The University of Hong Kong

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Interview with Thompson Reuters

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Of concern to attendees at the inaugural Compliance Conversation were the compliance challenges facing banking and financial institutions, and how best to respond to regulatory requests. Dione Schick, regional compliance services director at Thomson Reuters Governance, Risk and Compliance, moderated the event. Subject matter specialists in attendance included Dr. Bryane Michael, a visiting fellow at the University of Hong Kong’s Faculty of Law; Alan Ewins, head of the Asian regulatory practice at law firm Allen & Overy; David Nutman, head of Asian compliance for Prudential Corporation Asia; Grant Harbrecht, managing director and head of Asia Pacific compliance for Bank of America Merrill Lynch; and Louis Chow, managing director and head of Hong Kong compliance at Daiwa Capital.

Dione Schick: What are your compliance priorities for the rest of the year?

Grant Harbrecht: We’ve been focusing on monitoring and testing. We’ve stepped up testing routines and reviews of trading controls.

However, I would be remiss to not mention AML [anti-money laundering] and anticorruption. We’ve got a global program that follows, subject to regional requirements. In Asia developing countries, we focus on anticorruption, especially consulting fees and the use of finders.

Alan Ewins: We’re dealing with multiple regulations in Asia – at the local (domestic), regional and international level. For example, locally in Hong Kong there’s a massive bulk of regulations in or coming in, including on IPO sponsors and PSI (price-sensitive information) disclosures. Overlay that with keeping an eye on Singaporean developments, and the international extraterritorial aspects of the Dodd-Frank Act, UK Bribery Act, Basel III, the Foreign Corrupt Practices Act, and the Foreign Account Tax Compliance Act. It creates a huge compliance challenge because it’s an information overload which dominates the compliance agenda.

Another compliance priority is in relation to management of regulatory enforcement.

Regulators are increasingly aggressive and we have a large number of enforcement actions we’re dealing with concerning for example senior management at financial institutions and how far they knew what was being sold and done. It’s not just the big issues, but also some fairly humdrum day-to-day issues, which, although they’re certainly important, are not in the same league as other matters.

Another thing we’ve noticed is that the regulators’ requests are so much broader these days. Previously, regulatory queries were tighter and more specific. Now it feels like much more of a fishing expedition and it causes difficulties in complying with such notices given the need to divine the underlying thrust of the requests to allow a smoother response.

DS: I recently listened to Mary Shapiro’s [chair of the U.S. Securities and Exchange Commission] thoughts on the whistle-blowing provisions of the Dodd-Frank Act in a nine-minute piece on YouTube. She openly said: ‘We are going to leverage on the staff of these companies to
Compliance, accounting and legal professionals recently gathered (March 30, 2012) at the Mandarin Oriental in Hong Kong for a roundtable discussion. They shared their thoughts on the impact of more foreign financial regulation on Asian shores and the state of regional regulatory enforcement.

help us do our jobs because we don’t have the resources or staff, so we want your (institutions’) staff to help our staff in investigations — it’s shorter and more effective.’ We all know that costs are being pushed onto organizations, making them pay for investigations, but I hadn’t seen or heard it stated that clearly before.

Bryane Michael: That’s true, regulatory investigations are pushing the amount of work done away from regulators and on to companies. Regulators are basically saying — ‘we want banks to do our jobs for us, especially since you can pay for it as opposed to taxpayers.’

DS: Is there too much financial regulation in Asia?

Louis Chow: No, not too much — there’s more to come. But it does seem that Hong Kong regulators have gotten more aggressive just based on recent court cases.

GH: The easy answer is, yes, there’s too much. It’s easier in the securities area because it’s very prescriptive. In banking, it’s tougher. In the United States, for example, regulators are not going to define for you what’s high-risk — it’s up to you to define your risk profile and what documentation you’re going to keep.

AE: On a practical level, there’s a lot of reactive legislation — as we saw with the Lehman structured products (minibonds) case and the regulations released afterwards. It’s also interesting to see that the SFC has set up a risk assessment body to try to identify major issues coming down the track. I think that was a smart move, but whether it’s going to work is another matter — it may be seen as something of a double-edged sword for the regulators if something slips through.

For institutions grappling with client classification and customer suitability, there’s so much prescriptive regulation that, for example, for many of our private banking clients, it’s such a hassle to have all the professional investor documentation in order for SFC Code purposes and the annual monitoring checks, they’re throwing up their hands and saying that they are just going to treat everyone as retail customers. It’s a matter of careful calibration rather than quantity.

GH: In Asia, every country has its own regulations. It’s especially difficult for us because we deal with 12 separate jurisdictions with their own regulatory agendas, so you can’t regionalize all your compliance programs.

David Nutman: Asia definitely isn’t one place: It’s a conglomeration of national identities and national agendas — they all deal with things in their own way and at their own pace. In Asia, there are very different levels of development. While it’s in all our interests to improve markets, it’s important that the pace of [regulatory] change be appropriate to the marketplace.

BM: It’s not a matter of whether there’s too much or too little, but what is the right regulation? In discussions of Dodd-Frank, one criticism is that there hasn’t been enough regulation to provide guidance for this new legislative instrument. And we see a lot of that, particularly...
in emerging markets – where there’s regulation being pushed on them from the United States and EU, but there’s not enough guidance so banks don’t know what they can or can’t do. Yet, that creates a gap with customers. The banks are essentially saying: ‘Well, we don’t want to listen to them [customers], because we don’t know if it’s legal and don’t want to get into trouble.’ And so, I think in some areas there’s not enough regulation, in some areas there’s help in terms of figuring out how the business models and sectors fit into the regime. That’s something that needs to be addressed sooner rather than later.

CH: Agreed, especially in the private banking space, issues surrounding (customer) suitability and selling practices are critical. Everyone needs to understand that in some cases it is regulation by enforcement and you have to be aware of all recent cases and enforcement actions.

LC: That’s not exactly how it works in Hong Kong, although people think the HKMA are learning.

DN: In general, we (the financial sector) have an opportunity to share our concerns and be listened to by regulators in Asia. We need to learn from other regimes. Just following what happens in other parts of the world is not necessarily the best for Asia.

excessive regulation, so I think we need the ‘right-sized’ regulation.

DS: In terms of regulatory reform, where’s the greatest risk from a regulatory and enforcement perspective?

DN: I would argue that, broadly speaking, the biggest compliance challenges and prosecutorial risks come from the internationalization of regulation.

AE: Probably the main areas are product offerings, licensing and corporate governance, along with market misconduct and insider dealing, all of which are consistent with the SFC’s stated areas of focus.

Locally in Hong Kong, you’ve got retail, private and corporate banking and institutional professional investors. To deal with them, you’ve got regulations and codes, and all the other regulatory paraphernalia designed from a different perspective, which often doesn’t

AE: It’s also important to ensure there’s not too much reliance on regulation by footnote, i.e., where regulators’ expectations go beyond the legislation, the subsidiary legislation or even the codes, into letters and press releases. That creates a risk in the system as regards keeping regulations and regulatory policies and treatment consistent among regulators across the financial services industry. In turn, that makes compliance more challenging, piecing together the black and white of the regulations with the broader context of FAQs, press releases, etc.

For regulators, the attraction is that it’s more straightforward to regulate to an extent in this way because they can directly and quickly react to events flexibly and influence market behavior. The flip side of course is potential uncertainty.

GH: That underscores the importance of a consistent dialogue [between financial institutions and regulators] for that very reason.

AE: Also, with things like electronic trading, the regulators are clearly struggling with that. They’re carrying out consultations with the banks, but it’s more an information gathering exercise at this stage than ‘we’re going to tell you how we’re going to regulate the market.’ In any event, the market evolves regardless of what regulators want to do and they’re always a step behind. It’s reasonable that they’re trying to figure out how electronic trading will affect places like Hong Kong, but doomed to failure because by the time new rules are rolled out into the market, new strategies and approaches will have emerged: an ongoing dilemma for regulators, hence their desire for the flexibility that we talked about earlier. Not surprisingly, regulators believe they need to put in new rules to cover off a perceived risk, but that approach itself creates risks if they get it wrong.
DS: So, you eradicate one risk and create three more?
AE: Exactly right. Of course, everything’s a risk because another risk of course is not doing anything.
BM: The issue of cross-border liability is also worrisome. If you have an international wirehouse with a branch in Mozambique and they use it to get client funds, to what extent can compliance officers be not meant to be policemen – we’re business enablers. Compliance managers protect an institution’s brand and add to the bottom line in doing so; we keep them [institutions] honest and add value by preventing problems from occurring. Everyone talks about fostering a ‘compliance culture,’ but I would love it if someone defined for me what that means in one or two sentences.

the whole firm be held liable for the activities of one person operating in a jurisdiction? Additionally, there are customer concerns – either in cross-border transactions or the same jurisdiction. In recent years, we’ve all seen increases in the amount of information that financial institutions must collect on customers, transactions and intermediaries.

AE: I would add that for cross-border business activities, how you sell products and execute trades could land you in serious trouble with regulators. It has become much more commonplace that, as soon as a dispute has arisen in relation to a transaction, the aggrieved local counterparty complains to regulators, and even uses criminal legislation, including Interpol notices, with a view to disrupting and heading off foreign institutions’ claims.

BM: Yet, the trend of regulatory risk is going to become worse – not better. To give an example, in February I was training prosecutors in a developing country. The whole point of the training was to get them to move away from prosecutions that responded to specific legal breaches like ‘we found that this corporation violated article 342.7 of the code.’ I wanted to move them away from thinking that way towards thinking of risk and designing a prosecutorial strategy that addressed particular risk in their financial system.

DS: So, once they found an area of particularly high risk, the idea was to design an investigation and prosecution in order to manage certain types of risk that were going on. In a sense, it’s as you say – prosecution by footnote; but the driver of that is risk-based enforcement.

AE: If that type of approach in the example is adopted more widely, it would seem to suggest an attitude of: ‘We’ve identified a risk and got our prosecution strategy together to deal with that risk – now we need to find a “victim” to use it on.’ That would seem the logical (and unwelcome) result of that example. This is an extreme version of outcomes-based regulation.

DN: What I try to say to my staff is a ‘back-to-basics’ approach because there’s so much [regulatory] change going on. Ultimately,

Everyone at this table might have a different view. Of course compliance is complicated, but if you follow basic principles of ethical behavior, you won’t be far away from what’s expected under the rules and regulations. Simply having a compliance department does not devolve an institution of its risks and responsibilities – that’s something they own and must manage.

Disclaimer: The above conversation is based on personal opinions and does not necessarily represent the participant’s company or that of Thomson Reuters.

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