Risk & regulatory outlook

Financial Services
January to July 2016
The Risk and Regulatory Outlook for 2016 is very much shaped by both the reform agendas of the Australian Government and local regulators, ASIC and APRA, and globally the G20 and the Financial Stability Board.

In this edition of the Risk and Regulatory Outlook, Deloitte considers changes recommended by the Financial Systems Inquiry, how the banking industry responds to scrutiny on conduct, responsible lending, best practice remediation, and risk culture and conduct.

We also focus on the Australian Deloitte Cyber Intelligence Centre that both monitors cyber threats and supports organisations in building cyber security, vigilance and resilience. We also consider regulatory reform from a regional and global perspective in our article on the Asia Pacific State of Play and carry a timeline of key international and APAC regulatory events in the centre spread.

Our work with the World Economic Forum on innovation and what this means to the future of financial services is another exciting and emerging area and we include insights into distributed ledger technology – also known as blockchain.

We include an article on sanctions compliance given the significant changes internationally in this space in 2015 and we outline why it is crucial today to apply a risk management lens to embed compliance as part of an organisations’ culture and management systems in our final article on risk driven compliance.

We do hope you will find this compendium of regulatory and risk issues both helpful and useful as you plan your business strategies in 2016 and FY17. We are also keen to discuss these matters with you and assist where we can in all these areas.

Kevin Nixon
Lead Partner,
Risk & Regulatory,
Financial Services

Tim Oldham
Lead Partner,
Risk & Regulatory
Banking

Sarah Woodhouse
Lead Partner,
Risk & Regulatory
Wealth Management
## Contents

- Financial System Inquiry – Shaping the future: the Government’s response 4
- Banking industry responds to scrutiny on conduct 8
- Conduct risk and behavioural insights 10
- Responsible lending 11
- Best practice remediation 13
- Risk culture and conduct 17
- Cyber resilience 19
- Global change, regional context: Asia Pacific regulatory themes for 2016 21
- World Economic Forum – the Future of Financial Services 23
- Sanctions compliance 26
- Risk driven compliance 29
- Footnotes 33
- Contact us 34
Financial System Inquiry – Shaping the future: the Government’s response

The Australian Government accepted nearly all the 44 recommendations in the final Murray Financial System Inquiry Report to create an ‘efficient, resilient and fair’ blueprint for the Australian financial system for the next decade and beyond. Kevin Nixon, Lead Partner Global Centre for Regulatory Strategy & Australia FSI Risk & Regulatory Leader considers the implications of the Government’s response, the global G20 changes, and projects a timeline for adoption and next steps.

The Government included several additional measures, and formally rejected one recommendation - prohibiting Self-Managed Super Funds (SMSFs) from borrowing to invest. There are no planned changes to the current regime on limited recourse borrowings by SMSFs, but the Council of Financial Regulators and the Australian Taxation Office have been tasked to monitor leverage in the sector and report in three years’ time.

Several initiatives aligned with the Inquiry’s recommendations before the formal response including:

- The 2014 Cyber Security Strategy
- Increases to mortgage risk weights
- Establishing ASIC’s financial adviser register and Digital Finance Advisory Committee
- Consultations to progress crowd-sourced equity funding, innovative disclosure and removing barriers to business set up and closure.

Capital requirements, TLAC and more…

More powers to ASIC, higher bank capital, and the review of competition in superannuation are all now formal government policy. The requirements around recapitalisation capacity in resolution, in line with ‘too-big-to-fail’ and total loss absorbing capacity (TLAC) rules for globally systemically important banks, which have also been announced all require consideration for local implementation.

Superannuation reforms and competition

The superannuation sector will likely face new criteria for determining default funds, a task given to the Productivity Commission to foster competition and better returns. Improving retirement income product choice, penalties for super fund directors who fail to act in the best interests of their members, and enshrining the objectives of the superannuation system into legislation are some of the other reforms the Government intends to implement. The Government re-confirmed its governance reform of superannuation, which means having a minimum of one third of trustee directors on boards being independent.

Competition is not only being considered in the superannuation space. By 2016 the Government intends to explicitly include competition in ASIC’s mandate and also begin a Productivity Commission review of competition in the financial system.
Payments
With regards to payments, the Government has announced it will legislate to ban excessive surcharge fees and has made the ACCC responsible for enforcing these rules. What is less clear is the Government’s approach to interchange fees, leaving it to the Payment Systems Board to identify policies to address current problems.

Actions to enhance consumer outcomes include the introduction of legislation requiring financial advisers to hold a degree, pass an exam, undertake continuous professional development, subscribe to a code of ethics and undertake a professional year. In seeking to better protect consumers from harmful financial products, the Government will give ASIC new product intervention powers and place a financial product design and distribution obligation on issuers and distributors.

Innovation
Innovation featured strongly in the Government’s response. Technology neutrality will be embedded in all future legislation and rule making, and existing legislation reviewed through this lens. The development of a national digital identity framework, a review on how best to access and use data, and a discussion paper on impact investment are other examples of future Government initiatives.

Timeline
The Government’s response to the Inquiry shows a clear determination to implement reforms. A timeline for adoption and next steps has been formulated with multiple work streams running through to the end of 2016 and beyond. While the high level policy has been determined, attention and debate will now turn to the detail, ensuring a continued robust policy debate through 2016 and beyond.
The Government’s timeline for adoption:

<table>
<thead>
<tr>
<th>Category</th>
<th>In progress/completed</th>
<th>By mid-2016</th>
<th>By end-2016</th>
<th>Beyond 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resilience measures</td>
<td>• Legislation to facilitate participation in international derivative markets and better protect client monies.</td>
<td>• Consultation on regulatory tools needed to manage any future financial crisis.</td>
<td>• APRA to take additional steps on capital ratios.</td>
<td>• APRA to take steps on TLAC and leverage ratios.</td>
</tr>
<tr>
<td>Super measures</td>
<td>• Legislation to improve governance &amp; transparency in superannuation</td>
<td>N/A</td>
<td>Legislation on the objectives of the super system</td>
<td>Legislation on director penalties</td>
</tr>
<tr>
<td>Innovation measures</td>
<td>• Consultation on legislation to support crowd-sourced equity funding</td>
<td>Legislation to ban excessive card surcharges and other e-payment consumer protection measures</td>
<td>Give legal effect to the Asian Region Funds Passport Initiative</td>
<td>Measures to rationalise life insurance and managed investment scheme legacy products</td>
</tr>
<tr>
<td>Consumer outcomes</td>
<td>• Measures to address the misalignment of incentives in life insurance.</td>
<td>Legislation to provide a professional standards framework for financial advisers</td>
<td>Legislation to give ASIC the power to ban individuals from managing financial firms</td>
<td>Consultation/legislation to enable innovative disclosure</td>
</tr>
<tr>
<td>Regulatory system</td>
<td>• Completion of ASIC capability review</td>
<td>Updated Statement of Expectations for APRA, ASIC and the Payments System Board</td>
<td>Competition introduced into ASIC’s mandate.</td>
<td>Review of ASIC’s enforcement regime</td>
</tr>
</tbody>
</table>

Banking industry responds to scrutiny on conduct

The banking industry has responded to recent intense scrutiny on conduct, culture and conflicts of interest with a package of measures aimed at improving trust and confidence. Prashanti Ravindra, Governance, Regulation and Conduct Advisory Director, examines the industry’s response.

Australia’s banks have committed to a package of measures designed to improve community trust and confidence in how banks carry out their business, which has been damaged in recent times. The six areas of commitment are:

1. **Review product sales commissions**
   - The industry will commission an independent review of product and sales commissions and product-based payments in order to remove or change remuneration structures that could lead to poor customer outcomes.
   - Banks will ensure they have overarching principles on remuneration and incentives to support good customer outcomes and sound banking practices.

2. **Improve outcomes for consumers when things go wrong**
   - Banks have committed to:
     - Establishing an independent customer advocate in each bank to help give retail and small business customers a voice in the complaints process and to assist escalate and resolve complaints.
     - Evaluating the creation of an industry-wide, mandatory last resort compensation scheme covering financial advisers. The scope of such a scheme is still subject to consideration.
     - Working with ASIC to expand ASIC’s current review of customer remediation programs to all financial advice and products.

3. **Increase whistleblower protection**
   - Whistleblowers have played a key role in shedding light on the conduct issues in the wealth management arm of banks, that have been in the spotlight. Recognising the difficult situation whistleblowers often find themselves in, banks have committed to standardising the protection of whistleblowers across banks, including providing independent support, and protection against financial disadvantage.

4. **Removing individuals from the industry for poor conduct**
   - In 2015 ASIC’s Financial Advisers Register was established and includes details of any disciplinary action taken by ASIC against an adviser. The banks will now extend this existing identification of adviser misconduct to an industry register covering any bank employee, including customer facing and non-customer facing roles. The details of the information on employee misconduct that will be publicly available, are still to be determined.
5. **Reviewing the Code of Banking Practice**
   - The review of the Code of Banking Practice will be brought forward to be completed by the end of 2016. Bringing forward the review should also bring forward the implementation of any recommendations aimed at improving outcomes for consumers.

6. **Supporting ASIC**
   - Banks likely to face the largest levies under the proposed industry funding model for ASIC, have expressed their support for this model.
   - They have also committed to work with ASIC to enhance the breach reporting framework in the Corporations Act.

The banks have appointed an independent third party to oversee their agreed action plan and have committed to making quarterly public reports on its progress. Banks also recognise the need to work with Government and ASIC, particularly where legislative or regulatory approval is required to give effect to their proposals.

These proposals go beyond other regulatory reforms (such as FOFA and the Financial Advice Register) and other recent initiatives by the industry. The effectiveness of these measures to build community trust, and to address poor conduct, culture and conflicts of interests will be in the detail, particularly for remuneration and incentive structures. It is this detail and the speed of implementation which will determine the success of the banking industry’s proposed action plan.
Conduct risk and behavioural insights

Even if we think we’re rational, research into decision-making indicates we are actually subject to a set of cognitive biases and judgements that mean we sometimes don’t act rationally. For example, we prefer the status quo and are therefore likely to select a default option, even if it isn’t necessarily the most rational choice. We are also more adverse to potential losses than seeking equivalent potential gains.

Popular understanding of these insights has risen through books such as *Nudge* and *Thinking, Fast and Slow*. To be clear, these insights don’t mean that we’re always irrational; they simply imply that in some circumstances we may make decisions that don’t appear objectively rational.

These behavioural insights have long influenced economic research. Now, they are starting to impact financial services regulation. Policy makers and regulators are incorporating behavioural insights and economics into their activities and regulatory settings. In 2013, the umbrella organisation for the world’s security regulators, the International Organisation of Securities Commissions or IOSCO, resolved to incorporate behavioural economics into its policy work. Domestically, the Australian Securities and Investments Commission (ASIC) has referred to the role of behavioural biases in its work.

In the immediate impact of these insights on financial regulation has been in how policy makers perceive financial consumers. While the 1997 Wallis Inquiry assumed that individuals were rational and able to make self-protecting decisions provided they had sufficient information, the 2014 Murray Inquiry recognises that behavioural biases limit the utility of disclosure as an investor protection measure.

No longer ‘caveat emptor’ i.e. ‘buyer beware’
If customers are less able to protect themselves with disclosure because they may still make poor decisions, then the policy logic is that financial service providers and regulators must take more responsibility to ensure customers are not harmed. For example, issuers could be obliged to better ensure their products are well designed and distributed (product governance), and regulators could be empowered to remove products from the market if they are unsafe for customers (product intervention powers). The Murray Inquiry recommended both measures.

Beyond these recommendations, behavioural insights also suggest more subtle techniques to help improve staff member conduct and financial outcomes for customers. The insights can aid regulators and firms in understanding why staff members or consumers are making particular choices. And changes to how choices are presented or structured could make it more likely individuals will make the ‘right’ choice. Setting defaults, presenting choices as losses rather than gains (or vice versa) and providing evidence about what other people do can all change the decisions both staff and customers make.

The digital future
These techniques will be particularly important as we move to a world where more customer engagement occurs through digital channels. These channels contain structures that guide customers through the process of acquiring financial products and services based on their choices. Regulators will no doubt be curious as to whether these structures have been designed with an awareness of behavioural insights, both to avoid, and to foster, good financial outcomes.

Going forward, firms should ensure they have a good understanding of behavioural insights, continue to monitor how the insights are changing regulatory expectations (e.g. around product governance) and approach the design of customer engagement channels, particularly digital ones, with an awareness of how these insights can drive financial outcomes.

Rosalyn Teskey, Governance, Regulation and Conduct Advisory Director, shares insights into how we make decisions that are changing financial services regulation and offering new tools to achieve good conduct outcomes.
Responsible lending – what it is and why it’s important
The responsible lending conduct obligations of the National Credit Act 2009 (the Credit Act) and Regulatory Guide 209 Credit licensing: Responsible lending conduct (RG 209) placed on credit licensees are designed to increase the protection afforded to customers, with the aim of avoiding the sale of credit and financial products unsuitable to customer needs that could lead to substantial financial hardship.

The requirements of the Credit Act to consider loan suitability in line with customer objectives, has clear links to the emerging focus on product governance and the distribution and design of products that are not detrimental to customers, which were discussed in the March 2015 Risk and Regulatory Review. In its 2015-2016 to 2018-2019 Corporate Plan, ASIC has also strongly linked the conduct of lenders as gatekeepers, to their responsible lending obligations.

We recommend that organisations take proactive steps by embedding their responsible lending obligations within the development of their product governance and conduct risk framework.

What is the regulator doing in the responsible lending space?
ASIC continues to undertake general surveillance of the activities of credit providers, with the market surveillance and pronouncements regarding the conduct of lenders notably increasing in recent months. ASIC’s recent activity reinforces the areas of focus stated in its Corporate Plan, being:

• Payday lending
• Interest-only loans
• Finance brokers
• Consumer leases
• Margin lending.

Responsible lending in the small amount credit contract (SACCs) sector, also known as payday lending, has been a focus of ASIC for several years. In 2014, ASIC’s uncontested court ruling against The Cash Store Pty Ltd (in liquidation) (TCS), resulted in a record civil penalty against TCS of $19 million, and demonstrated that there may be a gap between the regulator’s and the market’s interpretation of the obligations of the Credit Act.

The TCS case was followed by ASIC’s report into the payday lending sector (March 2015), which further detailed concerns ASIC holds in relation to the design and distribution of pay-day lending products. In August 2015, the Government established a review of the effectiveness of the law relating to SACCs in the Credit Act, which contemplates extension of these rules to consumer leases.
We do not see the focus on SACC diminishing in the next 12 to 18 months, and indeed, we see it as a pre-cursor to ASIC’s intentions, which were again exemplified in its submission to the Senate Standing Committee on Economics inquiry into credit cards. In this submission, behavioural economics was used to inform its issues related to the design and use of credit cards as they relate to different segments of customers. Responding to the concerns raised by ASIC will require banks to carefully consider all elements of product governance, from design, to distribution and post-sale monitoring.

Practical steps
Organisations, in particular those involved in the industries identified by ASIC, should expect increased regulatory surveillance of credit activities over the next six to 12 months. Organisations should consider how adequately existing frameworks assist in meeting responsible lending obligations, including supporting policies and procedures, training, and record keeping systems.

We recommend lenders take the following steps:

• Use research to expand existing research around customers and their needs and capabilities and incorporate these needs and capabilities into product design
• Review key aspects of loan underwriting against recent ASIC pronouncements, including understanding objectives of a consumer and income and expenses
• Review lending practices and ensure that loan files sufficiently document the lending decision, and the reasons to support and judgements made, including rebutting presumptions of unsuitability
• Proactively manage and monitor standards applied in various distribution networks
• Utilise management information to ensure products are operating as intended and are being sold to the appropriate customer segments.
Best practice remediation
– A framework for a better future

Regulators expect remediation and review programs conducted by licensees that provide financial advice to be efficient, honest, and fair so customers can have greater trust that their remediation is consistent and transparent. Governance, Regulation and Conduct Advisory Partner, Vivienne Tang and Governance, Regulation and Conduct Advisory Director, Aneliese Algie, explore the key pillars that are essential to a successful remediation program.

The context
In December 2015, the Australian Securities and Investment Commission (ASIC) released Consultation Paper 247 (CP 247) Client review and remediation programs and update to recordkeeping requirements.

CP 247 sets out ASIC’s proposed guidance on client review and remediation programs that:

• are conducted by Australian financial services licensees who provide personal advice to retail clients (advice licensees)
• remediate clients who have suffered loss as a result of the decisions and behaviour of the advice licensee, or an individual adviser or advisers, in relation to the provision of personal advice.

The principles in CP 247 are intended to apply regardless of the size of the licensee, size of the remediation program, or nature of the issue requiring remediation.

To the extent relevant, the principles are also intended to apply to programs conducted to remediate retail clients for losses suffered in areas such as superannuation or credit, or programs conducted by advice licensees not relating to personal advice.

Key considerations include:

• when to establish a review and remediation program
• the scope of the program
• designing a comprehensive and effective program
• communicating effectively with clients
• ensuring access to the external review of decisions.

CP 247 also proposes to update the recordkeeping requirements by amending class order 14/923, so that licensees not only have to maintain client records for seven years, but must also have access to those records during this period.

In developing the proposed guidance, ASIC has been informed by its recent experiences in negotiating a number of review and remediation programs conducted by advice licensees.

We are broadly supportive of the proposed guidance and believe that, once consultation is complete, it will provide the framework for a better future.
A proper review and remediation program builds public trust and confidence

The four key themes of the ASIC consultation paper are:

---

**Build public trust and confidence in financial services**

Clients should have confidence that a program is conducted to lead to fair and consistent outcomes.

- A principles based approach to remediation will increase consistency across industry participants, while allowing for flexibility given the nature, scale and complexity of the issue in question.
- Independent oversight by an internal or external party, sufficiently skilled and competent to conduct the oversight role, will provide confidence in the quality and fairness of the program outcome.
- Clients should be provided with sufficient detail about their own situation, so they can make an informed decision as to any action required.
- Public reporting will generally provide transparency around overall program outcomes for clients.
- In principle we concur that guidance is helpful for all client remediation programs. However CP 247 will require tailoring to the specifics of banking, insurance and superannuation remediation programs.

---

**Achieve quality outcomes**

Licensees must maintain quality at all times which may inhibit the desire to achieve a fast response.

- It is important to set up and design a review and remediation program with adequate resourcing, a customer centric culture, and robust governance, in order to achieve quality outcomes.
- The consultation paper suggests advice licensees should decide whether to remediate an affected client within 90 days of notifying the client they are within scope. Depending on the nature, scale and complexity of the program, the aim should be to conduct the program so that it achieves quality outcomes and does not have to be repeated. This need for quality takes precedence over the time to respond.
- Clients should receive regular communication so they are aware of the status of their case, and have the opportunity to provide information at any time.
- A review and remediation program should include root cause analysis so that lessons learned can be used to enhance business as usual practices, including product, business process, control or reward design.
Address systemic issues

Existing business as usual practices for identifying, rectifying and reporting issues, and for compensating clients, will be strengthened.

- Licensees generally aim to do the right thing by their clients, and to put things right when issues have been identified.
- The consultation paper states a review and remediation program is generally appropriate where a systemic issue has been identified. A systemic issue is defined as an issue that may have implications beyond the immediate rights of the parties to a complaint or dispute, or that may have implications for more than one client. This definition requires further clarification including alignment with existing significance tests and breach reporting obligations.
- We suggest a tailored approach whereby licensees are required to assess the potential for a review and remediation program where groups of clients have, or are likely to have, suffered financial detriment, and to demonstrate their conclusions to those charged with governance and how this meets their obligations as a licensee.

Respond to historical issues

Clients should be treated fairly and consistently. A seven year period aligns with record keeping requirements.

- Clients who wish to complain about products and services can use existing internal and external dispute resolution schemes.
- The consultation paper is designed for licensees to proactively address the need for client financial compensation where there has been actual or potential client detriment. ASIC expects an advice licensee to review advice as far back as the licensee has retained records. This includes where a licensee has retained records for longer than the seven years statutory requirement for record retention. Unfortunately this will lead to inconsistencies depending on licensees’ record retention policies.
- We believe that a principle of seven years is sensible given it aligns with current record keeping requirements. We recognise licensees may choose to look further back where there are particularly egregious instances of misconduct or vulnerable client groups. Digitisation of all client records will assist with this.
Key pillars of a remediation program

Based on our experience of remediation, we have identified five pillars essential to a successful remediation program.

1 Principles

A program should:

• Have a client focused output
• Meet regulatory expectations
• Achieve a ‘one time review’ i.e. no further remediation required
• Transfer ‘lessons learned’ into business as usual operations
• Be conducted in a controlled environment, retaining clear, demonstrable audit trails and provide timely and accurate management information.

2 Procedures and policies

Develop and share consistent policies and procedures across remediation programs and complaints handling teams to:

• Communicate with clients (frequency and type, dealing with non contacts)
• Handle priority cases (emotional and financial hardships)
• Compensation principles including interest, alternate portfolios and fee reimbursements
• Set up policy and procedural approvals.

3 Process, tools, people and infrastructure

Steps to take include:

• Review processes including:
  - Databases
  - Management Information reporting

• Develop tools such as:
  - Workflow
  - Compensation calculators
• Allocate dedicated, qualified resources
• Create appropriate infrastructure to enable:
  - Designated location(s) to undertake the work
  - Mobilisation processes for scaling and flexing operational capacity
  - Pilot scheme implementation and assessment.

4 Governance framework

Establish a governance framework with:

• Steering committee structure
• Operational review check points
• Financial management and provision framework
• Change control and change governance
• Communications strategy
• Operational and business risk framework
• Quality assurance framework
• Central planning and management information function.

5 Client focused culture

Design an approach which errs in favour of the client by:

• Implementing a contact strategy which uses behavioural insights
• Providing clients with adequate information of any decisions made and the reasons behind those decisions
• Giving clients the opportunity to provide additional information
• Offering access to internal and external dispute resolution schemes
• Promoting a culture of continual improvement to deliver the most effective client outcomes.
Risk culture and conduct

While most Australian firms have taken action to define and implement programs to better understand risk culture, the breadth and sophistication of these programs may be undermined by the very thing they are designed to assess — the existing risk culture. Grant MacKinnon, Risk Advisory Director, outlines some of the industry challenges that Boards in particular should understand and scrutinise within their firms.

Culture is a key driver of conduct
Regulators globally (BIS, FSB), regionally (MAS) and locally (APRA, ASIC) have continued to keep the spotlight on risk culture and conduct, and its importance in building and maintaining trust in the financial system.

Concurrently, efforts of individual firms to establish and implement risk culture and conduct measurement, assessment and change programs have also picked up momentum. Yet this raises an interesting question: does the increasing regulatory focus on risk culture and conduct signal that regulators are not seeing substantive change in firms?

An emerging paradox
How a firm responds to risk culture could be a direct reflection of how risk is thought about and managed within the firm today and of the broader culture itself. Firms with a weak risk culture are unlikely to have the appetite to truly understand what needs to change, and take substantive action to address.

Perhaps this is best illustrated in the extent to which HR and risk functions proactively work together to drive an organisation-wide and cohesive risk culture response. While most firms have focused their risk culture activities into second line risk and third line audit departments, the interest and involvement of HR functions, the custodians of organisational culture, has not been demonstrated as clearly or as proactively. The lack of alignment across all of the channels staff can pick up culture undermines efforts to strengthen it.

The most recent Deloitte observations in Australia and globally continue to echo findings of the Macquarie University research conducted on risk culture — where they found a significant number of staff perceived that ‘remuneration and performance measurement systems do not support prudent risk behaviour.’

The self-reinforcing effects of a poor risk culture mean that even after independent risk culture and conduct reviews, the required actions may not be progressed to drive substantive change and create the required self-sustaining positive reinforcement.
While it is difficult to objectively see the culture you are in, organisations are increasingly looking externally to get an outside-in perspective on their risk culture. Customers, partners and regulators, through their interactions with the firm, hold a privileged insight into conduct and risk culture. ASIC has recently said that they ‘want to share information with boards and management when ASIC’s surveillance suggests they want to do the right thing but there may be cultural problems within their firm that they are not aware of’.

The focus of risk culture responses often does not yet consider participants across a firm’s extended enterprise, those third-party providers (white-labellers, outsource partners, franchisees/agents) that operate within the firm’s end-to-end risk management framework and have the potential to materially impact reputational, operational, compliance, and conduct risks.

Immediate practical steps our clients should take
Clearly the paradox won’t self-heal. While it’s tempting to create clear actions in a similar way to an audit review, risk culture and conduct activities must be multi-faceted to address all the channels staff pick up on culture: role models, systems and mechanisms, incentives, revealed preferences, and symbols.

It is also important to understand the risk culture of critical extended enterprise participants, to have greater confidence that risk management and conduct frameworks are operating as intended.

Finally, taking an outside-in perspective on conduct and risk culture can help organisations understand whether the good intentions of leaders and staff members result in consistently good outcomes for customers or whether they are a hindrance.
## 2016 and beyond
### Key International and APAC Regulatory Events

#### Q1 2016 Jan-Mar
- G-SIBs commenced reporting HLA to supervisors (Jan)
- BCBS risk data aggregation and reporting principles commenced for G-SIBs (Jan)
- Revised market risk framework released by BCBS (Jan)
- Basel III capital requirements for equity investments in funds, CCP exposures and SA-CCR commenced (Jan)
- IAIS guidance on BCR and HLA confidential reporting issued (Feb)
- IOSCO report on IBOR principals implementation issued (Feb)
- FSB’s issued consultation on non-cash collateral re-use measures (Feb)
- BCBS issued consultation on standardised approaches for calculating operational risk capital (Mar)
- BCBS issued consultation on consolidated and enhanced framework for Basel III Pillar 3 disclosure requirements (Mar)
- Comments due on FSB’s proposed approach for step-in risk (16 Mar)
- BCBS to conduct QIS on credit and operational risk
- IOSCO to start follow up on FX benchmark reform
- Phase in period begins for Basel III HLA G-SIBs requirements.

#### Q2 2016 Apr-Jun
- By G20 Washington meeting (14-15 April)
- FSB’s climate-related risk task force to consult on first-stage report, setting out the objectives and scope of its work
- FSB to report on implications of financial technology innovation
- Comments due on FSB’s proposed non-cash collateral re-use measures (22 April)
- Comments due on BCBS’ revised standardised approaches for calculating operational risk capital (3 Jun)
- Comments due on BCBS’ consolidated and enhanced framework for Basel III Pillar 3 disclosure requirements (10 Jun)
- BCBS to finalise treatment of STC securitisations
- CPMI-IOSCO to consult on CCP resilience and recovery
- FSB recommendations on gaps or weakness identified during shadow banking peer reviews.

#### Q3 2016 Jul-Sep
- Phase-in period begins for non-centrally cleared OTC derivatives margin requirements
- By G20 Chengdu meeting (22-23 Jul), FSB to have reported on
  - Implementation of OTC derivative trade reporting
  - Interest rate benchmark reform
  - Misconduct risks
- Need for further guidance for CCP resolution, prefunded financial resources and liquidity in resolution
- Implementation of the
  - Framework for oversight and regulation of shadow banking
- Market liquidity and asset management risks, including policy options to mitigate structural vulnerabilities
- By G20 summit in Hangzhou (4-5 Sep) FSB to report on
  - Incentives in preventing misconduct
  - Progress in addressing FICC markets issues
- National good practice governance frameworks for misconduct risk
- Progress on correspondent banking action plan.

### During 2016
- IAIS to finalise refinements to its assessment methodology for G-SIBs, consult first draft of its International Capital Standard and undertake BCR field testing for
- IOSCO to consider plans for monitoring and reporting on implementation of MMF and securitisation recommendations
- BCBS to complete work to address the excessive RWA variability, including consulting on the removal of, or further constraining, internal model approaches for certain risks
- BCBS to finalise approach to interest rate risk in the banking book
- Final rules due on assessment methodology and HLA requirement for D-SIBs.

### Australia
- Report on crowd-sourced equity funding framework tabled in the Senate (1 Mar)
- Comments due on revisions to prudential framework for securitization (1 Mar)
- Comments due on proposed amendments to Prudential Standard APS 110 Capital Adequacy and draft guide APG 110 Capital Buffers (18 Mar)
- Comments due on draft client money legislation (25 Mar)
- New rules for mandatory central clearing of OTC derivatives commence for entities above the $100bn threshold (4 Apr)
- Comments due on Prudential Standard: margining and risk mitigation for non-centrally cleared derivatives (20 May)
- Legislation to be released on: banning excessive card surcharges reducing disclosure requirements for ‘simple’ corporate bonds
- Consultations to be released on: ASIC product intervention powers and accountability for financial product issuers and distributors recapitalisation frameworks NSFR leverage ratio and other prudential issues tools for managing any future financial crisis.

### China
- CBRC to have policy framework for Basel III capital for equity investments in funds and for CCPS, SA-CCR, securitisation framework, NSFR, Pillar 3 disclosure and large exposures.

### Hong Kong
- SFC established FinTech Contact Point (1 Mar)
- Large scale roll out of requirement for banks to accept eCheque deposits.

### Japan
- JFSA to publish a summary report reviewing progress with 2015-2016 strategic directions and priorities, which include: FinTech, cyber security; algo trading; intermediary prioritisation of customers’ interests; enhancing skills of asset managers and institutional investors.

### Singapore
- Basel III liquidity requirements extended to merchant banks and D-SIBs capital conservation and CCyB LCR disclosure requirement took effect (1 Jan)
- Comments due on proposed legislation to implement reporting of commodity and equity derivatives contracts, as well as other revisions to complete the implementation of the OTC derivatives trade reporting regime (15 Feb)
- Consultation in progress or completed for draft rules on Basel III capital for equity investments in funds and for CCPS, SA-CCR, securitisation framework
- Draft rules to be issued on Basel III NSFR and large exposures requirements.

### Australia
- Standard setting body for financial advisers begins operation (1 Jul)
- Planned commencement of Prudential Standard Margining and risk mitigation for non-centrally cleared derivatives (CPS 226) (1 Sep)
- APRA to set capital standards and ratios that ensure ADIs unquestionably strong
- Legislation to be released giving ASIC the power to ban individuals from managing financial firms
- Legal effect to be given to the Asian Region Funds Passport initiative
- Consultation on strengthening ASIC’s enforcement tools in relation to the financial services and credit licensing regimes
- ASIC to review of remuneration arrangements in the mortgage broking industry
- Consideration to be given to technology neutrality in financial sector regulation.
### Hong Kong

- New rules for mandatory clearing of OTC derivatives to come into effect (1 Sep)
- Draft rules to be released for Basel III requirements re capital for equity investments in funds and for CCPs, SA-CCR, pillar 3 disclosure and large exposures to be published.
- VM and IM requirements for non-centrally cleared derivatives planned to be effective for commercial banks exceeding S$4.8 trillion threshold (1 Sep).

**Notes:**
- We expect regulators and governments in the Asia Pacific region to announce further regulatory initiatives in the aftermath of the G20 summit; as international intentions are clarified.
- Red text indicates deadline for industry or commencement of new requirements.

---

**We also have more to do to make sure that the Hong Kong regime remains aligned with those in the rest of the world and keeps pace with the evolving international regulatory agenda.”**

Mr Ashley Alder, Chief Executive Officer SFC

**ISDA Annual Asia Pacific Conference 26 October 2015**

---

### Australia

- New rules relating to raising educational standards of financial advisers takes effect (1 Jul 2017)
- Draft rule on Basel III large exposure requirements (2017)
- APRA to ensure banks have appropriate TLAC and leverage ratios in place
- Legislation to enable innovative disclosure for financial products
- Legislation to improve the regulation of managed investment schemes
- ASIC review of stockbroking remuneration arrangements
- Rationalisation of life insurance and managed investment scheme legacy products.

### Hong Kong

- Rules on mandatory OTC derivatives reporting (phase 2) come into effect (early 2017)
- CoC8 to increase to 1.25% (1 Jan 2017)

### Singapore

- VM requirements for non-centrally cleared derivatives planned to be effective for all commercial and merchant banks (1 Mar 2017)
- IM requirements for non-centrally cleared derivatives planned phase in period for all commercial and merchant banks exceeding S$13 bn threshold (1 Mar 2017-1 Sep 2020).IM requirements for non-centrally cleared derivatives planned phase in period for all commercial and merchant banks exceeding S$13 bn threshold (1 Mar 2017-1 Sep 2020).

**Notes:**
- If Asia is to further integrate its financial markets and allow cross-border capital flows and financial services to flourish, a precondition is to build strong mutual trust and confidence amongst regulators and supervisors, and achieve, over time, further convergence and harmonization in regulation and supervisory practices across the region.”

Masamichi Kono, Financial Services Agency of Japan 14 September 2015

---

**If Asia is to further integrate its financial markets and allow cross-border capital flows and financial services to flourish, a precondition is to build strong mutual trust and confidence amongst regulators and supervisors, and achieve, over time, further convergence and harmonization in regulation and supervisory practices across the region.”

---

**Notes:**
- We expect regulators and governments in the Asia Pacific region to announce further regulatory initiatives in the aftermath of the G20 summit; as international intentions are clarified.
- Red text indicates deadline for industry or commencement of new requirements.

---

**We also have more to do to make sure that the Hong Kong regime remains aligned with those in the rest of the world and keeps pace with the evolving international regulatory agenda.”**

Mr Ashley Alder, Chief Executive Officer SFC

**ISDA Annual Asia Pacific Conference 26 October 2015**

---

### Australia

- New rules relating to raising educational standards of financial advisers takes effect (1 Jul 2017)
- Draft rule on Basel III large exposure requirements (2017)
- APRA to ensure banks have appropriate TLAC and leverage ratios in place
- Legislation to enable innovative disclosure for financial products
- Legislation to improve the regulation of managed investment schemes
- ASIC review of stockbroking remuneration arrangements
- Rationalisation of life insurance and managed investment scheme legacy products.

### Hong Kong

- Rules on mandatory OTC derivatives reporting (phase 2) come into effect (early 2017)
- CoC8 to increase to 1.25% (1 Jan 2017)

### Singapore

- VM requirements for non-centrally cleared derivatives planned to be effective for all commercial and merchant banks (1 Mar 2017)
- IM requirements for non-centrally cleared derivatives planned phase in period for all commercial and merchant banks exceeding S$13 bn threshold (1 Mar 2017-1 Sep 2020).IM requirements for non-centrally cleared derivatives planned phase in period for all commercial and merchant banks exceeding S$13 bn threshold (1 Mar 2017-1 Sep 2020).

**Notes:**
- If Asia is to further integrate its financial markets and allow cross-border capital flows and financial services to flourish, a precondition is to build strong mutual trust and confidence amongst regulators and supervisors, and achieve, over time, further convergence and harmonization in regulation and supervisory practices across the region.”

Masamichi Kono, Financial Services Agency of Japan 14 September 2015
Cyber resilience

Deloitte’s Australian Cyber Intelligence Centre links with its global network to build business resilience. **Asia Pacific Cyber Leader James Nunn-Price** outlines the realities of threat intelligence in the cyber world and what Deloitte is doing about it.

- Cyber threats will increase exponentially and be more sophisticated than new systems
- Risks are global and evolving faster than organisations can react
- Cyber threats are potentially the most destabilising phenomena in the world
  (Dr Luke van der Laan Director, Professional Studies, University of Southern Queensland.)

Successful cyber-attacks are on the rise despite investment in security being at an all-time high. According to Gartner, organisations in the Asia Pacific and Japan spent US$71 billion last year on IT security, a figure which is likely to grow by almost 10% per year to reach US$170 billion globally by 2020.

As the threat and associated attacks grow in number and sophistication, businesses are struggling to keep up. The focus on protection and building ever higher ‘firewalls’ just isn’t working.

With more than 200 billion connected devices due to come online by 2020, cyber threats are also increasing in complexity and sophistication along with the digital world. It is becoming more and more difficult for businesses to keep up. However by accessing active real-time global threat intelligence, businesses can be more agile, anticipate and potentially get ahead of serious cyber risks, and be more able to focus on their core business.

Linking into the regional and global network

As a vital part of this ecosystem Deloitte launched its Australian Cyber Intelligence Centre in late November 2015. This Sydney-based centre links 24/7 to its Asia Pacific centres strategically located in Japan, Singapore, Malaysia and India. Hong Kong/China is due to come on line next year.

Aiming to help businesses become more secure, vigilant and cyber resilient, the Cyber Intelligence Centres provide a deep understanding of local markets, language, threats, regulatory security and privacy variations. These regional centres are linked in turn to the Deloitte global network of more than 20 centres in North and South America, Europe, the Middle East and Africa, which scan the global markets in which both criminals and multinational organisations operate.

This intelligence is also underpinned by deep technical cyber risk advisory services from a network of 3500 cyber specialists across the 46 countries Deloitte operates in.

Leading the field

Kennedy Consulting Research & Advisory, has named Deloitte as a leader in cyber security consulting. Kennedy’s Cyber Security Consulting 2015 report notes: “Deloitte’s notable depth across the breadth of the cybersecurity consulting portfolio coupled with its ability to effectively communicate and work with the span of a client organisation (boardroom down to IT operations) solidifies its position in the Vanguard.”
By collectively operating a network of shared services of Cyber Intelligence Centres, Deloitte combines global threat intelligence and local delivery at economies of scale with unique insights that individual businesses cannot readily achieve on their own.

Although cyber risks cannot be completely eliminated, they can be actively managed.

Any organisation trying to solve these risks just at an IT level will be ineffective. The solution has to be solved at the enterprise level, and business executives increasingly understand cyber risks in all the dimensions of business strategy and operations.

In Australia, Deloitte is actively involved in a coordinated Australian government approach to address cyber security threats that involves a strong partnership between the Government, businesses and the research community. Information on Australia’s Cyber Security Review and Strategy can be found at www.dpmc.gov.au.

Deloitte is also actively working with universities and education providers around STEM subjects (science, technology, engineering and mathematics), which will help to equip Australian talent with the skills to combat cyber risks.

Additional facts
- The average cost of a data breach per Australian organisation is more than *$2.5 million per year and rising*
- The average breach involved more than *20,000 records in Australia over the five years to 2014*
- There was also a 25% increase in data loss between 2013 and 2014 globally
- Most organisations are focused on prevention as opposed to detection
- Ninety two per cent of breaches are perpetrated by outsiders
- These known external perpetrators come from organised crime (55%), state affiliated hackers (21%), activists (2%) and former employees (1%)
- Only 14%*** of breaches are by insiders, but this is rising**
- More than three quarters of the breach incidents are caused by weak or stolen credentials
- With rogue hardware and malware also frequent causes of breach or service denial, it is important for all employees, contractors and suppliers to understand of how criminals are targeting them with their well-planned attacks, often triggered by ‘apparent insiders’ who lie in wait within the organisation.


**Source: 2014 Verizon Data Breach Investigations Report with the U.S. Secret Service, FBI, Deloitte, DHS and others

*** numbers overlap because some insiders and outsiders are in collusion
Global change, regional context: Asia Pacific regulatory themes for 2016

The Deloitte Asia Pacific Centre for Regulatory Strategy has identified four major regulatory themes for the Asia Pacific financial services industry in 2016. While each theme may have a varying relative level of importance across each institution and jurisdiction, we believe that in combination these themes will dominate strategic considerations in the coming period across the Asia Pacific region.

The themes cover substantial changes to how bank capital requirements are calculated and other ongoing crisis-driven and stability-related reforms, ongoing pressure to improve and demonstrate good conduct and culture, and important discussions concerning the interplay between technology and regulation. Overlaying these regulatory initiatives is the ever-present challenge of regulatory change implementation.

All four themes reflect the influence of the G20-led post-crisis international regulatory reform on the Asia Pacific region. Because of this, 2016 will be an important year for Asia as China assumes the presidency of the G20 and sets the agenda and tone for the year. The region and its institutions will have a heightened opportunity to voice their opinions on the international agenda and its impact across our divergent financial systems, economic needs and stages of development. This article gives a high-level view of the themes that Asia Pacific institutions should be considering for action both internally and within the broader policy context.

Resilience
Much crisis response regulation has concerned making institutions and markets resilient to financial stress. Despite substantial reforms already, these initiatives will continue through 2016 and beyond. They include:

- Changes to how bank risk-weighted assets are calculated and a capital floor (end 2015 and through 2016)
- Implementation of total loss absorbing capacity for global systemically important banks (starting 2019), with possible application of similar requirements to domestic systemically important banks
- A new comprehensive Pillar 3 framework (end 2016)
- Ongoing work on OTC derivative reforms, including the September 2016 commencement of margining for non-cleared transactions and resiliency work on central counter-parties
- Finalisation of insurer capital standards and higher loss absorbency for global systemically important insurers
- Further work on potential regulation of asset management.

These initiatives will require institutions to watch the policy space, understand the potential impact of regulatory initiatives, and prepare for implementation.

Culture and conduct
A major area of recent regulatory activity has concerned the behaviour of financial institutions and their staff with respect to consumer and investor protection and market integrity. The Financial Stability Board now sees misconduct as a systemic risk and is overseeing policy reforms to address it. At the domestic level, strong supervisory expectations concerning conduct and culture will impact Asia Pacific institutions throughout 2016.

Institutions will need to ensure they have robust processes to assess and, where necessary, improve their culture and conduct standards. Evidencing cultural improvements will be particularly challenging.
Technology
Technological innovation will be a defining competitive dynamic for financial services in 2016 and beyond. We see a debate emerging concerning the appropriate regulatory response, with different players contributing different perspectives.

- **Regulators** will be concerned to facilitate innovation but also regulate new activities to meet their objectives of stability, market integrity, and investor protection.
- **Fintechs** may seek to exploit low regulatory costs to facilitate market entry but ultimately want regulatory approval to bestow legitimacy and engender trust.
- **Incumbents** will be concerned about asymmetric regulatory burdens hampering their competitive response but forward-looking institutions will also be optimistic about opportunities.

Regulators are also increasingly concerned that institutions manage the risks associated with technology, particularly with respect to cybersecurity. In response, institutions will need to maintain awareness of regulatory requirements and ensure their risk measures are appropriately aligned.

Implementation
Beyond the themes arising from new or recalibrated regulations, we believe that financial institutions will continue to face implementation challenges in 2016: 

- First, the cumulative impact of the ongoing regulatory agenda risks reform fatigue and confusion concerning the cumulative impact of regulatory change.
- Second, institutions that operate across borders face ongoing challenges to reconcile different domestic rules, which can frustrate the desire for uniform operating models.
- Third, branch institutions active in the Asia Pacific region may face challenges in securing regulatory change and compliance funding as European and United States headquarters face greater regulatory burdens.

We believe that responding to these themes well requires institutions to have a strong understanding of the regulatory change agenda, the ability to assess the impact of proposed changes on business lines and incorporate upcoming changes into strategic planning.

Conclusion
The Asia Pacific regulatory policy agenda remains wide-ranging, comprehensive and impactful.

This article sets out the regulatory themes that we believe will dominate in 2016. Implementation of individual requirements, as well as the adaptation of business strategy in response to regulatory initiatives, is best done with an understanding of policy intent and future reforms and in a holistic context. The cumulative effect of all reforms, and the interactions between individual reforms, is far from understood or certain, and should continue to be analysed just as much by businesses as policymakers.

Engagement with the policy agenda, particularly in the year of China’s G20 presidency, will be essential to ensure that regulatory reforms are pursued in a manner that is sensitive to the interests of the Asia Pacific region. To engage effectively with this agenda, institutions should develop a nuanced and detailed view of where regulation is heading and its business and strategic impacts. These impacts need to be communicated to policy makers clearly.

More detail on the four regulatory themes and our understanding of the current and potential responses of institutions to them is available in the full report at deloitte.com/au/2016RegulatoryThemes.

We have also created a detailed timeline that sets out key international and Asia Pacific regulatory events in 2016 and beyond across the areas of resilience, conduct and culture, and technology. The timeline focuses on international regulatory activity and highlights national regulatory activity in the following key Asia Pacific jurisdictions: Australia, China, Hong Kong, Japan, and Singapore.
How disruptive innovations are reshaping the way financial services are structured, provisioned, and consumed. Financial Services Innovation Leader, Joel Lipman, considers the findings of the joint World Economic Forum and Deloitte research into the future of financial services, innovation and where distributed ledgers fit.

Deloitte and the World Economic Forum have spent the past 18 months with global financial services industry leaders, innovators and regulators researching the transformative potential of innovation. The result is the Future of Financial Services report, which considers disruptive innovation in financial services, highlighting the innovations that will be the most impactful and relevant to the industry.

There were five key observations that give useful insights into how best to think about innovation, how to predict and respond:

1. Innovation in financial services is deliberate and predictable. Incumbent players are most likely to be attacked where the greatest sources of customer friction meet the largest profit pools.
2. Innovations are having the greatest impact where they employ business models that are platform based, data intensive and capital light.
3. New entrants are employing parallel strategies aggressively competing with incumbents in some areas, while also leveraging their legacy assets to access key infrastructure and services.
4. Collaboration between regulators, incumbents and new entrants is needed to understand how new innovations alter the risk profile of the industry – positively and negatively.
5. Not all innovations are customer facing. A quiet band of innovators are modernising incumbent operational practices, delivering new capabilities and unexpected efficiencies.

These insights consider the 11 critical clusters of innovation that are changing financial services across the key sectors of:

- Wealth management
- Capital raising
- Deposits and lending
- Insurance (the sector that will be the most disrupted).

What was missing before the World Economic Forum/Deloitte research?
Before the research, tested recently in Australia, all the innovations could feel very chaotic (see figure one below). Understanding how the transformative innovations all connect was missing; as was a taxonomy for understanding the evolutionary path of emerging innovations, which innovations are and will be the most relevant.

In this context, in Australia, Deloitte also researched the status quo and called out the points under constant pressure to innovate across six key stakeholders.

For customers, the pressure points are the need to rebuild trust, and deliver simplicity and value.

In cyber security, Australia is seen as a soft target and needs to build agility, responsiveness, and resilience.

In fintechs Australia is also doing some good work internally, but needs to focus on both internal and external innovations to meet the complexity and speed of change. Fintechs will continue to thrive as global entrants are attracted to the profitability of the Australian financial services industry.
As for regulators, they need to be willing to partner and engage proactively with technology providers and consumers to help formulate products and the rules of the game to the benefit of all. Enterprise technology vendors need to help financial services meet the pace of change and connect employees across the enterprise, digitise operational processes, and reach out to customers.

It’s a balancing act

For the business models of incumbents, the winning play of scale that has historically shaped large institutions will shift to those that manage the transition to the future state that delivers the maximum value to customers. Models that commoditise value, deliver agility, create simplicity, and build customer trust.

Managing the pace of this transformation will be a key to success. Each business will need to work out how long it can sustain its current business model and how quickly it can transition effectively to its new state. As customer preferences and behaviours demand innovations, additional risks and considerations will be created. So through collaboration, the industry response needs to be well thought through, building agile policies and regulatory responses necessary to protect and grow Australia’s prosperity.

Creating the prosperity for Australia

As Australia’s largest economic sector, worth 9% of gross value, and contributing more than $130 billion to the GDP each year, the financial services sector has a critical role to play in driving the shift from a ‘products’ to a ‘services’ economy. As the sector feels the heat of disruption the most, it also has the greatest capacity to take advantage of its inherent innovation to facilitate business and protect capital, and to provide the necessary liquidity for growth in all sectors of the economy.

As Prime Minister the Hon Malcolm Turnbull says: "The Australia of the future has to be a nation that is agile, that is innovative, that is creative… it isn’t about ‘future-proofing the nation’. It is about embracing the future.”
Collaboration is the key
We will only achieve the Prime Minister’s vision if incumbents, fintechs, the government and regulators collaborate. Stated simply, it is critical that we create the right environment for financial services to thrive for the benefit of Australia and its citizens.

In Australia we are in the eye of a perfect storm. As we have seen, the Government gets innovation, consumers and customers want what it offers, and our financial services sector has the means to deliver it. Together we will achieve a win:win:win for Australia if we get it right.

As a smaller market we can look at the changes in the UK, US and European markets and closer to home, China and S.E. Asia, and watch and learn. As we externalise aspects of this knowledge and build R&D, Australian organisations can respond with a bit more runway than the others. Also Australian-based multinationals have a chance to run pilots with a smaller and more manageable consumer base and so be an exciting lab for financial services in innovation.

Where to next?
More than 20 global banks, including Australia’s NAB and the Commonwealth Bank of Australia, have invested in a venture to define common standards and experiment with applying distributed ledgers (block chain) to financial services use cases.

Around $2 billion in venture capital funding is estimated to be attracted in 2014-15 by start-ups in this space [ref. Coinbase]. Numerous ventures have been founded globally by entrepreneurs hoping to own a piece of the next unicorn. But as the technology is developed further, it is increasingly clear that the fully distributed, anonymous model exemplified by Bitcoin will not likely be viable in regulated industries such as financial services.

As a result we will be likely to see more distributed ledgers developed that are ‘permissioned’, as opposed to ones that are open and accessible by anyone, such as the Bitcoin block chain. The likely model will be one that connects a limited number of trusted counterparties such as banks.

These permissioned ledgers would require less computing power to maintain security because security is dealt with by managing access, while also making it much easier to comply with existing Know Your Customer (KYC), Anti-Money Laundering and Counter-Terrorism Financing (AML/CTF), and other regulations.

Permissioned ledgers would likely preserve the benefits of speed, efficiency and virtualisation, but without many of the risks. Deloitte is participating in the development of distributed ledgers, building block-chain based systems for clients, and developing applications for use in audits and client service. See http://rubixbydeloitte.com to discover more on applications in reporting, ticketing and loyalty.

Also in line with the World Economic Forum’s (WEF) research on the Future of Financial Services, Deloitte is assisting WEF research distributed ledgers, and their disruptive and innovative applications globally.

As part of an effort to position Australia in a leadership position in this space, Deloitte is also chairing the committee seeking to define relevant accounting standards through the Australian Digital and Cryptocurrency Association. While the ecosystem of technologies, participants, regulations, and standards is still evolving, block chain has the potential to help build a more efficient, productive and innovative Australia.
The recent volatility in sanctions regimes targeting Iran, Cuba and Russia presents both an opportunity to exporters but also substantial risk, due to the complexity and variability of these sanctions regimes.

Sanctions: a lesson in complexity
The recent breakthrough agreement between the permanent members of the United Nations (UN) Security Council and Iran on nuclear disarmament has signalled a winding back (at least in part) of the United States (US) Iranian sanctions. Similarly, the removal of Cuba from the list of ‘State Sponsors of Terrorism’ may also signal a shift in US foreign policy that may eventually lead to a substantial relaxation of the long term Cuban trade embargo. These factors, in addition to the recent visit by Australia’s foreign minister to Iran, are noteworthy developments, however, the US Iranian and Cuban sanctions, for now, remain largely intact and exporters should continue to exercise a high level of vigilance when dealing with either country due to the extraterritorial reach of US sanctions and the Iranian sanctions imposed by Australia.

Whilst the sanctions targeting Cuba and Iran may at some point be relaxed, the sanctions targeting Russia have been strengthened. Russian sanctions are somewhat novel. The sanctions have been crafted to sit between the limited sanctions (which primarily target Specially Designated Nationals (SDNs)) and the broad-based sanctions regimes that the US has adopted against countries such as North Korea. This balancing act has been achieved through the introduction of ‘sectoral sanctions’ which are designed, amongst other objectives, to limit the availability of medium and long term finance to key Russian industries. Due to the complexity of the Russian sanctions and restrictions on dealing with a number of significant Russian enterprises, many exporters have adopted enhanced due diligence measures, including the identification of their counterparty’s ownership structure, to confirm that their trade with Russia is compliant.

As the sanctions that target Iran, Cuba and Russia show, there can be significant variation between sanctions regimes. Unfortunately, there are also significant differences in the sanctions issued by key countries. The table below summarises the key components of the sanctions imposed by the US, the EU and Australia against Russia, Iran and Cuba.
Sanction variation:

<table>
<thead>
<tr>
<th>United States</th>
<th>Europe</th>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Russia</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• The US sanctions against Russia are complex, being imposed by legislation, regulation and executive orders. The sanctions restrict the export of arms and related material from the US to Russia and prohibit most trade with Crimea (but see OFAC General Licence 4)</td>
<td>• Like the US sanctions, the EU sanctions are complex, and imposed by multiple EU-level regulations, as well as EU Member State law</td>
<td>• Australia's Russia sanctions are similar to those implemented by the EU</td>
</tr>
<tr>
<td>• The US ‘sectoral sanctions’ are similar but not identical to those put in place by the EU, and restrict medium and long term financing from US sources</td>
<td>• The EU has instituted an arms embargo against Russia, which includes dual-use goods when those goods are for a military use or a military end-user</td>
<td>• Restrictions include trade in arms and related material, and restrictions on trade and investment with Crimea and Sevastopol</td>
</tr>
<tr>
<td>• Exports of specific items related to oil exploration are also restricted.</td>
<td>• Exports of specific goods and services related to oil exploration are also restricted</td>
<td>• Australia has also implemented 'sectoral' sanctions which restrict commercial dealings with certain entities</td>
</tr>
<tr>
<td><strong>Iran</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• A trade embargo is in place against Iran, subject to very limited exemptions</td>
<td>• The EU has significantly relaxed its sanctions targeting Iran since ‘Implementation Day’ (16 Jan) under the JCPOA. Sanctions changes included: (a) delisting Bank Sepah and other entities; (b) relaxing restrictions relating to (i) oil and gas (ii) shipping, (iii) gold and precious metals and (iv) funds transfers. Restrictions remain for trade in arms, and certain dual-use goods.</td>
<td>• Australia is currently updating its sanctions regime. It has already removed the requirement for DFAT authorisation for transactions above $20,000 that involved Iran.</td>
</tr>
<tr>
<td>• There has been a relaxation of certain ‘secondary’ sanctions – i.e. activity that is not subject to US jurisdiction, since the JCPOA, but restrictions that apply to US persons, including transactions settled via the US, largely remain in place.</td>
<td>• Trade restrictions are also in place concerning Crimea and Sevastopol</td>
<td>• Restrictions encompass trade in arms and related material, dual-use goods, and certain investment.</td>
</tr>
<tr>
<td><strong>Cuba</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• A long standing trade embargo is in place against Cuba – subject to very limited exemptions</td>
<td>• No sanctions – but regulations in place ‘blocking’ US sanctions.</td>
<td>• No sanctions.</td>
</tr>
<tr>
<td>• US banking institutions have been recently authorised to process ‘U-turn’ transactions in which Cuba or a Cuban national has an interest – subject to strict requirements.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Which sanctions regimes apply to you?
Exporters need to consider the extraterritorial impact of sanctions law. Sanctions law may apply by virtue of:

- Your head office location (e.g. if in Australia, Australia’s sanctions laws apply to your overseas operations)
- The countries the goods are shipped to, from or via
- The origin of the goods (e.g. if certain products incorporate controlled US origin goods, US export law may apply subject to certain de minimis thresholds)
- The method of settlement, (e.g. if the transaction is to be settled in USD using the cross-border financial system and global banks, the banks will usually screen the transaction for compliance with US sanctions law, as the transaction will be settled through the US banking system)
- The citizenship and location of staff involved in the supply chain – the more parties involved in your value chains, the more likely it is that additional sanctions laws will apply.

Accordingly, if your business has a nexus to either the EU or US, you may also have to consider the impact of their sanctions.

The export may be permitted – but can you get paid?
Sanctions compliance is not just a matter of export trade compliance – you should also check that you will be able to receive funds from the importer.

As financial institutions will likely handle the settlement of your payments and trade finance arrangements, they will apply their own sanctions due diligence procedures to transactions. These due diligence procedures often involve the screening of all international transactions for designated entities and prohibited countries. Furthermore, non-US banks will often apply US sanctions extraterritorially to certain transactions, because a substantial portion of world trade and financial activity is conducted in USD and at least one leg of a US dollar transaction will be settled in the US. This results in the application of US jurisdiction, and therefore, substantial financial penalties for non-US financial institutions that have not complied with US sanctions. Doing business in a country that is not supported by your banker can result in, at best, increased fees by using alternative payment methods, or, at worst, non-payment because the bank has blocked transactions in accordance with sanctions law.

Accordingly, exporters should be careful to ensure that they do not initiate transactions that are likely to breach sanctions requirements, or their bank’s sanction policies, as such transactions are likely to be identified and lead to difficult discussions between banker and client. The risk is heightened if your transactional bankers are also providers of debt, and the debt agreements require compliance with sanctions laws.

Other key questions
- Are you aware of the origin of the inputs/component parts that you are exporting? The origin of the goods can both cause you to infringe sanctions (e.g. Iranian origin goods) or cause additional sanctions laws to apply
- If operating in high risk countries, do you know who ultimately owns the counterparty you are dealing with?
- There are hundreds of sanctions regulations currently in force – do you know which apply to your business?

Next steps
- The first step towards compliance with sanctions is to identify any business that you have with entities operating in sanctioned countries or on one of the many designated entity lists published by sanctions regulators such as DFAT. Then take steps to determine whether you should continue with this business
- Examine your product list to determine whether any products come with the scope of dual-use legislation, meaning that your products, if exported to a country subject to sanctions, are more likely to require an export licence
- It is timely to also check that your filters/lists have been updated for the recently introduced lists, including the OFAC Foreign Sanctions Evaders list and Sectoral Sanctions list. With the large number of list changes it is pertinent to test your filters and lists to ensure that all relevant terms are present, and that your filter can detect variations of such terms or attempts to circumvent sanctions screening requirements
- Closely monitor developments with reference to the Iranian and Cuban sanctions – many of the US Iranian restrictions will remain in place for years to come.
As regulator expectations shift and the volume and pace of regulatory activity evolves, so too must an organisation’s compliance function. Tina Lin and Alana Weight explore how an effective enterprise-wide risk-based compliance management system is a move in the right direction given the wave of regulatory reform currently being experienced together with increasing regulator expectations and interventions. This has meant that embedding compliance as part of an organisation’s culture together with applying a risk management lens to its compliance management system is crucial.

The development of the new international standard on compliance management, ISO 19600:2014 Compliance Management Systems – Guidelines (ISO 19600:2014), sets the new expectation for compliance management and reiterates this view. The international standard has replaced the former Australian standard on compliance (AS 3806:2006) and has now been formally adopted as the new Australian standard, effective from 22 June 2015.

Figure 2. Over the next two years, which three tasks do you think will increase the most in their importance for your business?

<table>
<thead>
<tr>
<th>Risk Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory/compliance</td>
<td>51%</td>
</tr>
<tr>
<td>Cybersecurity</td>
<td>39%</td>
</tr>
<tr>
<td>Strategic</td>
<td>28%</td>
</tr>
<tr>
<td>Credit</td>
<td>26%</td>
</tr>
<tr>
<td>Data integrity</td>
<td>23%</td>
</tr>
<tr>
<td>Operational</td>
<td>19%</td>
</tr>
<tr>
<td>Liquidity</td>
<td>17%</td>
</tr>
<tr>
<td>Market</td>
<td>16%</td>
</tr>
<tr>
<td>Asset and liability</td>
<td>14%</td>
</tr>
<tr>
<td>Reputation</td>
<td>12%</td>
</tr>
<tr>
<td>Business continuity/IT security</td>
<td>10%</td>
</tr>
</tbody>
</table>

Note: Only the highest-rated risk types are shown. Figures reflect the percentage of respondents who ranked each risk type in the top three.
What does it mean to apply a risk-based approach to compliance?

The management of compliance risk in any regulated financial institution is critical. Deloitte’s recent Global Risk Management Survey has shown that regulatory and compliance risk is seen by the majority of global institutions surveyed as being the risk type that is increasing the most in importance.

Global institutions are increasingly recognising the importance of regulatory and compliance risk as part of their risk management framework and systems. Applying a risk-based approach to compliance evaluates the impact on an organisation’s strategic objectives from not meeting its compliance obligations that directly regulate the provision of its financial products and services.

Compliance risks can be identified by an organisation through a value-chain approach to relate its compliance obligations to its activities, products, and services in order to identify situations in which non-compliance with its obligations can occur and the arising consequences. An evaluation of compliance risks will involve comparing the level of likelihood and consequence arising from compliance risks with the organisation’s risk tolerance to guide the extent of implementing controls to reduce this risk within tolerance.

Compliance risks should be re-assessed periodically and whenever there are significant internal changes to the business or external changes in the business and regulatory landscape.

In particular, the ISO 19600:2014 importantly states that ‘the risk-based approach to compliance management does not mean that for low compliance risk situations, non-compliance is accepted by the organisation. It assists organisations in focussing primary attention and resources on higher risks as a priority. All identified compliance risks/situations are subject to monitoring, correction and corrective action.’

How has the compliance role and responsibilities of an organisation’s governing body evolved?

An organisation’s compliance with its obligations becomes sustainable when this is embedded in the behaviour and attitude of everyone working in the organisation. For this to be possible, active commitment from the governing body and top management is required that permeates the whole organisation.

In particular, the following can influence compliance behaviour and outcomes:

- Incentives and deterrence measures such as those impacting remuneration, performance management, and promotions can act as a mechanism to reward good behaviours and penalise poor conduct
- Applying governance principles to provide the compliance function with appropriate authority, adequate resources and direct access to the governing body whilst maintaining its independence from frontline.

ASIC has announced its focus on culture as part of its risk-based surveillance reviews in its corporate plan. The ISO 19600:2014 reiterates compliance culture further by compliance being ‘integrated with the organisation’s financial, risk, quality, environmental and health and safety management processes and its operational requirements and procedures.’

By identifying, analysing and evaluating compliance risks as part of an organisation’s risk profile, objectives, and strategy, an enterprise risk management-aligned compliance risk management framework can be developed to evaluate each compliance risk’s business significance in the context of an organisation’s macro risks and goals.
Key enablers to developing a risk-based compliance management system

The evolving business and regulatory landscape has meant that organisations are continually trying to meet the expectations of their shareholders in line with corporate strategy while meeting regulator expectations and satisfying customer demands. Regulators are turning their attention to qualitative issues such as risk culture and effectiveness of internal controls. As such, organisations should evaluate their enterprise-wide risk management systems to determine the extent to which compliance risks are considered and their impact on strategic objectives. The following key enablers will help build a risk-based compliance management system:

• Obtain active compliance commitment from governing bodies demonstrated by incorporating compliance risks into the enterprise-wide risk profile and strategic development initiatives
• Actively monitor the regulatory landscape to identify new compliance obligations that may prompt a compliance risk re-assessment, training initiatives and changes to policies and procedures
• Integrating a compliance management system with key business processes. For example, the proposal to introduce a new product or service should consider compliance risks as part of the due diligence to evaluate suitability to a specific targeted customer demographic or distribution channel
• Measuring compliance performance through the development of key compliance risk indicators that can be a combination of activity-based, reactive or proactive indicators. For example, a proactive indicator can involve measuring customer satisfaction with regards to a new product or measuring whether a product is being sold outside its target market.
Footnotes

3. Daniel Kahneman Thinking, Fast and Slow (2011)
4. International Organisation of Securities Commissions IOSCO Board focuses on behavioural economics and social media (Media Release, IOSCO/MR/24/2013, 1 July 2013),
11. Mr Ravi Menon, Managing Director of the Monetary Authority of Singapore, 23 January 2015 http://www.bis.org/review/r150126d.htm
16. On July 14, 2015, the P5+1 (China, France, Germany, Russia, the United Kingdom, and the United States), the European Union (EU), and Iran reached a Joint Comprehensive Plan of Action (JCPOA) to ensure that Iran’s nuclear program will be exclusively peaceful
17. Refer to the US Department of State Guidance on the lifting of Certain US Sanctions Pursuant to the JCPOA (click here).
18. Refer to the Information Note on EU sanctions to be lifted under the JCPOA for a detailed summary of EU’s recent changes concerning Iranian sanctions (click here).
19. Australian Standard 3806-2006 Compliance Programs
Contact us

Kevin Nixon  
Lead Partner, Risk & Regulatory  
Financial Services  
Tel: +61 2 9322 7555  
kevnixon@deloitte.com.au

Tim Oldham  
Lead Partner, Risk & Regulatory  
Banking  
Tel: +61 2 9322 5694  
toldham@deloitte.com.au

Sarah Woodhouse  
Lead Partner, Risk & Regulatory  
Wealth Management  
Tel: +61 2 9322 7510  
sawoodhouse@deloitte.com.au

James Nunn Price  
Partner, Risk Advisory  
Tel: +61 2 9322 7971  
jamesnunnprice@deloitte.com.au

Vivienne Tang  
Partner, Governance,  
Regulation and Conduct Advisory  
Tel: +61 3 9671 6742  
vtang@deloitte.com.au

Joel Lipman  
Partner, Financial Services  
Tel: +61 3 9671 7302  
jlipman@deloitte.com.au

Grant MacKinnon  
Director, Risk Advisory  
Tel: +61 2 9322 3693  
gmackinnon@deloitte.com.au

Prashanti Ravindra  
Director, Governance,  
Regulation and Conduct Advisory  
Tel: +61 2 8260 4013  
pravindra@deloitte.com.au
Ella White
Director, Governance, Regulation and Conduct Advisory
Tel: +61 3 9671 8251
ellawhite@deloitte.com.au

Aneliese Algie
Director, Assurance & Advisory, Financial Services
Tel: +61 2 9322 5450
amaione@deloitte.com.au

Adam Ruff
Director, Risk Advisory
Tel: +61 3 9671 7880
adaruff@deloitte.com.au

Tina Lin
Manager, Governance, Regulation and Conduct Advisory
Tel: +61 2 9322 5846
tjlin@deloitte.com.au

Steven Byrne
Manager, Governance, Regulation and Conduct Advisory
Tel: +61 3 9671 5364
stbyrne@deloitte.com.au

Alana Weight
Manager, Governance, Regulation and Conduct Advisory
Tel: +61 7 3308 7558
alweight@deloitte.com.au

Louise Denver
Director, Corporate Affairs & Communications
Tel: +61 414 889 857
ldenver@deloitte.com.au