

Conflicts of interest in mutual fund companies

Summary

Finansinspektionen (FI) has conducted an investigation into conflicts of interest in mutual fund companies. The purpose of the survey was to identify, review and analyze potential conflicts of interest in mutual fund companies and the companies' management of such.

In the survey, FI identified a number of potential and actual conflicts of interest in mutual fund companies. While FI assesses that some of the identified conflicts of interest are handled in a satisfactory manner, this is not the case for all. FI's investigation produced the following findings:

- The majority of mutual fund companies place a disproportionately high number of securities transactions with the closely related company. FI assesses that some of the fund companies display shortcomings in their procedures for managing conflicts of interest pertaining to securities trading on behalf of the mutual funds. In view of the above, FI cannot rule out the possibility that Group interests have influenced the fund companies' choice of brokers and that the unitholders' interests have been neglected.
- Some mutual fund companies have bonus programs that by design may potentially disadvantage unitholders.
- Examples of mutual fund companies in which the president holds employment or other appointments that may entail conflicts of interest.
- Several of the mutual fund companies do not ensure that securities loans are issued on market terms. One mutual fund company has never demanded collateral when loaning securities to the closely related company.
- Several of the mutual fund companies lack routines and instructions for the execution of block orders, i.e. trading on account of several funds.
- "Soft commission" agreements exist in several of the fund companies. FI does not deem soft commission to be in the best interests of unitholders.

In view of the above, FI proposes the following measures:

- Mutual fund companies must have a documented procedure for selecting brokers for securities trading. This must be followed up by the Board on a continual basis.
- Mutual fund companies should disclose information about the structure of bonus programs for asset managers, analysts and senior executives. FI intends to take a closer look at the information issue in the autumn of 2004 and to introduce proposals at a later date regarding possible regulation in this respect.
- The president should in principle solely be employed in the mutual fund company and should not have other assignments, functions and appointments in any other company that may give rise to a conflict of interest. When evaluating new presidents, FI will uphold the above principle and will be restrictive in its assessment of which other assignments, functions and appointments may be accepted.

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- The issue of securities loans is to be subject to continual evaluation and monitoring to ensure market terms for unitholders.
- Mutual fund companies must have clear instructions and procedures for processing block orders and must continually follow up that these instructions and procedures are adhered to. Instructions for processing block orders should include the following:
 - The allocation between funds must be clear before the order is placed.
 - Principles for allocation and pricing, such as by fund size and average NAV.
- FI will perform a more in-depth analysis of “soft commission” and will continue to pursue the issue through a dialog with industry players to investigate the need for possible future regulation to strengthen consumer protection.

In addition, FI believes that the Board has a central role in ensuring that the best interests of the unitholders are taken into account. FI therefore intends to further investigate the matter of Board composition in mutual fund companies in the autumn of 2004.