GLOBAL REGULATORY OUTLOOK

VIEWPOINT 2015

Opinions on global financial services regulation and the regulatory environment for the year ahead

As at 17 November 2014

Kinetic Partners
A Division of DUFF & PHELPS

CONTENTS

EXECUTIVE SUMMARY

Julian Korek
Chief Executive Officer
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If the financial services industry has not grown to love regulation, it is growing to accept it, according to Kinetic Partners' Global Regulatory Outlook (GRO) 2015 survey. The GRO 2015 survey sampled 283 financial services professionals, including 118 executives, from around the world to gauge the industry's perception and expectation of the key regulatory developments impacting business through 2015 and beyond.

39%
of senior executives believe that regulation is having a positive impact on stability in the financial services industry*

*All figures taken from our GRO 2015 survey

Our survey for this year's report shows increasing acceptance of the role of recent regulation. As seen in Figure A, more than one-third (39%) of senior executives (and 38% of non-executive survey participants) now say regulation is promoting stability in the financial services world. That is still a minority, but it is up from 30% last year and just 19% two years ago when we first asked. The proportion thinking regulations have little or no impact has shrunk over the same period, from almost two-thirds (63%) to under half – at 48% – today.

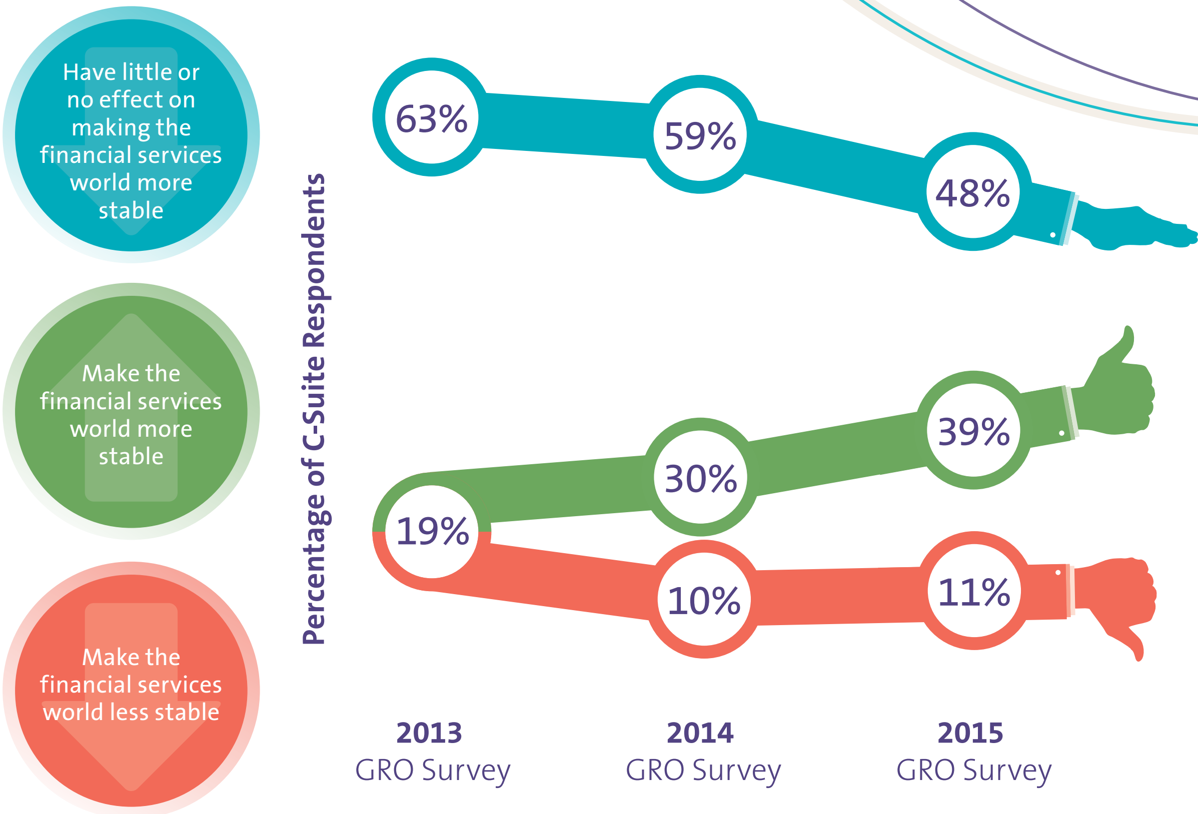
This softening in attitudes probably reflects a number of factors. One, no doubt, is growing confidence in the system over the past year, recent market wobbles, notwithstanding. As I write, the majority of the big US banks have reported strong third quarter profits. In the UK, despite some struggles, the Office of National Statistics' (ONS) recent figures show that financial sector profits are back to their pre-crisis peak and bonuses are at their highest rate since the crisis, too.[1]

With profits and bonuses not only continuing and indeed strengthening, it is harder to argue that regulations are undermining the industry to any significant degree, although 11% of all respondents do think regulations have made the financial services world less stable.

[1] ONS Economic Forum, October 2014, http://www.ons.gov.uk/ons/about-ons/get-involved/events/events/economic-forum/october-2014/index.html

FIGURE A - The impact of regulation on stability

DO YOU BELIEVE THAT FINANCIAL SERVICES REGULATION WILL*:



Note: The above figures do not include respondents who selected "Don't know"

**All figures taken from our GRO 2015 survey*

Key areas and criminal responsibility

There is another factor likely to be tempering firms' concerns, however: as last year's GRO report anticipated, regulators and the industry have moved from debating and drafting legislation to implementing and enforcing it.

Of course, that is not without difficulties for firms. Despite some criticism, the US Securities and Exchange Commission (SEC) shows no appetite to abandon its "broken windows" approach to regulation, cracking down on even minor infringements. In the UK, meanwhile, Bank of England governor Mark Carney has, in effect, told those unhappy with new rules potentially imposing criminal liability for bank failures to learn to adjust to the new standards, as this will be the law of the land moving forward. Senior respondents in our survey expect market abuse (44%), tax-related issues (22%) and high-frequency trading (18%), just ahead of anti-money laundering (AML) issues (14%), to be key focus areas for regulators.

However, the flipside is that firms are now operating increasingly in a post-implementation environment. They have less to worry about what regulations might require, and more about how to meet requirements in place. In short, they have greater certainty. There is even some support for making executives criminally responsible for the actions of firms, though the majority of survey respondents still believed it would be a bad thing. Nearly a quarter (23%) of senior executives (and 33% of others) backed the idea, as opposed to 40%, who say it will have a long-term negative impact.

Crisis and reputations

There is still skepticism about how much regulation can achieve, however. Even if some think regulation is adding to stability, the number of individuals who are confident that we are safe from another crash remains small. Just 2% of executives believe changes to regulation since the crisis have been adequate to prevent another crash. Over half of those polled (54%) think the risk has only been partly addressed.

There is also limited faith in the ability of regulation to restore the industry's reputation. While 43% of senior executives believe regulation can help rebuild financial services' reputation, more than half think it will either have little impact (50%) or tarnish the industry further (5%). Rebuilding trust, say those polled in the survey, requires public education (34%) and greater transparency in governance and management functions (27%), rather than increased fines on firms (5%).

Internally, more than half (53%) of executives cited that the culture of the company was the most important factor to get right to avoid regulatory problems. Externally, most executives consider principles-based regulation (30%) to be the most important factor. Consistency across borders was the second most-cited with a quarter of senior executives calling for single global regulatory standards.

53%

of executives cited that the culture of the company was the most important factor to get right to avoid regulatory problems*

All figures taken from our GRO 2015 survey

Trading places

The industry is not alone in desiring the latter, at least. In its most recent report on global financial stability in October, the International Monetary Fund (IMF) again called for international cooperation, this time to tackle the risks of shadow banking.

As it stated: *"Strong international policy cooperation is needed to prevent cross-border regulatory arbitrage and to address risks to global financial stability. Risks are more likely to increase when regulatory initiatives are implemented by only a few countries, or when they are poorly coordinated."*[2]

If rules are to be coordinated, however, the question arises as to whose standards will dominate.

Among those polled in the GRO 2015 survey, the leading financial centres remain New York (59%) and London (38%). In five years' time the two cities are still expected to dominate (with 46% and 28%, respectively), but 6% of survey participants say Hong Kong will lead. The leading emerging market centre in five years is expected to be Shanghai, by a significant margin – 53% of respondents (and 73% among those in Hong Kong), although nearly a quarter (22%) didn't know.

As capital markets in China open to the outside, it is interesting to ask how long the traditional centres and their regulators can assume it will be their standards that apply. As it is, Hong Kong is already trailing only New York and London for the number of IPOs in mid-October, according to Dealogic, and will be boosted by November's launch of Shanghai-Hong Kong Stock Connect, enabling foreign investors to access the Shanghai market.[3] A report by Credit Suisse in July predicted China would overtake the UK (and Japan) to become the second-largest global equity market after the US by 2030.[4]

The fate of London in our survey is interesting in this respect. Just two years ago 65% of survey respondents believed it to be preeminent, against 31% who cited New York. Now, the positions are almost entirely reversed.

Two lessons can be drawn. One, perhaps, is that while the industry can learn to live with regulation, there's little toleration of uncertainty. The tortuous progress in enacting and implementing the Alternative Investment Fund Managers Directive (AIFMD) and continuing shadow of the proposed EU financial transaction tax, for example, will have done London few favours.

The other lesson, however, is more certain and simpler: while Western financial centres dominate today, things can change quickly. In the debate and development of global standards, governments, regulators and firms in those centres should not assume theirs will remain the only voices for long.

If you have any questions or comments on any of the topics discussed in the GRO report, we would be pleased to hear from you. If you are interested in receiving periodic updates on relevant regulatory developments, you may sign up for these and other communications by emailing info@kinetic-partners.com.

[2] IMF Global Financial Stability Report October 2014 Risk Taking, Liquidity, and Shadow Banking https://www.imf.org/external/pubs/ft/gfsr/2014/02/pdf/text.pdf

[3] Jeremy Grant, Financial Times, "Singapore jostles with Hong Kong for financial crown." 16 October, 2014 http://www.ft.com/intl/cms/s/0/b18372a6-5297-11e4-a236-00144feab7de.html?siteedition=intl#axzz3HEWVUiV9

[4] Credit Suisse, "Emerging Capital Markets: The Road to 2030." July 2014 https://publications.credit-suisse.com/tasks/render/file/?fileID=9C351493-CF21-3FE8-DD5FBB479EA88C54

Eradicating human slavery: the impact on financial services of fulfilling growing regulatory expectations

By Arthur Middlemiss, Partner at Lewis Baach PLLC and former bureau chief of the New York District Attorney's International Financial Crimes bureau; Hillary Rosenberg, Counsel at Lewis Baach PLLC and former Assistant District Attorney in New York.

Arthur Middlemiss
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Human trafficking is slavery, the trade in human beings. It involves recruiting, transporting, harboring or receiving human beings, by the use of force, threats of force, fraud, or other forms of coercion, including the abuse of power or a position of vulnerability.[5]

Human beings are trafficked for purposes of sexual exploitation, forced labor, or even for the removal of organs. Apart from the drug trade, human trafficking represents the world's fastest growing, and second most profitable, criminal enterprise.[6] For good reason, human trafficking receives growing law enforcement and regulatory attention. We expect the trend to continue in 2015. In particular, two sectors should expect higher levels of regulatory scrutiny with respect to the issue: financial institutions and federal contractors that maintain labor-intensive supply chains.

Financial institutions

In September 2014, the US Department of the Treasury Financial Crimes Enforcement Network (FinCEN) issued guidance designed to help financial institutions identify and report financial transactions involving human trafficking activity.[7] FinCEN's guidance signals clearly that financial institutions need to understand human trafficking-specific typologies, evaluate their exposure to relevant activity in their AML risk assessments and tailor their AML monitoring systems to identify and report it. Simply stated, in 2015, financial institutions should expect regulators to ask them what they are doing about human trafficking.

Many financial institutions will be able to provide regulators exemplary answers. In recent years, many financial institutions have grappled with human trafficking, and dedicated substantial AML compliance resources to identify human trafficking-related transactions. Examples of successfully developed human trafficking-related AML typologies include low-dollar, high-volume transfers for the benefit of internet classified advertising agencies promoting adult services, and late night, after-closing-hours high-dollar credit card transactions at nail salons (both typologies present high risk that trafficked individuals are being sexually exploited). Learning the tell-tale signs of human trafficking transactions empowers AML investigators both to protect their institutions and to provide law enforcement real, actionable intelligence.

“Learning the tell-tale signs of human trafficking transactions empowers AML investigators both to protect their institutions and to provide law enforcement real, actionable intelligence.”

[5] Protocol to Prevent, Suppress and Punish Trafficking in Persons, Especially Women and Children, supplementing the United Nations Convention against Transnational Organized Crime, Dec. 25, 2003, art. 3, T.I.A.S. No. 29574, 2237 U.N.T.S. 319, available at http://www.uncjin.org/Documents/Conventions/dcatoc/final_documents_2/convention_%20traff_eng.pdf (last viewed Sept. 30, 2014).

[6] See, e.g., “End Trafficking,” Unicef, available at http://www.unicefusa.org/sites/default/files/assets/pdf/End-Child-Trafficking-One-Pager.pdf (last viewed Sept. 30, 2014); “Human Trafficking,” State of California Department of Justice, Office of the Attorney General, available at http://oag.ca.gov/human-trafficking (last viewed Sept. 30, 2014).

[7] “Guidance on Recognizing Activity that May be Associated with Human Smuggling and Human Trafficking – Financial Red Flags,” Advisory, FinCEN, Sept. 11, 2014, FIN-2014-A008, available at http://www.fincen.gov/statutes_regs/guidance/pdf/FIN-2014-A008.pdf (last viewed Sept. 30, 2014).

Federal contractors

Federal contractors with long, labor-intensive supply chains should also expect heightened regulatory scrutiny in 2015. Since 2006, federal contractors have faced an increasingly complex array of human trafficking compliance-related requirements.[8]

Proposed US regulations require federal contractors to focus on well-known indicia or "red flags" of trafficked labor such as unfair recruitment practices, low wages and poor living conditions, and to report such activity if it is detected. These rules, expected to become final later this year, would also require certain government contractors to develop and implement an anti-human trafficking compliance plan and annually certify that their agents and subcontracts are not engaged in human trafficking.[9] In addition, California is the first state to require certain retailers and manufacturers doing business in the state to publicly disclose steps taken to eliminate human trafficking in supply chains.[10]

Financial institutions monitoring transactions for indicia of human trafficking-related activity should be aware of these regulatory expectations for federal contractors, as they may inform their human trafficking-focused AML efforts, including with respect to on-boarding new customers and enhancing potential transaction-related inquiries to existing clients. Below, we describe these expectations.

Similar to the construction of a financial institution's AML compliance program, the basic elements of a regulatory sufficient human trafficking compliance plan will require US government contractors to:

1. Create anti-human trafficking policies and procedures to detect, deter and report human trafficking-related activity
2. Develop training programs
3. Provide for responsible internal program oversight
4. Allow for third-party testing and review

For federal contractors, a well-executed risk assessment is essential to informing the design and implementation of an effective anti-human trafficking compliance program. Following completion of a risk assessment, companies should develop and implement, or be prepared to enhance, relevant controls to prevent and detect human trafficking-related activity. This includes appointing someone to be responsible for the overall compliance program. Common controls include conducting and documenting due diligence, inserting representations and warranties into contracts, developing and executing a training program and creating protocols allowing individuals to report confidentially allegations of human trafficking. These controls should be tested periodically by an independent third party.

In addition, financial institutions that know about these increased regulatory expectations may be better positioned to identify human trafficking-related risk presented by their customers' transactions and to pose inquiries to their clients about questionable activity. We discuss each of these compliance expectations in turn overleaf.

Some of the red flags discussed are also useful in considering the development of human trafficking-related AML typologies.

Due diligence

Adequate and effective due diligence helps identify third-party risk, i.e., the risk that someone the company hires to perform services will utilize trafficked labor. Key elements of third-party due diligence include:

- Examining the third party's corporate structure
- Ensuring qualifications for the proposed engagement
- Considering business reputation
- Assessing involvement in industries or sectors high risk for human trafficking (e.g. restaurants, hotels, nail salons, factories, farming and agriculture)
- Understanding the business rationale for engaging the third party, including whether the cost of the contract reflects market and industry practice

[8] See, e.g., Exec. Order No. 13627 (Sept. 25, 2012), available at http://www.gpo.gov/fdsys/pkg/DCPD-201200750/pdf/DCPD-201200750.pdf (last viewed Sept. 30, 2014); National Defense Authorization Act for Fiscal Year 2013, Pub. L. No. 112-239, §§ 1701-08, 126 Stat. 1632, 2092-98 (2012).

[9] Federal Acquisition Regulation; Ending Trafficking in Persons, 78 Fed. Reg. 59317, 59317 (to be codified at 48 C.F.R. pts. 1, 2, 9, 12, 22 and 52).

[10] California Transparency in Supply Chains Act of 2010, CAL. CIV. CODE § 1714, 43 (2010).

Common red flags include a third party's assertion that it will complete work in an unreasonably short period of time or below market rates, that it implements workplace practices that impede worker freedom (e.g. passport retention), or that it maintains poor living conditions for its workers. For third parties posing higher human trafficking risk, periodic monitoring protocols could be employed. These protocols might include updating due diligence more frequently, performing on-site visits, exercising audit rights, providing periodic training to the third party and requesting annual certifications that the third party does not use trafficked labor.

Contractual representations and warranties

Contractual representations are often used to control risk. Anti-human-trafficking contractual provisions may include:

- Representations and undertakings that the third party will comply with human trafficking laws
- Access to audit the counterparty's books and records
- Indemnity provisions if the third party violates human trafficking laws
- Rights to terminate the engagement for violations of human trafficking laws

Confidential reporting and internal investigations

Effective human trafficking compliance programs should include procedures that allow individuals to report allegations of trafficking confidentially, without fear of retaliation. Employee training on hotline reporting procedures should reference the importance of reporting human trafficking concerns, and the individuals operating the hotline should receive training on how to handle such calls.

Training program

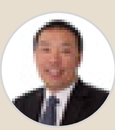
Training is vital to communicating the policies and procedures employees are expected to know and follow. Who receives training, how often it is provided and the method in which it is provided (e.g. online module, in-person, etc.) will be driven by the risk assessment results. The highest-risk employee populations should receive more in-depth training. Training sessions should also be well-documented, reflecting the attendees, date of training, length of training, training method and the list of materials provided at the training session.

Independent testing

Testing ensures that a compliance program exists not just on paper, but that its policies and procedures have been integrated into the company's operations and culture in both principle and substance. A company's general audit group may perform this testing function; however, to demonstrate a robust compliance program to regulators, it is beneficial to have an independent, external group conduct the testing.

Conclusion

In 2015, we expect regulatory pressure related to human trafficking to increase. As the law governing human trafficking-specific compliance evolves, there will be increased pressure placed on companies to develop compliance programs that identify and report human trafficking in supply chains. Per the recently-issued FinCEN guidance, financial institutions have a key role to play in monitoring transactions and data as part of their regulatory duty to report suspected illegal activity. Understanding the increased scope of the regulatory expectations placed on their customers should help financial institutions fulfill this role.



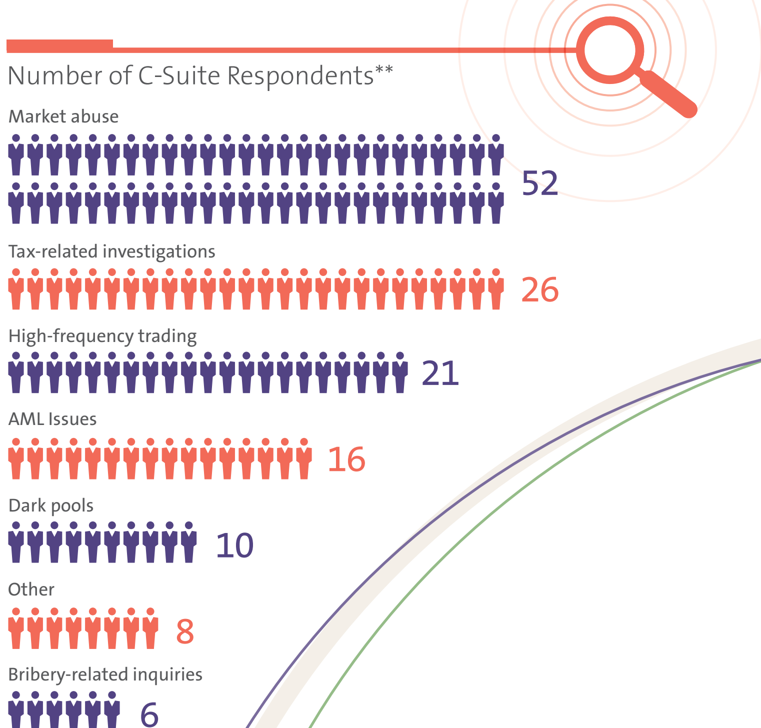
Derek Chung
Executive Director
Morgan Stanley Prime Brokerage

COMMENT

"Regardless of size, almost all financial institutions are subject to multiple regulators and making sense of the differing requirements is quite overwhelming and has led to a significant increase in costs. Greater co-ordination between national regulators can help ease this burden."

FIGURE B - Key focus areas for regulators

IN WHICH AREA DO YOU EXPECT REGULATORS TO FOCUS MOST IN THE COMING YEAR?*:



**All figures taken from our GRO 2015 survey*

*** Note: respondents could select more than one option if applicable*

HOME

Simon Appleton
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VIEWPOINT: MARKET ABUSE AS A KEY FOCUS FOR REGULATORS

Given the increasing awareness of how abusive market activity can impact institutions and consumers alike, it is expected that market abuse and market conduct issues will continue to be a focus for regulators globally.

Indeed nearly half (52 of 118, or 44%) of senior executives surveyed in our GRO 2015 survey cited market abuse as one of the key areas they believed regulators would prioritise in the coming year, the highest response area (Figure B).

Recent enforcement cases brought on grounds of manipulation of interest rates and foreign exchange benchmarks have shown the industry that regulators are not only reviewing transactions and trading activities, but are expanding the scope of their investigations to include communication with clients and other market participants via channels such as Bloomberg.

In particular, the recent case where UK and US regulators investigated and fined five banks £2bn collectively for traders' attempted manipulation of foreign exchange rates highlights the sophistication of the regulators in stamping out market abuse activities, not least because they are looking into complex areas by implementing better technology, deploying high calibre experts and collaborating across jurisdictions. Market conduct risk assessments and e-communication surveillance should be a priority for firms, which often necessitates leveraging archiving tools to complement existing trade and order monitoring systems.

In some regards, the regulators are playing catch-up with developments in the industry as they seek to deter, detect and prosecute abusive market activity, including in relation to automated trading execution strategies such as high-frequency and algorithmic trading. Initiatives such as EMIR and MiFIR in Europe were not only developed in response to the financial crisis but are being shaped by scandals in interest rate, foreign exchange and potentially commodity markets, where millions of trades take place every day.

Under MiFIR transaction reporting, regulations to help the authorities monitor for market abuse, client abuse and market developments will be extended from the current equity- and debt-related instruments to encompass all asset classes. The resultant reporting requirements will be much more complex and costly than in years past (in many cases requiring firms to undertake massive system re-builds to accommodate the nearly three-fold increase in requisite information). However, the effective implementation of these changes can help limit long-term costs and mitigate the risk of regulatory scrutiny and action.

A firm's first-line of defence when it comes to transaction reporting, surveillance and conduct risk is establishing clear ownership and communication at the outset of implementation, led by a project team comprised of professionals from every core function at the firm (including IT, compliance, operations and even the front office).

Transparency and clarity of responsibilities is essential for ensuring effective governance, efficient issue escalation and team member accountability. This in turn depends on senior leadership across the business having a comprehensive understanding of not only the regulations, but also the firm's IT systems and every facet of the business itself, such as the products traded and which areas are exposed to risk.

The project team responsible for administering the transaction reporting and surveillance functions should meet regularly to address and manage any changes and evolving risks that may impact the business. This can include developments in the regulation, product and business changes, evolving IT needs and staff turnover.

The aim of mitigating market abuse risk at the firm level requires a significant commitment of resources, both personnel and technology, but such an investment is critical to success for the business. The public expects those operating in the markets and employed by regulated firms to act with integrity and in the consumers' best interests. It is therefore the obligation and burden of those firms and employees to maintain market confidence by adopting the appropriate internal monitoring framework and controls.

44%
of senior executives surveyed cited market abuse as one of the key areas they believed regulators would prioritize in the coming year*

**All figures taken from our GRO 2015 survey*

Monique Melis
Partner
Global Head of Regulatory Consulting
Kinetic Partners, London

VIEWPOINT:
THE LONG ROAD TO CULTURAL CHANGE

Financial services firms' compliance challenge is best understood by appreciating that compliance is no longer enough. Regulators want a new culture in the organisations they oversee.

The UK's Financial Conduct Authority (FCA) was explicit about this in guidance to its approach of regulating large groups published in March: *"Your culture underpins everything you do, setting the tone for the behaviours you promote and reward,"* it read. *"An effective culture will ensure that you treat customers fairly in everything you do, and that you do not abuse the markets you operate in."* [11]

It is reflected, too, in the new Senior Managers Regime requiring banks to vet regularly for "fitness and propriety" and proposed powers to claw back bonuses. Nor is it restricted to the UK. In October the Federal Reserve Bank of New York held a conference for banks on ethics and culture.

This trend is reinforced in the findings from our GRO 2015 survey. As shown in Figure C, when asked which factors were most important to get right in a governance function to avoid significant regulatory problems, the two leading responses among senior executive respondents were culture of compliance (53%) and ensuring compliance had a place in the boardroom (30%).

Change, however, does not come quickly. The FCA's chief executive Martin Wheatley, among others, has acknowledged it could take years.[12] Partly that's because of the complexity and size of many of the organisations; new training and staff with new attitudes will take time to have an impact. It is difficult to argue with those who suspect that what is required could be generational change.

However, it is also because of the ambition of the project: banks are increasingly expected to police their own people's behaviour, and even that of those outside. From detecting and reporting market abuse, to AML regimes – even perhaps to tax evasion – banks and other financial services firms are increasingly called on, if not to supervise, then to monitor the market, reporting suspicions to regulators.

These developments challenge not just to the firms, but also their advisors. When commissioned to do regulatory systems reviews, for example, these advisors must be prepared to evaluate whether systems are in fact followed in practice and to challenge clients with evidence of failures.

However, there is also a challenge for regulators, particularly in how consistent they are in insisting on these new behavioural and cultural norms. As the power and influence of emerging markets such as China and Russia continue to grow, the question is whether they are prepared to enforce these standards on those from financial centres where they are not yet commonplace – or are even rejected.

Failure to do so will be noted by those they hope to police the market, and is likely to undermine the cultural change they hope to achieve at home.

Anthony Browne
Chief Executive
British Banking Association (BBA)

COMMENT

"Britain already has a competitive banking industry, but we would like to see more done to make it easier for smaller banks to establish themselves and grow.

We'd like some of the rules on capital for challenger banks relaxed as it is up to eight times more expensive for a smaller bank to give someone a mortgage than one of their high-street rivals. A more level playing field would be good for all."

[11] The UK Financial Conduct Authority, The FCA's Approach to Supervision for C4 firms." March 2014 (page 12) http://www.fca.org.uk/static/documents/corporate/approach-to-supervision-c4-guide.pdf

[12] Charlotte Malone, Blue and Green Tomorrow, "FCA: changing culture at financial services firms won't be a quick job." 1 April 2014 http://blueandgreentomorrow.com/2014/04/01/fca-changing-culture-at-financial-services-firms-wont-be-a-quick-job/

HOME

Julian Korek
Chief Executive Officer
Kinetic Partners, London

VIEWPOINT: LESSONS LEARNED FROM OTHER INDUSTRIES

As the financial services industry adjusts to the growing burdens of complying with regulation, looking to other regulated sectors may provide important best practice lessons that financial firms and regulatory bodies can draw on.

Product development in certain industries such as pharmaceuticals is an exceptionally long process when introducing new goods to market. For health and safety reasons, regulatory bodies in such industries mandate extensive testing over the course of a series of highly involved stages. This in turn requires a massive investment in research and development, particularly in hiring specialists educated, trained and certified in a particular field.

Additionally, many staff are from scientific – and therefore evidence-based – backgrounds. Product managers will be involved, but it is the results from the lab and testing that confirm whether or not a product is safe. The evidence-based approach to manufacturing articles is the basis for how these industries are regulated, and has come to foster a risk-averse culture in the companies themselves.

Other industries have a more personal impact on consumers and those consumers know what to look for. The food and beverage industry has long produced detailed packaging with an array of information clearly labelled. This allows those consumers who want it to make more informed decisions. For financial services firms, most terms and conditions require several hours (and strong bi-focals) to read through.

Establishing trust in the wider marketplace is essential for limiting liability and expanding business under such strict regulation. Financial services firms (and indeed the industry as a whole) should recognize that building trust requires more than mere compliance.

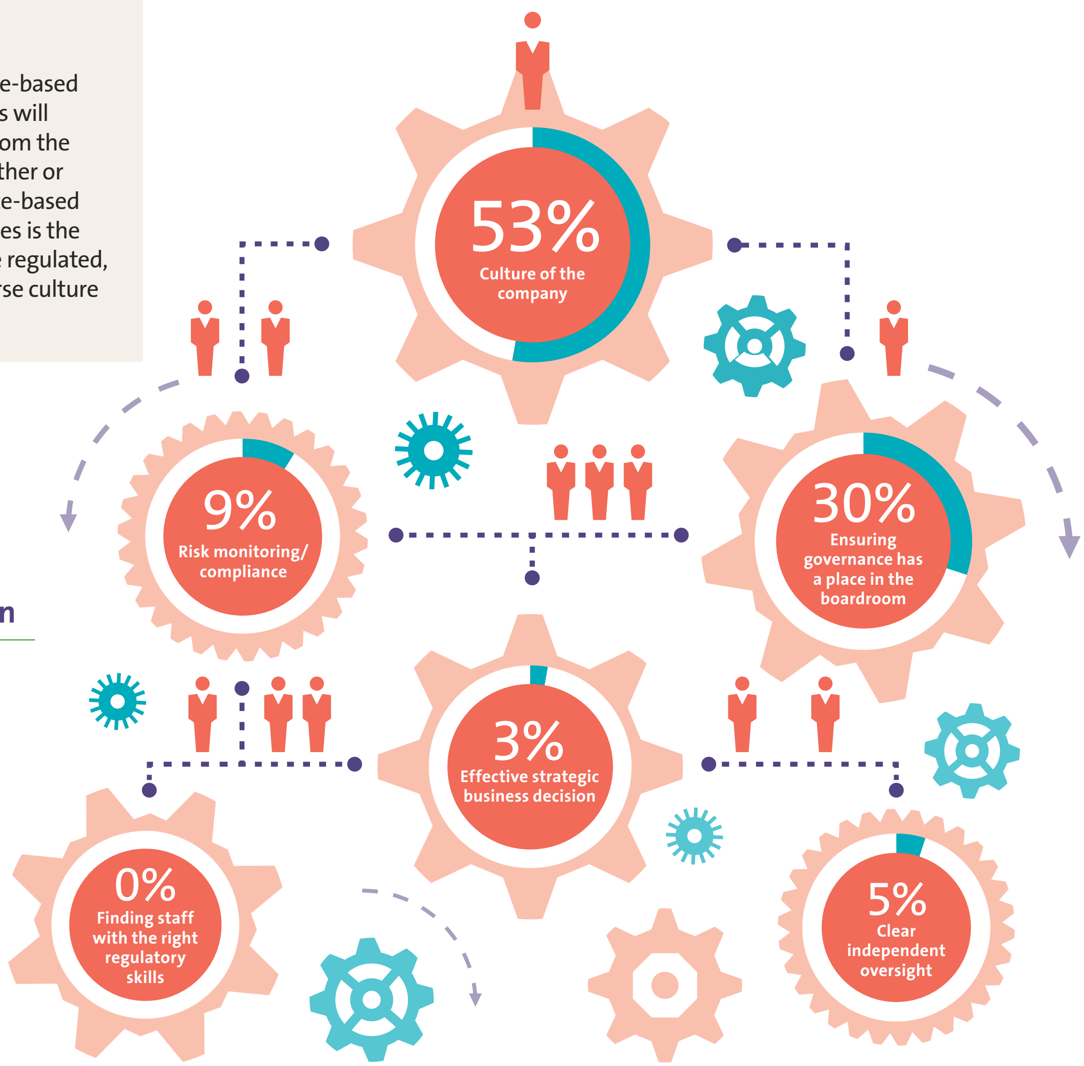
Rather than rushing to market with new financial products or services, comprehensive research and development processes that rely on testing and evidence could not only limit liability risk, but also inspire a great deal of confidence among consumers themselves.

There may also be new ways to promote products to make clear their risk profile, in particular for those institutions selling to the mass market.

FIGURE C - Protecting against regulatory action

IN A GOVERNANCE FUNCTION, WHAT DO YOU CONSIDER THE MOST IMPORTANT FACTOR TO GET RIGHT IN ORDER TO AVOID SIGNIFICANT REGULATORY PROBLEMS? OF EXECUTIVES SURVEYED*

**All figures taken from our GRO 2015 survey*



Nick Matthews
Partner
Global Head of Forensic Services
Kinetic Partners, London

VIEWPOINT:

CRIMINAL LIABILITY FOR SENIOR MANAGERS

When asked to consider the impact of making executives criminally responsible for the actions of employees at firms, 41% of respondents to the GRO 2015 survey said that it would have a long-term negative effect on the financial services industry, compared to only 29% who said it would be a good thing (Figure D). This marks a change from the 30% of respondents in 2014 opposed to such criminal liability. It comes in the wake of certain governments introducing legislation, such as the UK's Banking Reform Act and the advent of deferred prosecution agreements in the UK, that enables criminal charges against executives and firms in cases where staff or firms were engaging in unlawful activity.

The trend could be due to the increasing distance from the 2008 financial crisis, with memories fading and the public's bloodlust diminishing. The usefulness of such measures may also be questionable, given that criminal negligence or recklessness in supervisory roles is a difficult charge to prove.

More significant, however, may be the impact such strict accountability will have on staffing and recruitment. With the industry already witnessing a trickling "brain drain" to other sectors, the additional burden of possible criminal action on those in oversight functions will only serve as a further deterrent to qualified, capable leaders from accepting high-risk roles at financial institutions.

The sentiment behind these measures is laudable: intentional or reckless disregard for the need to maintain robust systems and controls is inconsistent with sound management of any firm, in any industry. Rather, it is the extension of criminal accountability to senior levels that gives pause.

The current regulatory regime, imperfect though it may be, goes a long way in deterring and preventing financial crime, but politics, whether reflective of or dictating "public opinion", drives politicians onward. Sadly, public ignorance about an industry often extends to those charged with making policies for its governance. An effective regulatory framework requires better, not more, regulation.

41%

of respondents believe making executives criminally responsible for the actions of employees within the firm would have a negative impact on the industry*

*All figures taken from our GRO 2015 survey

Marco Zwick
President
Luxembourg Association for Risk Management (ALRiM)

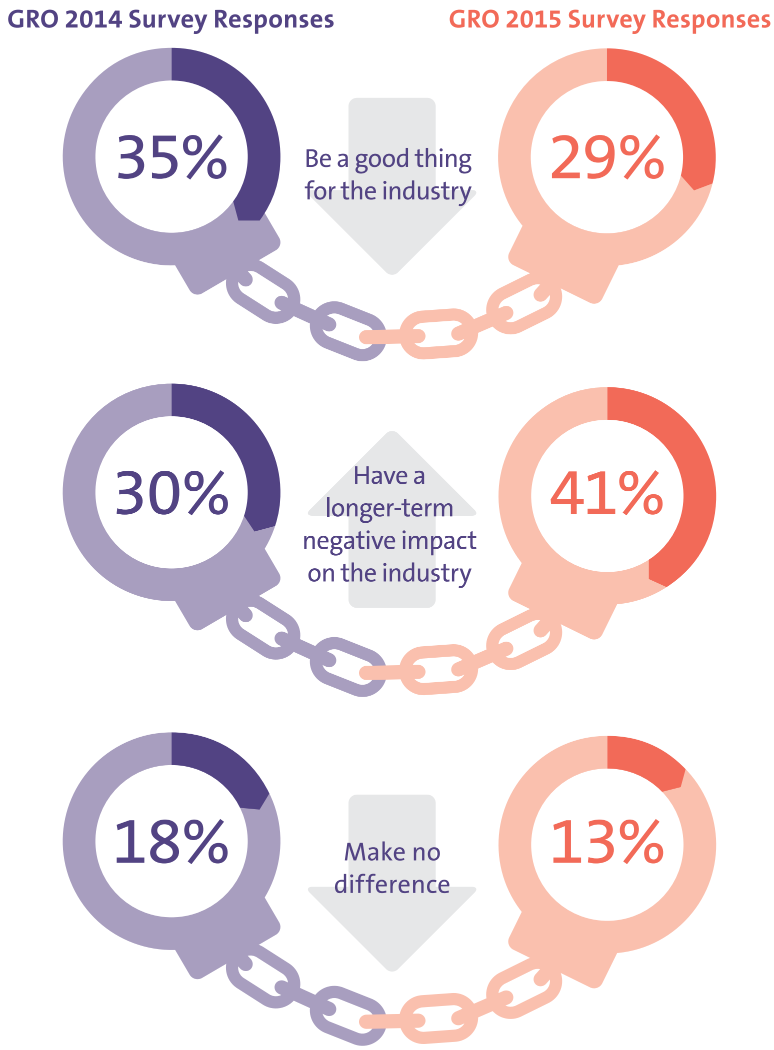
COMMENT

"Risk managers always support regulatory change, if it helps to make the financial industry safer. At the same time, it is important that policy makers demonstrate their intention of making better rather than more regulation by "stress testing" regulatory initiatives to verify periodically that they meet their stated objective."

HOME

FIGURE D - Bringing criminal action

WILL MAKING EXECUTIVES CRIMINALLY RESPONSIBLE FOR THE ACTIONS OF EMPLOYEES WITHIN THE FIRMS*:



Note: the above figures do not include respondents who selected "Don't know" or "Other"

**All figures taken from our GRO 2015 survey*

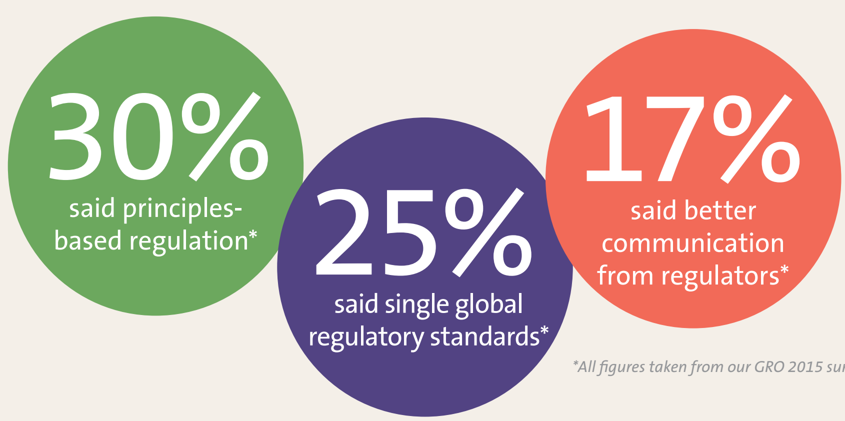
Mitch Ackles
President
Hedge Fund Association (HFA)

COMMENT

"Alignment of global regulatory standards and cooperation across borders is an essential function for fostering growth in the industry. The economy and the markets are global, but these global and regional regulators need to take into account the local needs and drivers for firms. This must be accomplished through agreement and communication between all these organizations.

Regulators have already demonstrated an ability to successfully deliver regulatory frameworks at a collective level on such regulations as AIFMD and FATCA. Indeed the alignment of regulations benefits everyone in the industry, and one of the greatest outcomes of an effectively unified regulatory front has been a safer environment for the end investor and Main Street."

What is the single most important factor in maintaining an effective regulatory system for the financial services industry?
Of senior executives surveyed:



**All figures taken from our GRO 2015 survey*

THE INDUSTRY'S RESPONSE TO REGULATION

Commercial controversy around market data

Lee Hodgkinson
Head of Information Services, Euronext

Market data, the often-overlooked side to the exchange world, has been under the spotlight recently.

This is as a result of the European Commission and ESMA having been given a mandate by the European Parliament and Council co-legislators to "clarify" what constitutes a reasonable commercial basis for the provision of market data in the EU. Effectively, these governing authorities are seeking to determine under what circumstances and how much European exchanges can charge for such market data. A consultation paper with a number of options was sent to industry participants and comments were submitted back to ESMA on 1 August 2014. ESMA has from now until 23 December to prepare their advice to the European Commission. The options on the table are transparency, revenue caps and cost controls.

The scope and limits of EU regulation

In assessing the mandate from the so-called Level 1 text (that is to say the framework agreed to by the Parliament and Council), it is important to take into consideration both the legal basis of the mandate as well as the substantive technical issues underpinning the debate.

In respect of the legal basis, it is clear that the mandate in MiFIR Article 13 given to the Commission asks for "clarifications". It does not empower the Commission to impose precise requirements – such as regulatory price controls or revenue caps – on market operators and investment firms covered by the scope of MiFID. In contrast, legislative frameworks governing credit rating agencies empowering specific regulatory price controls did so in the Level 1 text.[13] From a legal perspective, therefore, apart from the 'transparency option', the ESMA consultation explores two other options that are not strictly legally compatible with the mandate given and are not within the limits of delegated acts.

Turning to the substantive technical issues, one of the key objectives of this consultation should be to ensure that the final revised legislative framework is based on a comprehensive market evaluation founded on evidence. While much of the framework appears to be moving in this direction, Euronext believes that an objective assessment on the provision of market data in the EU is conspicuous in its absence.

Proportionate costs of data

Unfortunately, in advancing its work on possible ways to achieve this mandate, it appears that the European Commission has assumed that: (i) market data costs are higher in the EU than other jurisdictions and (ii) exchanges are exclusively responsible for all market data costs.[14] Neither of these assumptions is based on any proven evidence and both paint a false picture of the reality.

On the first point, the Commission appears to be basing its evidence on estimates of widely diverging costs of market data in the US and EU which have been advanced by some market participants, indicating lower costs in the US market. These estimates are fundamentally flawed as they do not compare like-for-like services and take no overall account of the specificities of the EU market, which include fragmentation, differentiated regulatory requirements and economies of scale. While end-user fees in the US tend to be cheaper than in Europe, a broader assessment of the US market reveals that many costs are not taken into account in determining end-user fees.

[13] Regulation (EU) No. 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No. 1060/2009 on credit rating agencies states in Annex 1, Section B, Point 3c that credit rating agencies 'shall ensure that fees charged to its clients for the provision of credit rating and ancillary services are not discriminatory and are based on actual costs'.

[14] European Commission Request for ESMA technical advice concerning the Markets in Financial Instruments Directive and Regulation (MiFID 2) of 24 April 2014, pp.36-38, available at http://ec.europa.eu/internal_market/securities/docs/isd/mifid/140423-esma-request_en.pdf

Examples include:

- The prevalence of charging access fees in the US for end users receiving data via a datafeed is often not factored into fee comparisons. If factored in, the overall fees are often higher than in Europe depending on the number of end users viewing the data
- Direct billing of exchanges in the US means that vendor mark-ups are often overlooked for US data but included in analysis of European fees
- European market participants may not trade on all EU markets and therefore not require data from some of them, whereas US participants are forced by regulation to have access to all 12 US venues
- The size of the US market means that the US consolidated tape is able to achieve significant economies of scale. The cost per user of creating a European consolidated tape is likely to be considerably higher

When like-for-like services are compared and the true differences between the jurisdictions accounted for, the evidence shows there is actually very little difference in the cost of market data between the EU and US.

On the second point, there appears to be an assumption that applying cost controls on European exchanges would lead to a meaningful reduction of market data costs in Europe. This is also a false premise. Independent research [15] has clearly proved that European exchange costs represent only a tiny part (8-15%) of the total costs referred to by clients. The same research also highlights that most European exchanges either waive completely or charge reduced fees for use of market data for trading purposes and that market data fees represent less than 0.1% of operating costs to the sell side. For a professional user to view the full depth of the order book and post trade data in real time across all Euronext equities and indices, for example, they would pay less than $5 per day.

It is a facile shortcut to say exchange fees for market data are too expensive. To understand market data costs, the entire market data value chain has to be examined. Data vendor and infrastructure costs represent the bulk of market data spend rather than exchange fees. Exchange market data licence fees are estimated to account for 8% to 15% of customer market data expenditure, whereas IT infrastructure is estimated to account for 10% to 16% and data vendor services are estimated to account for the remaining 65% to 80%. In order to reduce fees further for their end users, Euronext has already implemented simplified units of count such as User per Source which recognises a move towards user-based fees rather than application-based pricing. Other exchanges offer Natural User units of count which are another way to reduce fees. Understanding and proactively managing a firm's market data inventory can lead to significant cost savings.

Impact on market participants

Assuming, however, that the above arguments are ignored, and a decision is taken that the only participants in the market data vendor value chain subject to cost control provisions are European exchanges, the consequences would be twofold: on the one hand cost benefits to end users would be very limited or non-existent, as there would be no obligation on participants further down the value chain to pass on any fee reductions, and on the other, far more seriously, there would be a significant impact on exchanges' ability to provide high-quality and well-functioning capital markets throughout Europe.

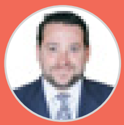
It follows, therefore, from both an assessment of the technical aspects of market data as well as an evaluation of the legal basis for proposed measures in this area, that some form of strengthened transparency obligations would be the best and only feasible outcome.

[15] Oxera – Pricing of Market Data Services, February 2014 - http://www.oxera.com/getattachment/33e57fa3-73c0-4462-9824-81f2bd0c77ca/Oxera-report-on-market-data.pdf.aspx?ext=.pdf

Justine Plenkiewicz
Head of Policy &
Development Division
Cayman Islands Monetary Authority (CIMA)

COMMENT

"One strategic area that could improve the industry is enhanced awareness of, and engagement between, regulators and industry about financial innovation, trends within the industry and global regulatory, economic and business developments with an eye on the long-term."



Daniel Klein
Head of EMEA
Smarsh

COMMENT

"Data management is paramount, and a critical piece of that strategy needs to be the archiving and monitoring of communications and messaging. This is clearly a best practice from a compliance standpoint, particularly as the full breadth of financial products comes under the regulatory microscope, and as regulators continue to impose more demanding reporting and monitoring requirements. Mandating that firms on-board such tools and processes would not only help regulators streamline their oversight and investigative approaches, as well as limit waste, but will help firms mitigate business risk in the long run. The ability to perform e-discovery on your own – to easily access and produce information - is an invaluable asset."

Simon Appleton
Director
Regulatory Consulting
Kinetic Partners, London

Edwin Lowe
Associate Director
Regulatory Consulting
Kinetic Partners, Hong Kong

VIEWPOINT: THE FUTURE OF ELECTRONIC TRADING

Algorithmic and high-frequency trading (HFT) remain a key focus for regulators. In October, the SEC brought its first enforcement action for market manipulation through HFT. It follows the UK's FCA, which in July 2013 fined Michael Coscia $903,176.[16]

Whether the offence is marking the close in the case of Athena Capital Research in the US,[17] layering and spoofing as with Coscia or a variety of other questionable strategies, the scope for manipulation is significant. The current trickle of market abuse cases is likely only to grow to reflect the significance and prevalence of automated trading in the market.

It is, however, the potential for extreme market movements – demonstrated in the 2010 flash crash and 2013 "Twitter crash"[18] – that is probably an even greater concern for regulators. And these are as likely to be the unintended result of interactions between algorithmic trading programmes or failures in pre- or post-trade controls as deliberate attempts to manipulate markets.

Consequently, regulators are insisting on tighter, more sophisticated controls. Germany's High Frequency Trading Act in place since May 2013 requires firms to have systems to prevent creating a disorderly market; a new code of conduct from Hong Kong's Securities and Futures Commission in place since January 2014 similarly introduced controls for algorithmic traders; and, in the US, the Financial Industry Regulatory Authority (FINRA) named HFT and algorithmic trading among its priorities for 2014. Building on ESMA's guidelines, MIFID II will introduce pan-European standards from 2017.

It is fundamental to "stress and scenario test" algorithms prior to launch and the release of material changes to ensure they function as intended in all conditions. Ensuring controls, such as appropriate price and order size limits, prevent the execution of erroneous automated orders that could lead to significant losses or create disorderly markets – both significant reputational risks. More than that, however, controls done well are also a source of competitive advantage.

In a fragmented marketplace, the benefits of HFT and algorithmic trading in terms of liquidity and transaction costs are well recognised – by regulators as much as traders. It benefits no one if orders are blocked needlessly. The key then is to identify controls that both protect the market (and guard against abuse) while ensuring those benefits are safeguarded. Firms' success – and their clients' – in this space will be determined at least in part by how successfully they strike that balance.

[16] The UK Financial Conduct Authority, "FCA fines US based oil trader US $903K for market manipulation." 22 July 2013 http://www.fca.org.uk/news/fca-fines-us-based-oil-trader

[17] The US Securities and Exchange Commission, "SEC Charges New York-Based High Frequency Trading Firm With Fraudulent Trading to Manipulate Closing Prices." 16 October 2014 http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543184457#.VE_GoPnF9ot

[18] Jake Zamansky, "The 'Twitter Crash' is 'Flash Crash' Redux." 1 May 2013 http://www.forbes.com/sites/jakezamansky/2013/05/01/the-twitter-crash-is-flash-crash-redux

The impact of technology on regulators and the regulated

Tim Mak
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Jonathan Wong
Associate, Freshfields Bruckhaus Deringer

"If you want to keep a secret, you must also hide it from yourself."[19] Although it has been more than sixty years since Orwell first fretted over the dystopian "big brother state," the advent of digitalisation and the information age is bringing us closer and closer to a world where almost everything we do can be observed, tracked, recorded and analysed.

This is particularly true for regulated entities and market participants, in a market where regulators are becoming increasingly active and have wider regulatory and investigative powers than ever before.

However, regulators have also had to adapt the way they operate and exercise their powers, to match a rapid evolution in how the market communicates and stores information. Confidential information which a company might once have kept locked in a dark, dusty vault is now more likely than not stored on servers, hard drives, or "in the cloud", often in multiple locations. The nature of that vault, how it is guarded, and the ways in which we might access it, have changed, and this presents a multitude of opportunities, as well as challenges, for both the regulators and regulated.

Electronic communications: the first line of defence

The first and perhaps most obvious change is to the volume and nature of information available. It goes without saying that the world has moved from binders to bytes, and the ease of creation, storage and sharing of electronic information has in turn led to an exponential growth in the amount of information which regulators and regulated have to deal with on a daily basis.

Today, an average company must deal with tens of thousands of emails daily, if not hundreds of thousands. And that's just emails. Communication by chat software is de rigueur for traders and certain bank staff while access cards and security videos can be used to track every employee's movement within an office building. Usage and access logs on PCS can betray what users have done and what they have accessed at particular times. And handheld smart devices can betray what messages may have been opened, downloaded and when.

Secured, managed and analysed in the right way, these reams of information can be a gold mine for a regulator or investigator, but conversely, the sheer volume of information can be overwhelming and an investigator can find itself searching for a needle in a haystack.

Responding to demand in the age of technology

A growing number of specialist service providers now offer electronic review platforms to deal with large volumes of digital information, and almost every regulatory matter we have dealt with in recent years requires us to manage, review, analyse and often produce information in digital form. In this regard, certain regulators, such as the Securities and Exchange Commission in the US, have put together detailed guidelines on how digital information should be produced, and this is something we expect to become more common as regulators get increasingly familiar (and sophisticated) with digital production. Regulators are also increasingly using forensic IT analysis and retrieval. Many have internal teams, or engage external experts, to secure data and identify information destruction or concealment.

The sheer volume of information correspondingly creates risks and challenges for the regulated – for example, maintaining legal privilege, protecting personal data and confidentiality, and ascertaining relevance are key issues which regulated entities and individuals need to consider carefully when dealing with regulatory raids or electronic document productions.

It is also crucial to keep track of where information is stored (whether on email servers, computers, storage media or in the cloud) and maintain

[19] George Orwell, 1984. Penguin Group (USA) Incorporated, New York. ©1950. Part 3, Chapter 4, pg. 283

appropriate security to prevent leakage of information and ensure that regulatory requirements and expectations relating to client confidentiality and personal data are met. It is not uncommon for senior management to delegate this responsibility to IT. But it is important for legal and compliance to work closely with IT and management to devise and implement an appropriate data storage and security system, because a well-designed system can help to manage down potential legal and regulatory risks. This is where a lawyer's appreciation of technology and an IT specialist's appreciation of the law are important and must be applied in unison.

Redefining investigative scope and burden

Where data is stored in multiple jurisdictions, other considerations come into play. Does each jurisdiction recognize legal privilege? How easy is it for regulators to access that data? Can they access data which is outside of the jurisdiction using equipment or infrastructure within the jurisdiction? Might there be impediments to taking data out of a jurisdiction (e.g. personal data or state secrets laws)?

Senior management must stay on top of these issues. Failure to do so could lead to regulatory scrutiny, affect potential litigation and result in reputational damage, amongst other risks. We see clients increasingly engaging law firms and external experts, as well as hiring appropriate internal specialists, to help them to manage these sorts of potential risks.

From the regulator's perspective, searching for that sometimes amorphous needle in the haystack can also be a challenge. Today, we have analytical tools such as keyword and metadata searches, concept clustering and predictive coding, which can assist in achieving the right balance between thoroughness, time and cost in an investigation. However, they are not yet a complete solution to the challenge.

Another challenge which regulators and the regulated face is the application of "old" rules to new technology. For example, algorithmic trading, HFT and dark pools were virtually unheard of when Hong Kong's Securities and Futures Ordinance was drafted in the mid-late 90s, and yet these are highly complex products to which the Ordinance is now applied.

Looking forward

So the world is becoming much smaller and the amount of data, rules surrounding such data and places in which such data is stored are becoming increasingly varied, voluminous and complex. Regulators are, perhaps more so than ever before, alive to these challenges. They are often in a position to access the closest-held secrets of the regulated, whether through careful investigation, review and scrutiny or voluntary/inadvertent disclosure. In an increasingly regulated world, this creates interesting challenges for both the regulators and regulated, and we are likely to see more rules, tools and developments aimed at addressing these issues.

> "Certain regulators have put together detailed guidelines on how digital information should be produced, and this is something we expect to become more common as regulators get increasingly familiar (and sophisticated) with digital production."

> "The advent of digitalisation and the information age is bringing us closer and closer to a world where almost everything we do can be observed, tracked, recorded and analysed."

Donald Babbitt
Director
Regulatory Compliance
Kinetic Partners, New York

VIEWPOINT: REGULATORS RECRUITING SPECIALIZED STAFF

There has been a noticeable change in the regulators' approach to market supervision since 2008. One especially notable change was a shift in recruitment practices, which was signaled by the appointment of a number of individuals who joined, for example, the SEC after having gained market surveillance experience from the New York Stock Exchange, along with a number of ex-traders. The SEC is also staffing its ranks with private equity professionals, as the agency has been focusing on developing deeper scrutiny in the sector.

In this way, the SEC has demonstrated that it is committed to ensuring that the skills it has in-house match those in the industry. But the question that many are asking is how did the SEC manage to persuade so many relatively highly paid private sector professionals to join its ranks? The answer could be related to their longer-term career goals; working for the regulator may offer other benefits including a more structured career path, long-term job security and an opportunity to be involved in policy making.

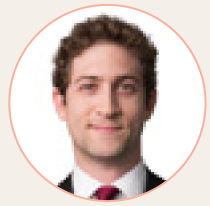
According to the findings in Kinetic Partners' Global Enforcement Review 2014 report, the SEC, the FCA and The Securities and Futures Commission of Hong Kong (SFC), had ramped up their annual expenditures over the past several years. SEC annual expenditures rose nearly 62% in the six years to 2013/14, the FCA nearly 50% and the SFC a whopping 120%. Staff numbers at these regulators, however, generally rose by a lower percentage leading us to surmise that they are recruiting a higher caliber of professional and that these industry specialists are being paid commensurately more.

Armed with a deeper, more specialized staff, regulators have been able to expand the scope of their surveillance, which in turn has yielded more instances of enforcement in recent years. Indeed, regulators across the world, particularly in the US, have made it clear that they intend to be vigilant in maintaining pace with the industry as markets evolve.

45%

of executives indicated that technical knowledge of regulations would be the most crucial skill-set when recruiting in-house compliance teams through 2015*

**All figures taken from our GRO 2015 survey*



Sebastien Petsas
Associate
Regulatory Consulting
Kinetic Partners, London

VIEWPOINT: TECHNOLOGICAL PRESSURE

The need for firms to stay on top of technological change is a key trend for any business; the use of technology for compliance and regulatory matters is no different in this respect. This trend is driven by the increasing use of technology in financial services and in the new commercial opportunities it presents for firms.

New forms of online banking, e-currencies, portable banking and platforms for international payments outside of the typical banking structure are growing as a result of public demand for such services. From a regulatory perspective, advances in technology and new services are likely to result in further regulations and regulatory pressures – particularly as these services grow in popularity, therefore posing a greater risk to a market and its consumers.

The continued and increasing use of technology (such as with high-frequency algorithmic trading) will continue to drive the need for technological advances of both companies and regulators with their monitoring capabilities. Regulators are now recruiting more experienced and specialised personnel, in particular those with advanced forensic and technological skills. Significant resources are being poured into increased surveillance by regulators globally (especially as it relates to operational or tactical infrastructural enhancements and technological innovation), thus enhancing their capabilities for undertaking enforcement action in the future.

As a result, a firm's use of technology in regulation and compliance issues must continue to grow correspondingly. In turn, this will create a need for a new breed of compliance personnel, IT infrastructure, processes, systems and controls; all at a time when firms are under increasing revenue pressure. Finding the right personnel who are tech savvy and have adequate regulatory expertise may be a potential problem area for firms going forward.

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Stephen Rabel
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HOME

VIEWPOINT: TAX AND POLICING

Perhaps nowhere is the tendency to push down responsibility for regulatory enforcement to financial institutions clearer than with tax requirements. Banks and other firms are increasingly expected to police compliance – or at least to deter evasion through their reporting.

Most by now will feel enough has been said about the US' Foreign Account Tax Compliance Act (FATCA). To misquote Trotsky, however, if you're not interested in FATCA, it's still interested in you.

FATCA's approach has proved highly contagious. First, there are the national jurisdictions that have followed its lead, such as the UK. Its own version, dubbed UK FATCA will see British crown dependencies and overseas territories exchange information with the UK's HMRC from 2016. More significantly, the OECD's Global Standard for Automatic Exchange of Information published in February will take FATCA global.

FATCA's more pernicious elements are again present: pseudo-extra-territoriality, (strictly speaking, each country enters into a bi-lateral agreement and executes local enacting law, but there is little choice), and delegation to the private sector of the burden of identifying foreign account holders. Moreover, awareness of the OECD regime's requirements, which start in 2016, remains very limited.

Despite the work it will require, at least there is a nod towards consistency: the OECD proposals are in part designed to introduce common standards for customer classification and reporting. At the very least, having an eye on the OECD proposals when developing systems for FATCA, UK FATCA or any other bilateral agreement will likely save work in the long run.

Longer term, the costs of compliance (and they are expected to be significant) should be set against the chance banks are being given. By being asked to monitor and supervise compliance – not just with tax rules, but around market abuse and AML as well – institutions have the opportunity to work alongside regulators, rather than simply being subject to them. It is an opportunity to show they can play what is acknowledged as a valuable social role (where sometimes their core functions are not considered to do so).

This may be, in fact, an opportunity to help repair the industry's reputation. Given that the requirements are coming anyway, firms would do well to seize it.

INDUSTRY GROWTH AND REGULATION: FINDING THE BALANCE

The impact of EU regulation on the UK

The Lord Flight
Member of the UK House of Lords EU Economic and Financial Affairs Sub-Committee

I believe Gordon Brown made a grave mistake in surrendering Sovereignty in Financial Services Regulation to the EU. Much of the initial reforms followed a UK agenda and were steered through the EU by the FSB, in which the UK had a dominant position.

Indeed, it is arguable that the EU Parliament watered down some of the proposals and the UK Regulators have gold plated some of the initial EU requirements, particularly, under MiFID. For example, the detailed and, arguably, impertinent personal financial information which Private Client Fund Managers are obliged by the FCA to obtain from their clients, for the purpose of justifying the investment strategy being followed, goes well beyond MiFID requirements.

No longer a symbiotic relationship

But while EU regulation was, initially, substantially driven by the UK and in the UK's interests, and mostly of a "light touch" nature, increasingly EU regulatory initiatives are focusing on curtailing markets with protectionist measures to exclude non-EU and non-EU regulated institutions from addressing EU markets. We are now starting to see a fundamental divergence between the EU, with the long-term objective of setting up a Eurozone Treasury, and the UK, whose markets in financial services are essentially international and where a less prescriptive regime, which is much more oriented towards high-quality supervision and the use of market forces, is appropriate.

So far, the EU initiative which has been most damaging to the UK, and wasteful of resources, has been AIFMD. Its alleged objective was to curtail the activities of hedge funds for which many in the EU, quite wrongly, attached blame for the 2008/09 financial crisis. As it has turned out, it also applies to all investment fund structures other than UCITs – including both domestic investment trusts and other funds of a similar nature. It requires very detailed risk analysis and risk reporting information, much of which is essentially unnecessary for, for example, UK investment trusts. The massive risk reports are likely to sit in regulators' files and never be read! This increases costs and makes London a less attractive international centre. Also, it imposes detailed regulations with regard to promotion and marketing, overriding perfectly satisfactory existing UK rules.

MiFID I, and MiFID II when it comes into operation, constitute an unsatisfactory "fit" for UK investment management services and products and also constitute an element of protectionism towards non-EU based providers of a range of financial services.

Banking's best interest

By contrast, in the banking sector the problems caused by the Euro, and facing the Eurozone, have resulted in the UK "doing its own thing" with the Banking Act, and the establishment of the separate responsibilities of the UK Prudential Regulation Authority (PRA) and the FCA, together with the increased capital requirements, driven by Basel II. The Eurozone Banking Union measures have been designed to underpin the Euro. They are important for the long-term, but inadequate, so far, to sustain the Eurozone. The transfer to the ECB of the regulation of major banks should be a positive step, particularly as regards better and common regulation in weaker Eurozone economies. The "Resolution" arrangements, with a fund of only €55 billion, are wholly inadequate for purpose and, therefore, cannot succeed in separating bank resolution and Sovereign Debt, as most of any bailout costs are likely to fall on the relevant individual countries.

Cross-border European banking is now significantly less than pre-2008, largely because there are also no common or collective deposit insurance arrangements. Clearly, in times of uncertainty and crisis, banks in stronger Eurozone economies are more attractive to depositors, than in weaker Eurozone economies. Interestingly, as a result of this, via the Target, Eurozone Central Bank Clearing and Settlement arrangements, the Bundesbank is financing Central Banks in the weaker Eurozone economies to the extent of some €750 billion. More fundamentally, there looks to be no chance of US-style, fiscal, economic and political integration in the Eurozone, largely as Germany is unwilling to finance the significant transfer payments to the weaker economies, which this would require.

Cross-EU cooperation

Notwithstanding, relations and cooperation between the Bank of England/PRA and the ECB remain constructive and effective.

There have been some EU-wide banking regulations, particularly with regard to the payment of bonuses, which have affected not just UK banks but also the UK investment management industry. These have been mostly unwise and contrarian in their impact, serving to drive up fixed remuneration levels, where more flexible bonus-related remuneration makes better economic sense. The main UK Banking Act initiative has resulted from the Vickers Report, implementing the ring-fenced banking regime as a compromise to the full separation of commercial and retail banking and investment banking, per Glass-Steagall.

The most practical long-term initiative has, however, come from Basel, increasing banks' capital ratios, where it remains a major condemnation of prior UK regulation that banks in the UK were permitted to operate on such minimal capital ratios. The UK has also installed the PRA as the guardian/supervisor of the financial soundness of banks with the FCA regulating banking conduct. By contrast, the EU has been generally light on consumer protection.

Limitations on lofty goals

The body intended by the EU to eventually become the EU-wide regulator is ESMA. So far this has not been as powerful as had been anticipated. It is also hampered by the fact that it does not have the power to correct drafting errors in EU directives. There has been a major drafting error problem with regard to the rules relating to derivatives, which requires a new EU directive to correct.

For the insurance industry, Solvency II has been the main EU initiative. This requires large increases in capital reserves and is highly complicated and expensive to administer.

There is a further, major issue. Behind EU directives, and in the case of the UK its own measures with regard to the banking industry, are international financial regulation initiatives, many of which effectively come from the USA. From the perspective of a practitioner in London, there is the need to be cognisant of, and comply with, measures emanating from the UK itself, emanating from EU directives and also emanating from international initiatives. The particular internationally driven territory that has gone way over the top has been AML requirements, where the US is, in practice, claiming international jurisdiction. This has led to the further problem that, in some areas, the EU is out of kilter with international rules and requirements and, particularly, with regard to Basel II.

We have yet to see how the EU initiative with regard to the proposed Financial Transaction Tax (FTT) works out. It has "gone quiet" and there has been a lot of opposition, but it is by no means dead. Its original intent looks to have helped finance a Eurozone-wide Treasury. If it ended up being implemented – as intended – UK financial institutions, as members of the EU – albeit as a non-FTT participating country, are obliged to collect and pay over the Financial Transaction Tax, if one party to a transaction is based in a participating FTT country. This would be highly damaging to London. It would add to costs substantially, driving business elsewhere in the world, e.g. to Singapore, and reduce market liquidity significantly. The cost to consumers would also increase.

It is important to note that 70% of the UK's financial services business is with non-EU parties. Across the board, it is the impact of EU-driven regulation on London's international and domestic business which is at risk. The tradition and practice of EU measures has been not to attack the major industry of any particular EU member, e.g. in the case of France, agriculture, and in the case of Germany, engineering. It would appear that this principle is being ignored with regard to the UK and its main industry, the financial services industry. The "double majority lock" requirements give the UK a strong say over EU financial rules relating to the banking industry, but this has not been extended to cover other/all financial service regulation, as has been suggested by the Chancellor, George Osborne. It is also set to expire if and when more countries join the Euro.

Arguably, the greatest problem for the financial services industry is the growing volume and complexity of Regulation, coming from all angles – EU-led, Eurozone-led, internationally/US inspired and, often, gold plated by UK regulators. Above all, it is anti-competitive; I would not want, again, to set up an investment management business and it would be much more difficult and higher risk so to do.

Alan Picone
Partner
Global Head of Risk
Kinetic Partners, Luxembourg

VIEWPOINT: WHOSE OBLIGATION IS STABILITY?

When asked what would strengthen accountability and rebuild trust in the industry, the two most cited answers by respondents were better education of the public on the financial services industry (34%) and greater transparency in governance and management functions (27%). By comparison, only 5% of survey respondents indicated that greater or more fines on firms would accomplish this objective.

In calling for greater education, simplicity is the key. Teaching your child to use a chequebook and spend their pocket money wisely is one thing. Simplifying futures and options, not to mention complex structured products, is another. For non-professional investors, 'if you don't understand it, don't invest' is as apt now as ever.

With request for transparency, trust is at the heart. For their part, regulators have sought to involve investors, consumers and laymen in their approach to rule-making in an effort to make the dissemination of valuable information more readily available to all. This has included requiring firms to provide potential investors with important documentation via Key Information Documents. Empowering market participants with knowledge is an objective that can benefit every party.

Firms, too, should recognize that this mandated transparency is often a positive thing for their own business. In the long run, transparent and forthcoming reporting helps firms to mitigate systemic risk down the road and reduces the possibility for breach of responsibility claims to be made against the firms. Indeed, it is in the best interest of investment firms to have an informed investor base, and establishing a culture of transparency from the outset when building relationships with prospective clients will enhance the firm's attractiveness. Doing so presents an opportunity to establish trust early on and gain an edge over the competition.

Beyond mere compliance, firms would do well to understand the virtues of transparency with clients. Regulators will likely continue developing policy aimed at fostering greater provisions of information in the market, and those companies that have taken steps to preempt this will be the winners.

What would strengthen accountability and rebuild trust in the industry?

34%
better education of the public on the financial services industry*

27%
greater transparency in governance and management functions*

**All figures taken from our GRO 2015 survey*

HOME

Malin Nilsson
Director
Regulatory Consulting
Kinetic Partners, Channel Islands

VIEWPOINT: THE BOTTOM LINE CASE FOR EFFECTIVE REGULATION

As governments and politicians rushed to respond to the global financial crisis by passing new regulations intended to protect consumers and re-build trust in the industry, such regulations were often penned by lawmakers who, although familiar with regulation, did not always have hands-on experience of the complex industries they oversaw.

Communication channels between the industry and regulators have since improved, with later draft regulations being designed to make industry professionals think twice when it comes to risk without stifling innovation. Kinetic Partners sees increased calls by industry participants for a more global approach to regulation, so as to ensure consistency and clarity across different jurisdictions.

Regulators are hiring more staff and investing in new technologies to meet this demand. Recent legislative and policy developments are also providing regulators with greater enforcement powers, both criminal and civil, which are being used with greater frequency than ever before. According to the findings of Kinetic Partners' Global Enforcement Review 2014,[20] since 2009, the average value of regulatory fines in the UK has increased by more than 1,500%.

Indeed, the increasing size of recent regulatory fines is successfully bringing attention to the importance of the compliance function as a more visible and worthwhile cost centre within an organization, to guard against regulatory risk. It is perhaps surprising, however, that we still encounter some firms who have made little or no investment in bolstering their compliance arrangements.

As an industry, we need to question why that is the case, and what it will take for this to change. The firms that have invested money and energy to reflect the changing approach of international regulators are so far ahead of their peers in pre-empting regulatory exposure that the costs of these investments are actually quite marginal, even if they seem high at the outset. As noted above, such investments are in fact significantly lower than the cost of an enforcement action with accompanying damage to a firm's reputation.

Delivering measurable cultural change in a firm's approach to compliance is, however, notoriously difficult, and our research found that the vast majority of executives surveyed (97%) said they believe that recent regulation has either failed or only been partly successful in guarding against a future crash. Regulators will therefore need to assess whether the high levels of fines are leading to better outcomes and less risk, thereby making the system safer, or whether these measures are instead counter-productive and produce less innovation for the industry.

Many complain that regulators are being heavy-handed, and for some, the effort and investment required to enhance their existing systems and controls has come as something of a shock. We see this as a move by regulators to show that they are serious about their aim to make compliance central to financial services firms' business.

Legislators and regulators need to continue to focus on the longer-term cultural and functional changes they expect to deliver. Additionally, they need to work even more closely with industry to ensure their frameworks are understood and that firms recognise the new regulatory landscape, including the the bottom line investment required to provide long-term benefits for the industry.

William Mason
Director General
Guernsey Financial Services Commission (GFSC)

COMMENT

"Appropriately applied international standards should enable regulators to be responsive to risk, entrepreneurialism and innovation in financial services. Proportionate, risk-based supervision gives regulators the opportunity to be responsive to innovation and new product development. By understanding firm governance and business models regulators can have grown-up conversations with firms, something which is more difficult if the focus of both parties is on compliance rather than risk control. Our view at the GFSC is that risk, properly understood and managed, is an absolute prerequisite for successful development and growth."

97%
of executives surveyed said they believe that recent regulation has either failed or only been partly successful in guarding against a future crash*

**All figures taken from our GRO 2015 survey*

[20] Kinetic Partners, Global Enforcement Review 2014

Growth in the context of compliance

Mark Kaplan
Of Counsel at Skadden, Arps, Slate, Meagher & Flom LLP and affiliates

> "The compliance and regulatory treatment of financial services firms has the potential to make the business model of entire segments of the industry unviable"

It is possible to chart the progress towards finalizing the 398 rules required by Dodd-Frank (under 60%) – even if keeping abreast of domestic and international legal requirements is a tall order.

Firms can also identify the various bodies they are answerable to, from the SEC down, though this, too, is getting harder. We can even quantify at least some of the costs.

However, the impact on the culture, shape and future of the financial services industry is far more difficult to track. Certainly it is not captured by the $34 billion figure that Standard & Poor's estimates is spent annually by the eight largest banks to fulfil Dodd-Frank obligations;[21] nor the 10,000 new JP Morgan compliance staff that Republicans on the House Financial Services Committee quizzed Barney Frank about over this summer.[22]

The impact on smaller firms is particularly hard to quantify, but nevertheless profound. Firms whose businesses are built on the basis of lean, nimble operations are struggling badly with the additional layers of regulation and reporting imposed on them by Dodd-Frank, alternative investment regulation, AML and know-your-customer requirements, to name a few.

For many this is an existential challenge. Just as it is assumed US companies require a minimum market capitalization of $300 million to make public listing economic, the compliance and regulatory treatment of financial services firms has the potential to make the business model of entire segments of the industry unviable.

And the scope of regulation continues to expand inexorably, whether it is recent controversies over the Financial Stability Oversight Council's extensions to the list of systemically important financial institutions, or proposals in May to impose increased record-keeping, reporting and notification requirements on registered security-based swap dealers and broker-dealers engaged in security-based swap activities. Private equity, financial intermediaries and hedge funds too have all faced incremental costs.

This has significant implications for the industry's future and, perhaps particularly, for its innovation. Smaller firms have frequently been strong in that area, but it is ever harder now for successful managers, feeling constrained in their existing houses, to set up alone and to grow their own firm.

[21] Standard and Poor's, "Two Years On, Reassessing The Cost Of Dodd-Frank For The Largest US Banks." 9 August 2012. http://www.standardandpoors.com/ratings/articles/en/us/?articleType=HTML&assetID=1245338539029

[22] Derek Templeton, DS News, "Frank Testifies Before House Financial Services Committee." 23 July 2014 http://dsnews.com/news/07-23-2014/frank-testifies-house-financial-services-committee

[23] Speech to Private Equity International (PEI), Private Fund Compliance Forum 2014 by Andrew J. Bowden, Director, Office of Compliance Inspections and Examinations. 6 May 2014. http://www.sec.gov/News/Speech/Detail/Speech/1370541735361#.VE5dyPnF9ot

[24] Speech by Mary Jo White to Council of Institutional Investors fall conference in Chicago, IL. 26 September 2013. http://www.sec.gov/News/Speech/Detail/Speech/1370539841202#.VE5eg_nF9ot

Aggressive, but destructive

The change is as much cultural as it is regulatory. It is inevitable that as new regulatory regimes bed in for the likes of hedge funds and private equity, attention turns to enforcement. By May, SEC officials had visited more than 150 private equity firms, according to reports, for example – finding serious deficiencies in many.[23]

But it is also a question of attitude. The regulator's new chairwoman Mary Jo White last year promised "aggressive and creative" enforcement. With the annual number of cases for the fiscal year seeing its first year-over-year rise since 2011, she has delivered on that.

"That means we should neither shrink from bringing the tough cases, nor fail to bring smaller ones. When we detect wrongdoing, we should consider all the legal avenues to pursue it," she added.[24]

That, too, is a promise that has been kept, and one can question whether proportionality has been lost in the process – and not just in the SEC's approach, but more widely.

For a start, for regulators' regional offices, small broker-dealers and investment advisers present a less threatening target than the multinationals. There is no way to guarantee the attention they receive does not outweigh the risk they pose. Moreover, regulators now reflexively resort to enforcement channels, leaving far less scope for a collaborative approach to resolve issues between firms and the regulator.

It is difficult to say whether an adversarial relationship necessarily reduces risks for investors. However, open communication between firms and regulators is certainly a casualty. It is also worth noting that former SEC head of enforcement Stanley Sporkin's reputation as a robust supervisor of the sector remains more than thirty years after he left the regulator. Yet over his tenure there was not a single indictment.

As Kinetic Partners' GRO report has noted in previous years, changing attitudes are not limited to regulators. To date, shareholder activism in the banking industry has remained fairly muted in comparison to increases elsewhere – aside from a couple of high-profile cases, some say-on-pay recommendations and other limited exceptions. However, this is in large part due to low levels of M&A in the market. As deals return with profitability, it is unlikely to last.

In this environment, firms that fall foul of aggressive regulatory enforcement regimes not only open themselves up to enforcement action, but provide ready ammunition for belligerent shareholders too.

Finding the silver lining

For all that, there are a number of opportunities in this for financial services firms.

Most obviously, there is the chance to act now on a prophylactic basis to put in place the best possible systems and processes. Within that, there is an opportunity for firms that can evaluate and provide a level of certification and credibility to these systems. Evidence that the business has done all it can to comply means that any aberrant practices of rogue employees that are discovered are more likely to be treated as such by regulators.

And businesses should certainly expect to fall foul of the regime. In large groups, someone, somewhere is always going to be doing something stupid. Small firms, meanwhile, face a struggle to keep abreast of the mounting regulatory burden. Indeed, the other big opportunity is for those who can find a way to cost effectively meet this need. No one has yet managed it.

In the absence of this, small firms face a choice: grow fast or find a home in a larger organization with an infrastructure that can support the cost of compliance. This should promote acquisitions by larger groups, but it also provides openings for lift-outs from the investment banks, for example, into smaller, more focused firms. Free of the requirements that come with carrying customer accounts, these firms can offer teams an infrastructure that allows them to concentrate solely on their deals. That will be an attractive proposition for some.

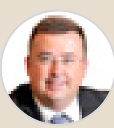
Finally, there are opportunities for countries to look again at their regulatory approach, although this is unlikely to be taken up by other developed markets. This is not because of the extra-territorialism of regulation typified by FATCA; nor due to the requirements on those looking to market across borders that is seeing smaller managers avoid Europe rather than face compliance with AIFMD. Rather, the US strain of financial regulation has proved a communicable disease, encouraged by the supranational regulators such as G20, Financial Stability Board and Bank for International Settlements. Few are not infected.

However, it is arguably still open to China and other developing nations to take a different approach as they adopt accepted international norms that will enable them to increase access to capital markets. At the very least, there will be opportunities here for firms that can provide openings and confidence for investors in those markets as they decide the way forward.

David Dalton-Brown
Non-Executive Director
Tax Incentivised Savings Association (TISA)

COMMENT

"Over recent years UK regulators have focused, quite rightly, on protecting the consumer through changes to regulation relating to distribution, charging etc. but in doing this they have made saving more difficult. Have you tried recently to open a new savings account or move/consolidate a pension? Paperwork has increased and advisers are reluctant to advise on some fairly simple transactions due to cost and regulatory risk. With the level of savings falling and the need for consumers to save more to pay off growing levels of debt and to secure a living retirement income, the regulators need, in conjunction with government, to simplify and encourage increased levels of savings across all age groups and levels of society."



Pat Lardner
Chief Executive Officer
Irish Funds Industry Association (IFIA)

COMMENT

"Regulators and policy setters generally should only introduce effective but pragmatic regulations. Specific measures facilitating direct lending through non-bank financing, like the new loan origination AIF in Ireland, should benefit the economy. Furthermore, regulators should ensure the effective monitoring of systemic risks from analysis of new regulatory reporting data."

Chris Lombardy
Partner
US Head of Regulatory Compliance
Kinetic Partners, New York

VIEWPOINT: PROFITING FROM COMPLIANCE

While meeting regulatory requirements may seem costly at face value, it has nevertheless yielded favorable outcomes for many financial services firms. Implementing and executing comprehensive controls and infrastructure that are central to compliance arrangements often improves end-to-end business value by creating efficiencies, centralizing oversight, limiting risk and building a risk-aware culture.

While compliance departments do not generate revenue, an effective controls environment with senior management involvement can significantly reduce regulatory costs.

Compliance is no longer just a focus for regulators; it is also being driven by the institutional investor base and clients of financial services firms. Prospective investors expect hedge funds and private equity firms, for example, to have strong compliance and operational systems in place before investors commit any capital. Due diligence meetings are longer, more detailed and more focused on operational controls and compliance mechanisms. Clients also increasingly value a firm with a reputation for a strong compliance culture when selecting their financial services provider.

Many firms that have taken such steps are generally more attractive for investment and so are often able to grow faster than their peers who have not.

54%
of respondents said commercial opportunities are the most significant factor in determining where they seek to do business*

59%
of survey respondents believe that New York is currently the preeminent global financial center*

*All figures taken from our GRO 2015 survey

Allison Gill
Director
Regulatory Compliance
Kinetic Partners, New York

VIEWPOINT: THE FUTURE OF NEW YORK

While New York being viewed as one of the leading hubs for financial services is no surprise, our recent survey indicates that New York is currently seen as the preeminent global financial center. Up from 49% last year, 59% of survey respondents believe New York is the central jurisdiction for financial activity and 46% of those polled believe it will remain so in five years' time. This reinforces our view that New York continues to draw and maintain institutions that still believe it is the best place to grow their business.

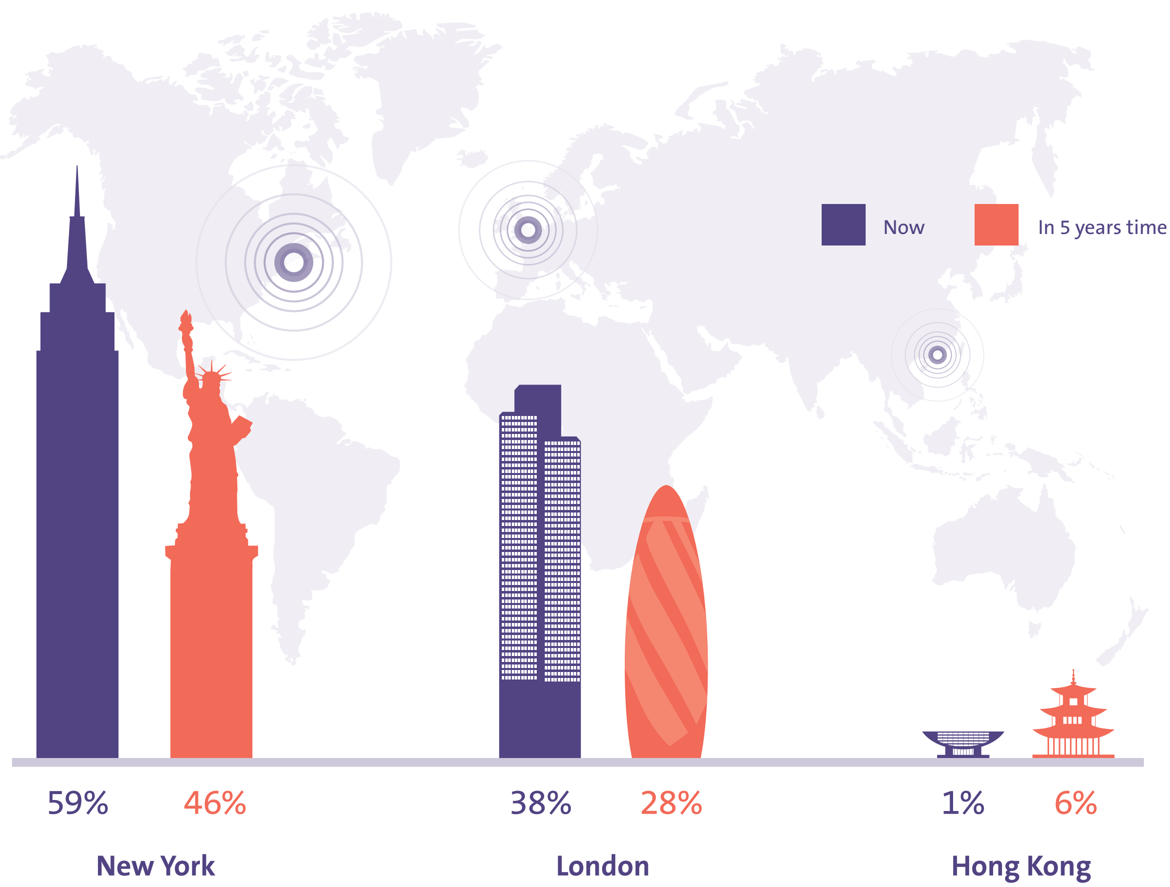
We can all agree that the US may have lost a few popularity contests in recent years due to the seemingly never-ending barrage of legislation, some with international reach, but the larger picture has come into view. Other jurisdictions' regulators were either walking side-by-side or just a few steps behind. The debate over the relevance and benefit from the countless hours spent by politicians and regulators will go on, but the fact remains that the industry has largely adapted and the global community seemingly still has confidence in the power of New York.

As capital continues to move and regulatory requirements change, it will be interesting to see who does land on top in five years' time. What about the emerging market financial centers? Shanghai is expected to be leading, according to our survey, but who else will profit from greater investment?

These are changing times and while New York certainly enjoys being seen as the gold standard, one day soon that gold may be found in Asia.

FIGURE E - The global center for financial services

WHICH DO YOU BELIEVE IS THE PREEMINENT GLOBAL FINANCIAL CENTER?*



All figures taken from our GRO 2015 survey

Geoff Cook
Chief Executive
Jersey Finance

COMMENT

"The continuing challenge for regulators and policy makers across all jurisdictions, not just in Jersey, is to find the appropriate and proportionate level of regulation, supervision and reporting. Regulators need to ensure that their functions and processes are operating at the highest level of efficiency, making full use of modern technology to target supervision whilst minimizing business disruption. Policy makers need to ensure that, in considering politically expedient demands from certain sectors of the community for more regulation and accountability, they do not inadvertently enact requirements which will ultimately drive legitimate business away."

[25] The World Bank, World DataBank. "World Development Indicators: China 1984-2013." http://databank.worldbank.org/data/views/reports/tableview.aspx?isshared=true

AnnMarie Croswell
Partner
Hong Kong Head of Regulatory Compliance
Kinetic Partners, Hong Kong

VIEWPOINT: THE CHINA OPPORTUNITY

New York and London have long been viewed as the leaders in the financial industry, as has been consistent with the findings of our GRO survey data in the past several years. Our GRO 2015 survey revealed, however, that 59% of senior executives polled believe that Shanghai will be the premier emerging financial services jurisdiction in five years' time, a figure which is up from 45% in last year's survey.

Market trends and the movement of capital indicate that the balance of power in the world of financial services is indeed shifting to the East, particularly China. Hong Kong has long been viewed as a city of choice for financial institutions and firms, but cities on mainland China such as Shanghai and Shenzhen are well positioned to supersede Hong Kong as the dominant market in Asia.

Size does matter, and the numbers tell a compelling story about China's rise. With a growing population of more than 1.3 billion people and GDP growth of approximately 10% year-on-year over the last 30 years (compared to the US growth rate in that same period, which is under 4%), China is almost neck and neck with the world's largest economy.[25]

The China opportunity is an alluring one. Alibaba's IPO in September of 2014, which was the largest in the world to date, is just one example of how much investment appetite and market power the Chinese have been able to capture.

However, as with any growing market, there will be some challenges. As the Chinese financial services market is a relatively nascent one, in some regards the law and its interpretation have yet to catch up with the developments

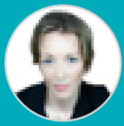
HOME

in the industry. Beyond that, there are highly nuanced differences in the implementation of rules than in other parts of the world. For example, following the Shanghai Hong Kong Stock Connect's launch on 17 November 2014, tax questions still surround how capital gains will be treated in the long-term, as at the time this report went to print. This uncertainty will likely be clarified soon after launch, but implementation concerns and cross-border tax disputes are expected to persist into the coming year.

The fundamental variables at work, therefore, come down to how well-established (or a better word to sum up "good" from every perspective) the companies are in China. Global confidence in these companies is an enormous consideration when evaluating investment opportunities.

While Alibaba has been, at least initially, a historic success, there have been some Chinese companies which listed their IPOs on the US and other western exchanges and have come under market scrutiny, which degraded, somewhat, western confidence in the Chinese corporates.

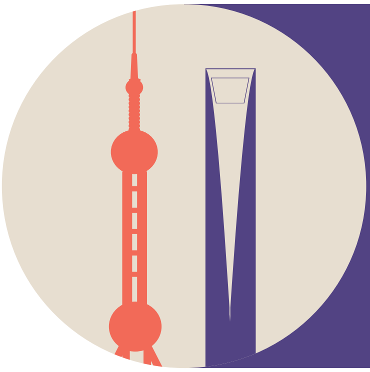
There is no doubt that the China market has grown considerably in the last 30 years and that China is certainly positioned to be one of the largest markets in the world. However its success will be evaluated, in part, on how well it matches up with its global counterparts in areas such as market performance, corporate governance and transparency.



Heide Heiden-Blunt
Managing Director and Head of Asia-Pacific
Alternative Investment Management Association Limited (AIMA HK)

COMMENT

"The positive impact of a deeper capital market on economic growth overall is a compelling topic that should continue to engage and provide impetus for regulators, policy makers and all financial industry stakeholders alike; and particularly here in Asia with respect to the economic reforms and developments already underway."



While New York and London continue to be recognized as the leading global financial centers,

53%

of survey respondents believed that Shanghai would be the leading emerging financial center in five years' time*.

**All figures taken from our GRO 2015 survey*

Killian Buckley
Partner
Regulatory Consulting
Kinetic Partners, Dublin

VIEWPOINT: FUND CORPORATE GOVERNANCE – SAFETY IN NUMBERS

Let’s get a few misconceptions out of the way about investment fund corporate governance. It’s not just about the Board. It’s not just about the Board meeting.

Yes, the Board is the focal point of the governance regime for funds, the prism through which governance takes place, frequently on a delegated basis with underlying service providers performing the investment management, distribution, administration and safe keeping of assets, among other tasks. The task is delegated, the responsibility is not. It is a particularly nuanced model, different from other corporate entities, without a centralised operational office. Yes, it is vital that the Board, collectively and individually, has sufficient expertise, experience, independence and resources to oversee these delegated functions.

It is equally important that there is a robust corporate governance matrix in place, owned and managed by a party with sufficient resources to do so, that allows the directors to oversee the fund and clearly supervise the delegates. As such there must be a method to identify issues and gaps, to judge performance, to measure and manage all risks every day, not just at a quarterly Board meeting.

In our GRO 2015 survey, we found that 85% of respondents believed that investment in independent governance at financial services firms would help strengthen reputation. It is now the norm rather than the exception to involve firms such as Kinetic Partners in achieving this robust governance infrastructure. This frequently takes place in the regulatory context of UCITS and AIFMs, with Kinetic Partners assuming pre-authorised regulatory roles. Directors take comfort (without any abrogation of responsibility) of knowing that on a day-to-day basis the real activity of the fund, be it trading, settling or calculating NAVs, has a sufficient level of oversight, within a clearly documented governance framework designed by Kinetic Partners and reported on to the Board.

Board meetings are therefore meaningful, with a detailed agenda, clear supporting information, and decisions, discussions, and action points all clearly documented.

85%
of respondents believed that investment in independent governance at financial services firms would help strengthen reputation*

**All figures taken from our GRO 2015 survey*

Kinetic Partners

A Division of DUFF & PHELPS

As at 17 November 2014

Kinetic Partners, a Division of Duff & Phelps, provides a full range of award-winning consulting, regulatory compliance, corporate recovery, forensic & dispute services, tax advisory, risk advisory and due diligence services to financial services clients who value our expert service delivery and unique approach. Established in 2005, we have built a multidisciplinary team of recognized experts drawn from regulators, financial institutions and leading professional services firms and are a trusted advisor to over 1,300 clients across our 10 offices in New York, London, Hong Kong, Cayman Islands, Channel Islands, Chicago, Dublin, Luxembourg, Singapore and Switzerland. Within the Duff & Phelps Corporation, the premier global valuation and corporate finance advisor, we are part of an expert team of over 1,000 employees across more than 35 global offices.