remuneration schemes must ensure that the risk of customer overcharging is mitigated. Remuneration schemes must be clearly documented and evidenced as being formally approved by an appropriate governance body (e.g. Board or Remuneration Committee). See section B3 below for additional guidance on remuneration.

We expect all member firms to meet regulatory obligations, but we are aware of concerns that there may be other firms who do not adhere to regulatory standards. We would encourage member firms to make AFEP aware of generic or specific concerns so that we can consider referral of issues to the FCA.

	Good practice	Poor practice
1	Pricing strategy clearly documented and consistently applied. Ability to demonstrate how charges correlate to pricing strategy.	Unable to demonstrate "fair" pricing to customers. Unfair practices would include quoting low prices and increasing rates at time of trade, widening spreads for existing customers without justification or communication, not adhering to agreed spreads and/or widening spreads for less knowledgeable or vulnerable customers.
2	Regular surveillance monitoring in place to identify exceptions to pricing.	No controls in place to identify non- adherence to agreed pricing.
3	Remuneration schemes are developed taking into consideration and mitigating the risks of poor customer outcomes. Remuneration schemes are clearly documented and subject to formal review and approval by an appropriate governance body (e.g. Board or Remuneration Committee)	Sales staff are driven, through remuneration, to maximise rates regardless of TCF considerations. Remuneration schemes carry a high proportion of variable pay and/or a large proportion of pay is linked to revenue targets. Remuneration schemes are not clearly documented and/or reviewed or approved by an appropriate governance body.

4	Firms ensure that all forwards sold fall within the MiFID exemption. Firms have written procedures in place to ensure that the close out is due to a change in commercial circumstances (such as failure of supplier or customer) and monitoring takes place to ensure such procedures are operating effectively. Remuneration structures should not reward staff for rolls or close outs. Where customers of a firm may also book MiFID products within the same entity, or with another group company, it is made clear to customers which entity they are contracting with and the differences in regulations and protections that apply (such as customer money).	Lack of controls to ensure that forwards fall under the MiFID exemptions and / or reward schemes that incentivise staff to encourage customers to speculate.

A3. Misselling

While the FX products offered by member firms are unregulated and, arguably, therefore carry a lower risk of misselling it is important to recognise such risks still exist and firms must ensure they have controls in place to mitigate them.

Key risks include:

a) Not clearly explaining the risks or opportunity costs of a product (FX forwards / margin call);
b) Creating relatively complex products which may not be suitable for customers without assessing knowledge, affordability or suitability (e.g. layered hedging);
c) Encouraging over-hedging and/or market speculation by customers;
d) Selling MiFID products without the correct licence (inadvertently or otherwise);
e) Lack of oversight of distribution channels;
f) Influencing customers to deal based on market predictions / "advising" on market rates (fear); and,
g) Not presenting a balanced view to customers when describing products or services but only highlighting benefits.

As above we expect all member firms to apply TCF principles across their businesses. To minimise the risks of misselling we expect firms to:

a) Present a balanced view of products or services to customers in all circumstances, clearly identifying potential risks as well as benefits;
b) Have strong first line controls in place to prevent misselling;
c) Consider which customer sets different products may be suitable for and assess the risks of individual products or services to different types of customers. This is particularly important for more complex strategies such as layered hedging approaches which may not be suitable for all customers and require strong cash management disciplines and an ability to sustain average market moves over the longer term;
d) Have adequate controls in place to ensure that customers are not overhedging and/or speculating in the market. This requires an understanding of the customers' underlying business and rationale for the transactions they are booking. The firm should assess whether there may be any reason for a material change in the customer's circumstances that may result in a change in currency need (change in supplier, potential change in sales volumes etc) prior to any sale of forwards;
e) Ensure a clear policy is in place and training provided to differentiate between regulated and unregulated forwards;
f) Ensure that they are not intentionally or unintentionally selling regulated products to customers. The nature of the MiFID exclusion requires contracts to be booked where there is an underlying good or service, if a customer wishes to put in place a hedging strategy that allows alteration to contracts for profit then he will be booking an investment product. We expect member firms to have controls in place to identify clients who may be using their service to purchase regulated forwards, for example, identifying clients who have repeatedly closed out a forward contract for profit
g) Have in place proportionate oversight and monitoring of all distribution channels.
h) Ensure staff do not provide customers with advice on rates. There is a significant difference between giving customers information on expected market movements with relevant caveats and telling customers whether a particular rate will be achieved in a certain timeframe. Customers should never be encouraged to trade through fear of rate movement and should be provided a balanced view; and,
i) Have formal MI and monitoring programmes in place to assess the risk of misselling.

Distribution Channels

Foreign exchange providers use a wide range of distribution and referral channels including:

- Digital and mobile (online / mobile app etc)
- Telephone (direct sales)
- Referral brokers / partners (referral only solutions where partner businesses refer customers for a fee or commission, these customers become the direct customers of the authorised firm)
- White labels (as referral brokers /partners whereby the customer is a direct customer of the authorised firm but the service is given the appearance, through branding, of being a service offered directly by the referring partner)
- FX brokers (unauthorised firms or individuals offering FX services directly to customers but linking to the services of a principal e-money or payment institution to provide payment services)
- Aggregators / comparison sites (where the customer is passed directly to the underlying payment service provider)

Firms should ensure that the risks of these channels are formally assessed and appropriately mitigated. The highest risks present themselves where the relationship with the client is not directly held by the authorised payment services firm (FX broker model). Risks include:

- Confusion for the customer about who is providing the service and their credentials (e.g. promoting themselves based on the principal's credentials, amounts transacted, length of operation etc as opposed to disclosing their own size and length of operation);
- Conflict of interest where the broker is paid on a commission basis;
- Due to unauthorised status, a lack of protection for customers and lack of adherence to industry standards;
- Lack of transparency about who is providing the underlying services; and,
- Poor disclosure to customers.

It is essential that, where allowing unregulated FX brokers to piggy back off a firm's payments licence it is essential that the service provided by the broker and the licence holder are clearly described to the customer, especially those services which are regulated and those which are not. Where the distributor is also booking transactions on behalf of the customer, monitoring should be in place to ensure that the broker meets industry and firm standards and that the customer is given the same level of information as they would if they were a direct customer of the payment or

e-money institution. We expect member firms to conduct a documented independent audit of all such service providers on a regular basis.

AFEP has produced separate guidance on the use of Agents, Introductory Brokers, White Labels and Program Managers which should be read in conjunction with this guidance.

	Good practice	Poor practice
1	Product governance processes are in place and all products and services undergo an assessment including consideration of the customer groups they may be appropriate for and the risks they may present to the customer.	No product governance processes are in place and there are poor customer outcomes – e.g. Unsophisticated customers with low profit margins, poor cash flow forecasting and a need to meet a minimum budget rate are sold layered hedging solutions.
2	Staff are well trained to ensure that they fully understand customer requirements and underlying transactions. This is supported by second line monitoring.	No controls are in place to ensure customers aren't placing speculative trades and customers regularly close out forward trades for profit.
3	Firms have full oversight and control of all distribution channels to ensure they meet internal standards.	Firm allows unregulated FX firms to sell to customers using its licence without ensuring adequate controls are in place to monitor activity and ensure the firm's own standards are adhered to by such third parties. In addition it is not clear to customers who they are dealing with as the unregulated brokers use the statistics of the payment service provider to advertise their services.

A4. Other

a. <u>Unfair contract terms</u>

We expect member firms to have controls in place to ensure that terms in consumer contracts are clear and fair. Examples of terms that would be considered potentially unfair are those that:

a) charge the consumer a large sum of money or an amount that goes beyond what would be considered a reasonable pre-estimate of loss incurred by the firm, if a consumer doesn't fulfil their obligations under the contract or cancels the contract
b) require a consumer to fulfil all their contractual obligations, while letting the firm avoid its own
c) allow a firm to change the price payable under the contract after a consumer has agreed to the conditions in the contract
d) bind consumers to hidden terms
e) limit a firm's obligation to honour its agents' commitments to the consumer
f) allow the firm to transfer its rights and obligations under the contract, where this may reduce guarantees for the consumer, without the consumer's agreement
g) mislead the consumer about the contract or their legal rights
h) exclude or limit the consumer's legal rights or remedies when the firm has failed to meet its obligations under the contract

Firms should have regard to Schedule 2 of the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs) and of the Consumer Rights Act 2015 (CRA), as these Schedules contain an indicative and non-exhaustive list of types of terms in consumer contracts that may be regarded as unfair. We would also signpost firms to the FCA's library of unfair terms.

b. <u>Identification and treatment of vulnerable customers</u>

A vulnerable customer is defined by the FCA as someone who, due to their personal circumstances, is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care.

Vulnerability can come in a range of guises, and can be temporary, sporadic or permanent in nature. It is a fluid state that needs a flexible, tailored response from firms. Many people in vulnerable situations would not diagnose themselves as 'vulnerable'.

Vulnerability is not just to do with the situation of the consumer. It can be caused or exacerbated by the actions or processes of firms. The impact of vulnerability is strong, and many people are trying to cope with difficult situations and limited resources, energy and time. Stress can affect state of mind and the ability to manage effectively.

Examples of risk factors for vulnerability include:

- low literacy, numeracy and financial capability skills
- physical disability
- severe or long-term illness
- mental health problems
- low income and/or debt
- caring responsibilities (including operating a power of attorney)
- being 'older old' for example over 80, although this is not absolute (may be associated with cognitive or dexterity impairment, sensory impairments such as hearing or sight, onset of ill-health, not being comfortable with new technology)
- being young (associated with less experience)
- change in circumstances (e.g. job loss, bereavement, divorce)
- lack of English language skills
- non-standard requirements or credit history (e.g. armed forces personnel returning from abroad, ex-offenders; care-home leavers, recent immigrants)

Vulnerability should equally not be ignored for corporate customers. The decision maker may be vulnerable due to personal circumstances or issues affecting the company.

The FCA continues to focus on the treatment of vulnerable customers. Its occasional paper, published in 2015 highlighted the following issues relevant to our industry:

Policy

- Many firms lack an overarching strategy or policy on consumer vulnerability.
- Policies designed to prevent financial abuse and fraud can inhibit staff empowerment to use discretion, particularly regarding legitimate access by third parties.

Systems

- Failure of internal systems, where firms fail to communicate and connect information internally. For example, this can lead to customers having to tell firms multiple times of bereavement.
- Interfaces or channels of communication that are not inclusive.
- Increasing automation and use of call centres may create challenges in spotting potential vulnerability and ensuring customers are referred on to specialist teams where necessary.

Products

- Inflexible products and services that are designed for a standardised perfect customer and do not factor real-life events into their design. Some customers who face a change in circumstances are therefore not able to receive a flexible, tailored response.
- Product and information complexity and confusing communications.
- Lack of suitable affordable products for people in some non-standard situations.
- Lack of solutions for temporary delegation (enabling a family member or carer to manage your affairs for a short time) which retain privacy and safety.

Implementation

- Policy/practice gap at firms, where frontline staff are not aware of or do not implement policies. Frontline staff may not refer people on to specialist individuals or teams.
- Consumer time is not valued highly and many people give up if the process is too time consuming, especially if they are in a stressful situation with other demands on their time.
- Inconsistent approach around flexible temporary forbearance.
- Arrangements around temporary delegation (enabling a family member or carer to manage your affairs for a short time) and accompaniment (sitting in or helping with a phone call or interview) not sufficiently developed and flexible to enable family and carers to help.
- Inappropriate selling and sales practices which exploit behavioural biases.
- Issues around disclosure of a vulnerability and data protection – inaccurate or overzealous application creates unnecessary problems.

We expect member firms to:

a) Have in place a high-level policy on consumer vulnerability and ensure that all relevant staff receive appropriate training;
b) Conduct reviews and ongoing evaluation of the effectiveness of vulnerability strategies in place;
c) Consider what flexibility may be appropriate in the application of terms and conditions when faced with a vulnerable client and have a clearly documented process to approve such changes;
d) Signpost staff to a specialist team or individual who can support them in how to deal with a vulnerable customer;
e) Have strong policies and practices in place to handle disclosure or meet communication needs of vulnerable customers; and,
f) Ensure that policies around data protection and affordability of products are based on correct understanding and do not create problem for vulnerable customers.

c. Provision of Information to customers

Please refer to AFEP's guidance on Customer Communications.

d. Handling of complaints

The rules for handling complaints from eligible complainants are set out in DISP (the Dispute Resolution: Complaints sourcebook in the FCA handbook). The rules within DISP differ depending on whether the complaint is a PSD/EMD complaint or not. The rules for handling PSD/EMD complaints from non-eligible complainants are set out in regulation 101 of the PSRs.

We expect all member firms to meet the requirements of DISP and the PSRs and to have controls in place to monitor that such requirements are being met. In addition, we expect action to be taken to address the route cause of complaints and for management information to be provided to the firm's governing body.

	Good practice	Poor practice
1	Contracts with customers are clear, fair and not misleading. Customer outcomes are in line with expectations and there are mechanisms in place to identify and address unfair terms.	Contracts include hidden or unfair terms which mislead customers or limit their legal rights.
2	Firm has in place clear policies to address customer vulnerability, training is regularly given to staff and the firm conducts reviews to evaluate the effectiveness of its policies on an ongoing basis.	No clear policy is in place on vulnerability and inadequate training is given to staff.

PART B – CONFLICTS OF INTEREST

B1. Introduction

Principle 8 states that "a firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.

A conflict of interest is a set of circumstances that creates a risk that professional judgement or actions regarding a primary interest will be unduly influenced by a secondary interest.

Contexts in which conflicts may arise include, but are not limited to: situations where personal or firm interests may conflict with those of a customer or other stakeholder, or where such a conflict arises for the firm because the interests of one customer may conflict with those of another; personal relationships; gifts and corporate entertainment; and Personal Dealing.

Firms should put in place appropriate and effective arrangements to eliminate or manage conflicts of interest.
This could include:

- segregation of duties and/or reporting lines;
- establishing information barriers (for example, physical segregation of certain departments and/or electronic segregation);
- implementation of a confidentiality matrix;
- altering the duties of personnel when such duties are likely to give rise to conflicts of interest;
- providing training to relevant personnel to enable them to identify and handle conflicts of interest;
- establishing declaration policies and/or records for identified conflicts of interest and personal relationships, as well as for gifts and corporate entertainment received; and,
- having policies and controls on Personal Dealing.

Where it is concluded that a specific conflict of interest cannot reasonably be avoided or effectively managed (including by ceasing to undertake the relevant service or activity), Market Participants should disclose sufficient details of the conflict to enable the affected parties to decide beforehand whether or not they wish to proceed with the transaction or service.

The primary expectations is that all firms will;

- Identify conflicts of interest;
- Manage conflicts of interest;
- Establish and maintain a policy;
- Disclose conflicts;
- Keep records of conflicts;

As a minimum, all firms should be able to demonstrate that they have the following:

a) Documented policies and procedures
b) Top-level commitment and senior oversight
c) Conflict of interest Risk assessment
d) Training
e) Due diligence of third parties
f) Monitoring and review

The following sections contain more detailed guidance on key areas of conflict risk for member firms:

B2. Anti bribery and corruption

The UK bribery Act 2010 came into effect on 1 July 2011 to take a tougher stance on bribery and corruption, enabling prosecutors and courts to respond more effectively to such criminal conduct home and abroad. We expect all member firms to have procedures in place, proportionate to the risks they face.

Key considerations

a) Organisations will be criminally liable if anyone "associated" makes a bribe in the conduct of business;
b) Associations include relationships with inter alia employees, agents, intermediaries, franchisors, suppliers and distributors etc.;
c) Strict liability offence - the only defence the organisation will have is to show that it had "adequate procedures" in place to prevent bribery;
d) Company directors could be personally liable, having implications on professional indemnity insurance;
e) Facilitation payments and/or kickbacks are not allowed where the intention is to induce improper conduct; (Facilitation payments, also known as "back-handers" or "grease payments", are typically small, unofficial payments made to secure or expedite a routine or necessary action (for example by a government official), kickbacks are typically payments made in return for a business favour or advantage); and,
f) Corporate hospitality has come under more scrutiny.

a. Gifts and Entertainments

All firms should have a clear gifts and entertainments policy in place and monitor adherence to it. Policies and procedures should ensure that Gifts or Entertainment offered or accepted must:

a) Be reasonable in cost, quantity and frequency;
b) Not involve activities, products, services or venues that might embarrass, or that might be considered of bad taste;
c) Comply with applicable written laws;
d) Be ordinary and customary in the context of industry standards;
e) Not create conflicts of interest with duties owed to customers, suppliers or other stakeholders; and,
f) Be transparent. No gifts or entertainment should be given if there is reason to believe that the recipient will attempt to conceal it

Reasonable and appropriate hospitality or entertainment given to or received from third parties is acceptable for the purposes of establishing or maintaining good business relationships and marketing or presenting products and/or services effectively.

We would expect member firms to ensure that the following apply to any gift or entertainment offered:

a) it is not made with the intention of influencing a third party to obtain or retain business or a business advantage, or to reward the provision or retention of business or a business advantage, or in explicit or implicit exchange for favours or benefits;
b) it is not known or suspected that the gift or entertainment is offered with the expectation that it will provide a business advantage for anyone in return;
c) it is not made during any commercial negotiations or tender process, if this could be perceived as intended or likely to influence the outcome;
d) it is not unduly lavish or extravagant under the circumstances;
e) it is not offered to or accepted from government officials or representative, or politicians or political parties which may constitute a bribe;
f) it is given in the company's name, not in the name of an individual;
g) it does not include cash or a cash equivalent (such as gift certificates or vouchers);
h) it is appropriate in the circumstances, taking account of the reason for the gift, its timing and value. For example, in the UK it is customary for small gifts to be given at Christmas;
i) it is given openly, not secretly; and,
j) it does not impair the firm's ability to act fairly and honestly; and
k) it complies with any applicable local law

Promotion gifts of low value such as branded stationary to or from existing customers, suppliers and business partners will usually be considered acceptable.

Reimbursing a third party's expenses or accepting an offer to reimburse firm expenses (for example, the costs of attending a business meeting) would not usually amount to bribery. However, a payment in excess of genuine and reasonable business expenses (such as the cost of an extended hotel stay) would not be considered acceptable.

We appreciate that practice varies between countries and regions and what may be normal and acceptable in one region may not be in another. The test to be applied is whether in all the circumstances the gift, hospitality or payment is reasonable and justifiable. The intention behind it should always be considered.

b. Donations

Member firms are expected to only make political / charitable donations that are legal and ethical under local laws and practices. There should be a process to approve and document all such donations.

c. Record-keeping

Firms must keep records and have appropriate internal controls in place which will accurately record all gifts, entertainment and donations. This should enable the firm to evidence the business reason for such.

In addition, firms are expected to provide Management information to senior management on gifts and entertainment to enable proper oversight and control.

d. Agents, representatives, intermediaries and other third parties

Firms are reminded that they could be held criminally liable for the acts of agents, representatives and other intermediaries who are involved in bribery when they are acting on the firm's behalf. Before engaging a third-party firms should consider whether the use of such a person is necessary; whether the proposed person is appropriate for the role (including by reference to their expertise and any possible conflict of interest); and whether the proposed remuneration is appropriate.

Firms are responsible for ensuring that expectations in this regard are communicated to and followed by such persons/entities, and that appropriate contractual protections and safeguards are in place where necessary (e.g. standard Anti-bribery wording is incorporated into all contracts and agreements).

Thorough due diligence should be undertaken before engaging any agent, representative or intermediary, which may include commissioning third-party risk assessments in high-risk areas. In particular you should find out who they are (including details of the ultimate owners of any company); what their business history is (including whether there has ever been any allegation or report of their involvement in any wrongful business conduct); and for whom they have previously worked. Appropriate references must always be obtained.

Commission and/or other payments to any agents, representatives or intermediaries under an approved intermediary (or equivalent) agreement must be properly recorded, approved and paid in accordance with the agreement and any other legal requirements. We would expect that all payments to an agent, representative or intermediary be made by direct bank transfer (not to any third party) into the country in which the agent, representative or intermediary has its principal place of business or performs substantial services on behalf of the firm.

AFEP has issued separate guidance on the use of Agents and other 3rd party introducers and it is important that members refer to this.

Case Study – Brand Rex

On 25 September 2015, the Civil Recovery Unit in Scotland recovered £212,800 from Brand-Rex Limited ("Brand-Rex") under an agreed civil settlement, after Brand-Rex self-reported the fact that it had benefited from unlawful conduct by a third party.

Brand-Rex develops cabling solutions for network infrastructure and industrial applications. Between 2008 and 2012, it operated an incentive scheme which offered UK distributors and installers rewards, including foreign holidays, for achieving varying levels of sales targets.

This scheme was not unlawful. However, one of Brand-Rex's independent installers (an "associated person" for the purposes of section 7 of the Act) gave travel tickets earned by him under the scheme to an employee of one of his customers; that employee was in a position to influence purchasing decisions in relation to cabling. Staff from this company and individuals connected to them used these tickets for foreign holidays in 2012 and 2013.

Brand-Rex became aware of the issue and engaged external solicitors and forensic accountants to investigate. As a result, in June 2015, Brand-Rex self-reported the matter to the authorities, accepting responsibility for its failure to prevent bribery by an associated person under section 7 of the Act. The civil settlement was calculated based on the gross profit made by Brand-Rex as a result of the misuse of the incentive scheme. Going forward, the company agreed to enhance its anti-bribery and corruption ("ABC") policies and procedures and to engage in an appropriate ABC training programme.

It should be noted that civil recovery proceedings can be instigated against any 'innocent' party that comes into possession of the proceeds of unlawful conduct by another. However, where a party has come into possession of assets or funds (e.g. profits or dividends) which it knows or suspects are the proceeds of crime, it can be prosecuted under the money laundering provisions of the Proceeds of Crime Act 2002.

This case highlights the risks that companies face under section 7 if they do not maintain adequate procedures to prevent bribery by associated persons. Brand-Rex reportedly had ABC policies and procedures in place but did not attempt to assert that they were "adequate"; had it been able to do so successfully, the company would have had a complete defence to a charge under section 7, thereby eliminating any risk of criminal sanction. The case also highlights the benefits of undertaking a full internal investigation into alleged wrongdoing and making a prompt self-report to the appropriate authorities, which was inevitably a major factor in avoiding criminal charges.

B3. Best execution

Member firms act as a principal taking on one or more risks in connection with an order, including market and credit risk. Where the acceptance of an order grants the principal executing the order some discretion, it should exercise this discretion reasonably, fairly, and in such a way that is not designed or intended to disadvantage the customer.

Key risks:

a) Customers do not understand the role of the firm as principal in the transaction
b) Customers are charged a higher cost due to a firm's internal processes. Firms often use the pricing offered by their professional counterparties to obtain a price for the customer. In certain circumstances firms may choose to use a more expensive counterparty in order to balance their book or spread the risk across multiple counterparties. In this instance there is a risk that the customer is charged a higher price purely to meet the preference of the firm.
c) Consumers are not informed of the margin applied on orders and therefore the rate at which the order will fill. For example, a customer wants to purchase USD at a rate of 1.30, the firm is charging an undisclosed margin of 1% which means the order will not fill until a rate of 1.313 is achieved. Should the market reach 1.31 the customer may be under the misapprehension that the order has filled.
d) Firms may try to increase their margin on an order in a rising market resulting in failure to fill an order and significant detriment to a customer or financial loss to the firm. Taking the example above, a firm sees that the market is rising and wishes to exceed the margin of 1% so waits to fill the order, the market moves to 1.3150 and then quickly declines below 1.30 without the firm placing an order.

Where acting as principal firms are expected to disclose the terms and conditions under which the principal will interact with the customer, which might include:

- that the principal acts on its own behalf as a counterparty to the customer;
- how the principal will communicate and transact in relation to requests for quotes, requests for indicative prices, discussion or placement of orders, and all other expressions of interest that may lead to the execution of transactions.

In addition, member firms are expected to:

- establish a transparent order execution policy that should supply information relevant to the order and ensure that customers are fairly treated
- be transparent with the customer about their terms and conditions, which clearly set out fees and commissions applicable throughout the time of the agreement
- Where a customer is a consumer they must be informed of the rate at which a market order will fill in addition to the rate that the customer will achieve

	Good practice	Poor practice
1	Firms ensure that customers clearly understand the firm's role in any transaction or order.	Customers are not given clear information and are not clear about the role of the firm in a transaction.
2	When orders are placed customers are aware of the rate at which an order will fill as well as the rate they will achieve.	Customers are not informed of the margin applied on orders and therefore cannot determine whether their order should have filled. A firm "runs" positions to try and increase profit at the risk of the customer.
3.	Firms have a clear order execution policy in place which ensures that a customer is fairly treated and does not suffer detriment due to internal decisions of the firm.	There is no clear policy in place. Customers may be adversely impacted by the firm's internal choice of counterparty.

B4. Remuneration

AFEP recognises that firms want to incentivise their staff to sell and that therefore incentive schemes are a necessary part of a firm's reward policy and AFEP has issued separate guidance on this which members should refer to.

There is considerable evidence to demonstrate that the way staff are paid influences their behaviour and hence has an impact on customers and it is imperative that incentive schemes should not be at the customer's expense and the risks must be properly managed. A firm must ensure that its remuneration policy is consistent with and promotes sound and effective risk management and includes measure to avoid conflicts of interest.

While inherently carrying a lower risk than investment products, unregulated FX products are still at risk of being missold. Risks to customers include:

a) Being left with more of a particular currency than is required (overhedged);
b) Not understanding the product, for example sales or dealing staff have not properly explained or omitted key information such as margin terms;
c) Being pressured to purchase (for example by informing them that the rate is likely to deteriorate, or they will not be offered the same spread if they don't book now);
d) Making personal recommendations for a non-advised sales process;
e) Misleading a customer about how sales staff are incentivised for individual product sales;
f) Hiding spreads or charges from customers in order to achieve more revenue; and,
g) Being left without the ability to use another provider as they have been encouraged to send their funds pre-trade and being offered a very uncompetitive price.

Key Risks in incentive schemes:

a) Incentive schemes encourage staff to missell to customers (for example leaving customers overhedged, applying disproportionate spreads or hedging too far out for a customer to be able to accurately forecast his requirements;
b) Firms failing to understand their own schemes due to high levels of complexity leaving them unable to assess the impact on behaviour or customers;
c) Schemes being open to manipulation or fraud by sales or dealing staff resulting in financial loss to firms and a culture of non-compliance;
d) Firms not having enough information about their incentive schemes to understand and manage the risks;
e) Firms relying too much on routine monitoring to address risk rather than taking account of the specific features of their incentive schemes;
f) Managers with clear conflicts of interest are not properly managed;
g) Qualitative measures built into incentive schemes are ineffective;
h) Where back office staff obtain bonus based on meeting financial targets there is a risk that they relax controls and take undue risk to support the business in meeting those targets (e.g permitting onboarding of clients outside of risk appetite, allowing suspicions transactions to proceed etc and;
i) Failure to do enough to control the risk of misselling in face-to-face situations; and,
j) The expectations below apply to all firms. Firms equally need to ensure that where they use an unregulated FX broker as a distribution channel the broker also has a suitable incentive scheme for its staff which adheres to this guidance.

We expect firms to:

a) Ensure that its Board adopt and annually reviews the general principles of the remuneration policy and is responsible for overseeing its implementation whether directly or via a Remuneration Committee;
b) Formally consider if their incentive schemes increase the risk of misselling and if so, how;
c) Review whether their governance and controls are adequate;
d) Where a recurring problem is identified, investigate, take action and pay redress where customers have suffered detriment;
e) While this guidance looks at financial incentives, we expect firms to manage the risks from sales targets and performance management which will also influence the behaviour of sales staff. Firms should ensure that risks from incentive schemes are not transferred to these areas; and,
f) In assessing the risks arising from the features of incentive schemes, firms should consider a wide range of misselling risks that may arise. They should consider factors such as type of product and method of distribution;
g) Ensure they are meeting the standards in the Remuneration and Intra Industry Moves Good Practice Guidance.

Examples of incentive scheme features that significantly increase the risk of misselling

We expect member firms to ensure that these features are not present in their incentive schemes:

a) Disproportionate rewards for marginal sales – reaching a certain target or goal that triggers an increase in earnings much higher than the normal rate at which incentives accrue. An example is a retrospective accelerator where passing a target increases the level of incentive earned for all sales over a period rather than those just above the target. Equally "first past the post schemes" or enhancing the following year's annual commissions if targets are met in the current year;
b) Accelerators (or stepped payments) where a higher rate of incentive is earned with higher volumes of sales where the higher rate only applies to sales over a target. This form of incentive creates increased risk as staff try to maximise their sales before the end of the incentive period;
c) Inappropriate incentive bias between products where there is an inappropriately larger incentive for one product compared with another whether suitable or not. Sales and dealing staff should be indifferent as to whether a customer books a spot or forward or enters into a longer-term series of layered hedges;
d) Variable salaries or very low basic salaries – incentive schemes which vary basic pay based on performance against sales targets in a set period. A reduction in basic pay or a very low level of basic pay may have a significant impact on an individual's ability to meet financial commitments and may reduce other employee benefits linked to pay and encourages sales or dealing staff to

e) push sales in order to earn industry acceptable salary . In addition, it may encourage inappropriate sales in order to earn an industry acceptable salary;
f) Inappropriate requirements to determine if incentives are paid. For example, incentive payments are accrued but will not be paid unless a minimum target is met which potentially leads to sales to meet quotas rather than meeting customer needs;
g) Thresholds – once staff achieve an certain threshold they get bonuses on each sale above the threshold.

Other incentive scheme features that increase the risk of misselling

While not prohibited these are generally considered poor practice and where used firms must ensure that they have fully considered and addressed the risk of harm to customers.

a) Competitions / promotions / mini incentives – campaigns or competitions designed to increase sales volumes or based on similar measures where staff can earn additional payments or win prizes. These can be product specific or simply based on general sales volume.
b) Incentives linked to type of product or length of term – for example, many firms offer higher incentives to sales teams for year 1 sales. This may lead to customers being persuaded to take out forwards for longer than is required or attempts to overhedge customers in year 1 if not appropriately managed.

Good practice

We expect members to introduce the following into their incentive schemes for sales and dealing staff:

a) Balanced scorecards – we expect all firms to have an incentive scheme where a bonus is not just based on volume of revenue but will include other measures that determine how much bonus is awarded. An example of the measures in a balanced scorecard approach might include: Revenue, sales quality results; customer satisfaction: complaints: customer retention etc. the element relating to revenue must not be the dominant factor in how the incentive is calculated. This means that a minimum of 50% of the incentive should not be linked to revenue but should be linked to salary or other non-revenue related amount;
b) Emphasis on quality: Bonus and incentive schemes need to reward quality or good compliance (selling the right way) with sufficient deterrent to penalise poor behaviour or misselling. Quality measures should reflect the fair treatment of customers and not just customer satisfaction. Deterrents will not work if the rewards for revenue are set at a much higher level;

c) Clawback – firms should have claw back arrangements where incentive payments already received by staff have to be repaid or offset against future incentives if they do not meet the required qualitative standards;
d) Limiting variable incentives – we would expect firms to ensure that variable incentive earnings are not disproportionate to basic salary and generally do not exceed a ratio of 2:1; Exceptions should be reported to, and reviewed by, the Board.
e) Deferral of incentive payments – we expect part of incentive payments to be deferred until the end of the year or longer. Qualification for payment of the deferred element should then be linked to ongoing sales quality results or other measures such as complaints; and,
f) Rolling target thresholds – where a firm has a threshold based on a minimum revenue before incentive payments begin to accrue, we would expect this to be based on a rolling average of sales made. For example, a threshold in a quarterly bonus scheme based on a minimum revenue averaged over a 12-month rolling period.

Guidance on managing the risks and governance of incentive schemes

Customers can lose out if firms do not have effective governance arrangements and controls to identify and manage the increased risk of mis-selling from features of their incentive schemes. Effective controls and governance should include:

a) robust risk-based business quality monitoring and adequate controls to mitigate the risk of inappropriate behaviour during sales conversations;
b) MI to identify, and act upon, trends or patterns in individual sales or dealing staff activity that could indicate an increased risk of mis-selling as a result of features in the incentive scheme. Using this MI to inform the approach to monitoring sale and dealing staff incentive risks;
c) proper management of managers' conflicts of interest;
d) effective oversight of incentive schemes by appropriate senior management and compliance, including approval of the incentive schemes; and
e) an effective risk identification and mitigation process, including regular reviews of incentive schemes and the effectiveness of controls, taking into account customers' interests.

B5. Business quality monitoring

Where incentive schemes increase the risk of mis-selling, we expect firms to take account of these increased risks in their approach to monitoring and when identifying sales cases for checking. Well-designed business quality monitoring (including call monitoring for telephone sales), carried out by competent staff, can be an effective control. However, this is unlikely to be sufficient on its own because

firms are likely to need a range of controls depending on the incentive scheme in place and the type of product or distribution method.

Staff undertaking business quality monitoring should be sufficiently independent of the sales function to avoid inappropriate influence by sales staff or managers. Firms should take appropriate action where issues are identified, for example, reviewing individual sales, re-training and undertaking follow-up monitoring to ensure issues are not recurring. Firms should also check if the issues identified indicate trends of mis-selling.

	Good practice	Poor practice
1.	Ensuring all risks are assessed and effective controls are in place to monitor. Keeping the scheme simple to ensure that the risks are understood.	Firm has not properly identified the risks posed by their incentive schemes to ensure effective controls are in place. Scheme is so complex that management does not understand it.
2.	Ensuring that at least 50% variable pay is linked to qualitative factors and is bonused based on salary as opposed to linked to revenue.	Material incentive schemes based on revenue. Sales quality has much less of an impact on staff incentives than the quantity sold.
3.	Ensuring a target ratio of 1:1 variable to fixed pay and maximum ratio of 2:1	High ratio of variable to fixed pay
4.	Eligibility for incentives and/or clawbacks are in place and enforced for poor sales quality, misselling or other behaviour falling outside the firm's policies and standards.	Poor quality sales or misselling are not adequately reflected in the eligibility for, or level of, incentive payments.
5.	Strong controls, including additional monitoring for higher performing staff and additional MI and monitoring around the features of incentive schemes that increase the risk to customers.	Firm relies too much on routine business quality monitoring to mitigate the risks created by their incentive schemes. Also, firms were not always collecting or using appropriate management information (MI) effectively in these risky area
6.	Ensuring appropriate MI is available to management to ensure that risks are understood and managed.	Firm does not collect or use appropriate management information (MI) to understand or manage risk
7.	Manager incentive schemes are designed to encourage good customer outcomes across their teams.	Managers earn a bonus based on the volume of sales made by the staff they supervise creating a conflict of interest for managers who also play a role in checking the sales of their staff.
8.	Strong controls to actively identify inappropriate behaviour by sales staff during face-to-face sales conversations. This may include contacting a sample of customers shortly after compeing a sale, recording face to face sales conversations for later review or additional scrutiny of high-performing sales staff or those with unusual trends.	Firm with face-to-face sales staff fails to fully considered the risks of poor sales conversations, including leaving out important information or pressuring customers, and the specific controls that might reasonably be needed to monitor staff behaviours, including what is actually being said to customers.
9.	Strong governance arrangements around the design and sign-off of incentive schemes.	Inadequate governance and oversight of the design, approval and review of incentive schemes, with risks not identified, assessed or adequately mitigated. Senior management agree to incentive schemes without sufficiently understanding the risks that could arise

10.	Taking strong action when quality of sales is poor. Depending on the seriousness of the breach this may mean the sales person could be removed from the incentive scheme immediately. Lesser failures lead to deductions in bonus payments depending on how serious and frequent the problem is.	Sanctions not applied or not having a material impact, for example, staff remaining part of the bonus scheme even when quality standards are not met.

B6. Personal account dealing

All firms should have in place a policy relating to personal account dealing and should monitor activity. While our member firms do not allow clients to trade speculatively we are aware that certain members of staff may do so through appropriately authorised investment firms. If firms allow staff to do so during work hours there is a risk of detriment to customers. For example, in a declining market a member of staff may prioritise his own trade before executing a transaction for a client. Equally speculative trading can present a significant risk and therefore firms should consider their duty of care to employees when formulating policy.