SIFMA Compliance & Legal Society 2020 Annual Seminar

Panel on Establishing and Maintaining a Robust Cross-Border Program

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1. INTRODUCTION

The legal and reputational risks associated with cross-border financial services have increased enormously in the last decade. These risks will continue to increase over the next decade. Cross-border programs are an essential tool for firms to manage these risks and to adjust to future challenges.

Looking at 2019, there have been several significant changes in regulatory regimes in key jurisdictions including Luxembourg, Switzerland, Israel and Australia.

Enforcement action by regulators, like the FCA in the UK, has generally been on the increase since the financial downturn, as evidenced by the increased number and level of publicised fines\(^1\). The exception was 2018 where we saw a notable dip in enforcement action across Europe, probably explained by the focus on the far-reaching changes brought about by MiFID2 which came into force in January 2018. However, the pace in 2019 seems to be surpassing 2018 as the general upward trend continues.

Our overall perception, based on a survey with counsel in over 100 jurisdictions\(^2\), is that enforcement action with a cross-border element varies from region to region and is increasing in two areas. First, the more developed jurisdictions where global firms operate through a mixture of branches, affiliates and reach-in/fly-in activities have seen enforcement action, such as in France, Australia and the US. Second, there is a focus on online trading platforms which are often blocked, as opposed to fined, as regulators try to grapple with the cross-border nature of those types of web-based offerings. The focus still naturally seems to be on the consumer market but there are more investigations into the wealth side and even in the institutional space. Brexit will undoubtedly be a factor going forward, in particular in relation to Europe, but also with how Europe interacts with other regions such as Asia and the Americas. Finally, developments in the crypto space and other fin tech disruptors are likely to get significant attention in the next few years.

Following the financial crisis, many jurisdictions introduced more sophisticated legal regimes, began enforcing their existing laws more rigorously and increased the level of sanction for breach. The Dodd-Frank Act, CRD IV, MiFID II, the Senior Manager and Certification Regime, EMIR, PSD2, the

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\(^1\) UK FCA regulatory fines.
\(^2\) Survey conducted in January 2020 of over 100 jurisdictions; Simmons & Simmons navigator services.
Benchmarks Regulation and MAR are just a few of the pieces of legislation that have been passed as a result of the financial crisis. Mitigating the regulatory risks associated with cross-border banking services is therefore complex and requires financial institutions to ensure that they are compliant with not only their domestic regime but also the laws and regulations of any other jurisdictions in which they operate. This challenging task is made all the more complex by differences between, and duplication of, regulation that applies to cross-border financial activity. In order to manage regulatory risks, financial institutions need robust cross-border frameworks which:

- set out the local laws and regulations in each jurisdiction;
- enable the financial institution to identify and control cross-border risks;
- assist the financial institution to implement measures to execute their cross-border business in a compliant manner; and
- are frequently updated.

This panel looks at the ways in which establishing and maintaining a robust cross-border program can assist firms to manage and mitigate these risks and challenges.

2. CHALLENGING CONCEPTS IN CROSS-BORDER BUSINESS

Anyone familiar with global financial services will be aware that regulation varies significantly amongst jurisdictions – especially when it comes to cross-border business as distinct from domestic business. For domestic business, the laws and regulations (including guidance) are typically clear and regulators have a firm view, in most cases, as to what is regulated and what the process for obtaining authorization is.

For cross-border business the lack of express legal commentary and the nature of the nexus with each jurisdiction add significant complexity. For each jurisdiction, the key considerations include:

- **Licensing:**
  - trigger for licensing
  - carrying on business
  - physical presence
  - use of intermediaries or agents
  - remote booking
  - chaperoning
  - client specific restrictions/product specific restrictions

- **Exemptions:**
  - legal
  - tolerated market practice
  - reverse enquiry

In this panel session, we will discuss these concepts further.
3. INITIATING AND ESTABLISHING A CROSS-BORDER PROGRAM

Regulatory obligations

Regulators of global financial markets expect firms to have robust compliance programs in place. The FCA, the UK regulator, makes clear in its Handbook in SYSC that a firm must establish, implement and maintain adequate policies and procedures sufficient to ensure compliance of the firm including its managers, employees, appointed representatives with its obligations under the regulatory system. These requirements are derived from the MiFID directive and apply to investment firms across the EEA, as implemented by the local regulator in each jurisdiction.

In the UK, HK, and Singapore, senior managers responsible for international business now also have personal liability for the conduct of the firm under their respective management.

How to obtain the advice

Advice is often sought by financial institutions across multiple jurisdictions as they seek to understand what can and cannot be done in a given jurisdiction and the related steps that must be taken to ensure that they operate within the boundaries of the regime in that jurisdiction. This typically requires input from legal counsel and other professional services firms across many jurisdictions around the world.

In the last decade, law firms and professional services firms have turned to technology to provide efficient, tailored and accessible solutions for their clients. These innovative technological solutions provide clients with multi-jurisdictional advice in a harmonised, cost-effective, succinct and user-friendly way.

Typical Cross-Border Program Clients

a) Private Client Offshore Wealth Services

Wealth managers and private bankers frequently need to cross borders to service their international client base. Institutions who offer private client offshore wealth services need to be aware of the latest regulatory developments in their home jurisdiction as well as their clients’ country of residence.

Regulatory frameworks such as consumer protection regulations, investor protection rules and the Foreign Account Tax Compliance Act (FATCA) have all had an impact on private banks and wealth management firms and their cross-border operating models.

Private banks intending to service clients, new or existing, may either set up a branch in the client’s home jurisdiction, provide services on a ‘reach-in’ basis (i.e. providing products and services remotely to the client who stays in its home jurisdiction) or provide services on a ‘fly-in’ basis (i.e. providing products and services in the client’s home jurisdiction). There are many challenges to the provision of these services including:

- the differences between local regulations;
- the fact that certain regulations may prevail;
- the different approaches taken by the relevant supervisory authorities;

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3 SYSC 6.1.1
4 MiFID 16(2)
language/translation requirements;
- frequency/duration/totality of visits annually;
- whether it is necessary to set up a local branch or subsidiary to carry out business in the jurisdiction;
- whether the institution is ‘carrying on business’ in the jurisdiction and what the location of the provision of the service is; and
- whether a passive, ‘reverse solicitation’, principle is adopted in the jurisdiction and the steps that must be taken to evidence the way in which the client is contacted.

Private banks must also consider rules governing the sale of financial services, including marketing, consumer protection, distance selling and financial advice to consumers as these rules vary from jurisdiction to jurisdiction and add complexity.

Country-specific regulatory solutions that are digital and easily portable should provide wealth managers and private bankers with clear instructions about the permissible products and services in any given jurisdiction, enabling them to remain compliant and competitive.

b) Investment and Corporate Banking

Investment and corporate banks also need to manage their global cross-border risk. The law and regulation applicable to investment and corporate banks is highly complex and uncertain and often attaches severe sanctions for breach. Many banks have existing business practices which are inflexible, and frequent change and the constant evolution of products and services can present structural challenges. Banks’ appetite for risk also needs to be taken into account.

The use of external legal advice is key to investment banks mitigating their risk when conducting cross-border business. Investment banks look for service providers who know their businesses, have leading multi-jurisdictional teams, experience of similar projects, dedicated cross-border teams and who take an innovative and efficiency-driven approach. A typical request from an investment bank to a financial services regulatory team in a law firm is to source cross-border financial regulatory advice in relation to a specified list of jurisdictions and to transpose that advice into tailored country guides which reflect a harmonised perspective on the bank’s business activities and risk appetite. This advice can also be converted into digital content, entered into, stored in and disseminated through a single legal database and updated at regular intervals.

4. LEVERAGING TECHNOLOGY

*Technology can be leveraged in many ways.*

a) Advice needs to be delivered in an easily digestible way to Compliance and Sales/Bankers

Cross-border regulatory advice needs to be valuable, accessible and succinct. Technological solutions are valuable tools in reformatting complex legal advice into practical rules-of-the-road which can be used by legal, business and compliance teams.

A typical approach is to prepare two sets of advice: one for the client’s legal team and another for the client’s compliance or sales/banking teams. The advice prepared for the legal team is comprehensive and detailed whilst the advice prepared for the compliance/sales/banking teams is condensed and non-legalistic. RAG (red, amber, green) tables are a quick way to condense detailed, bespoke advice into a format which can be used at-a-glance by non-legal personnel.
b) Need governance – link advice to travel approvals and keep records, etc.

It is essential that regulatory advice is reflected in the way the financial institution operates its cross-border business model. Strict frameworks should be put in place and adhered to and relevant records kept as advice relating to cross-border business in any given jurisdiction could cover a huge number of topics.

Detailed jurisdictional advice, for instance, will set out the specific activities that may be carried out and the basis on which they may be carried out, for example on a reach-in or a fly-in basis. This advice acts as a rules-of-the-road for the jurisdiction and should be reviewed before any activity is undertaken in a given jurisdiction.

It is important that records are kept of scale, continuity and repetition of activity in each jurisdiction to ensure that the level of activity does not constitute carrying on business in the jurisdiction.

Typically, clients would link the jurisdictional advice to their online travel tool so that necessary pre-approvals are requested before any travel to the jurisdiction takes place. This is an area where leveraging technology to assist the business but also to provide additional controls can make a real difference.

c) How to condense legal advice from multiple jurisdictions into a usable database

The standardisation of advice across jurisdictions is key when providing clients with cross-border advice for multiple jurisdictions. Although the source of the advice will be different local law firms around the world, the retained firm will act as the hub. This role encompasses:

- sourcing, instructing and liaising with all local law firms, as well as arranging payment for their services;
- reviewing and commenting on the output from the local law firms;
- ensuring consistency across the advice (e.g. that jurisdictions where the licensing position is the same are described consistently); and
- providing the client with the final work product on a user-friendly platform and acting as the central point of contact for queries.

Often, carrying out a trial across a small number of priority jurisdictions enables the process to be tailored and streamlined, with any template documents finalised before being rolled out across the remaining jurisdictions.

Again using technology to deliver the guidance to the business, either via portal or an app, is an option for firms.

d) How to maintain the cross-border program

Once the program is established, it is key to ensure that the information is kept up to date. Regulation is an area of constant change – whether express (change in law) or implied (change in a regulator’s position). If not maintained there is a risk that the firm is found to be operating in breach of local regulations.

There are various ways in which program maintenance can be achieved, and it will vary depending on the size of the firm’s operations internationally. The most common ways this is done is by running
regular update programs (annual, bi- or tri-annual) using external counsel or more continuously by accessing law firm cross-border databases. Once information of change has been received, the challenge will be to apply this to business specific situations and to update business guidance as necessary. Further or new controls and training may be required in this process.

The introduction of new products or services or new jurisdictions will also need to be fed into the maintenance piece, again showing the continuous evolution of any cross-border program.

5. GLOBAL BOOKING MODELS

a) How to govern complex financial institutions with multiple products/businesses – coordination between businesses and countries

Booking models have been a key area of focus for a number of years due to increasing interest from UK and US supervisory authorities. With significant changes to market access rules expected once the UK leaves the EU, regulatory attention on the cross-border practices of banking groups is only intensifying.

What is a booking model?

A booking model describes a bank’s product mix, client base, risk management, operating structure and capabilities. It is the combination of branches, subsidiaries, physical and human infrastructure, and oversight frameworks through which the group transacts in financial instruments and manages the resulting exposures. Trades are “booked” into particular legal entities, which then hold the risks and rewards, and which are accounted for on their balance sheets under the relevant accounting standards.

The booking model is a set of principles which dictates in a systematic way how these instruments are booked, where they are booked to, and how the risks are then managed. The booking model sets out what should be done, along with a rationale. The emphasis on a systematic framework is important – a booking model is more than just a description of how an individual business line books its business.

6. TIPS ON HOW TO RUN GLOBAL REGULATORY PROJECTS

There are many key questions to be addressed at the outset of a project of this kind. Examples of these questions are set out below.

1. Identify scope: coverage of regions, business lines, products, services. Timing and budgets clearly identified up front. Any lessons learned from previous projects identified. Consider doing a feasibility study at outset.

2. Rational for project: why is the project required? Is it to ensure compliance, is it to make existing guidelines more practical, is it to digitalise processes, is it align risk across regions/divisions? What can be improved? Future proofing - is this a staged process.

3. Identify stakeholders: who owns the project? Who needs to be consulted? How to get buy in to proposed output across all stakeholders? Agree ‘risk policy/appetite’ of the firm. Get buy in on key messaging/outcomes with senior business owners to avoid difficulties in implementation.

5. Pilot phase: before starting in earnest, run a pilot to determine output and to get stakeholder buy in. Ensure engagement across stakeholders and regions.

6. Finalise the output-template: if you are doing global projects, it is essential that the output is agreed and not amended throughout the project, particularly where a large number of jurisdictions are being covered. This will save costs and time.

7. Ownership of internal review: identify a small number of people who can take decisions/ensure consistency in approach.

8. Ongoing communication/ lessons learned: open communication with advisors and ongoing reporting.

9. Closing out: ensure internal team working with advisors are working towards closing out the advice. Agree most efficient way to do so, such as regular webex, calls, emails etc.

10. Implementation: roll out to business. Training on new guidelines. Establish support including key Q&A. Consider establishing oversight tools to identify risks across the institution and coordinate with maintenance to manage changes.