



Financial Crime Compliance:

A Brief Guide for Senior Bank Management, Compliance Officers and Internal Auditors

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Dear Subscriber

Banking is always a complex industry to predict and with both significant economic pressures combined with major regulatory change this can never have been truer. As we write the US Federal Reserve Bank has announced the end of QE or quantitative easing. What impact will this have on the financial services sector and the real economy and will this lead to the expected interest rate rises? With Basel 3 (for banking) and Solvency 2 and the ORSA (for insurance) in the process of being implemented including new requirements for liquidity and capital all firms in the financial services industry need to assess their business models to ensure that they remain relevant.

In this the Q4 2014 edition of the GRU you will read about how the financial regulators have turned the guns from risk managers and internal auditors to risk, audit and now human resources and compliance functions as they seek to mitigate Conduct Risk. Lisette Mermod shares her experience and insights as to what happened when risk and HR were forced to meet at the watercooler in a failed EU regional bank. Gruesome reading but with a happy ending.

How regulators are limiting market change especially in the derivatives market is a question expertly discussed by Madrid-based risk specialist Flora Prieto. Julian Sampson (Client Money) and Jonathan Ledwidge (Financial Crime Compliance for Auditors) experts have each been knee-deep in AML and sanctions projects this year and share with us some key lessons. As does Kelvin King, one of the world's leading valuations experts. His article offers practical guidance for those in risk roles struggling to value intangibles, good will and intellectual property. And with winter upon us in the northern hemisphere David Thompson, FCA and fund broker for NivenCapital's energy and environment unit cautions risk managers on the impact of Climate Change Risk on asset management, investments and lending.

Finally, as the BIS has just released its latest consultative paper on Bank Corporate Governance – with definitions! – I just had to share my own insights and analysis. Yes, it is 13 principles but the real question is what's missing and do firms need to start making changes to comply now?

On behalf of all of us at the GRU Editorial team, Happy Holidays to you and yours – and in the spirit of the season, (as this publication is still free of charge) please support your most needy charity.



Dennis Cox BSc, CFSI, FCA
Chief Executive Officer

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TO THE EDITOR

Do you have risk issues in your organisation or region you would like to share?

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Financial Crime Compliance:

A Brief Guide for Senior Bank Management, Compliance Officers and Internal Auditors

Recent events and penalties have resulted in Financial Crime moving to the forefront of financial industry concerns and this poses particular challenges for Senior Management, Compliance Officers and Internal Auditors who are all struggling to come to terms with this 'monster.' The author is currently engaged in a global AML CDD compliance project for a major bank.

Gamechangers

For a very long time banking was all about the extension of credit in one form or another—and thus a borrower's ability to repay. Regulators had guidelines for both capital and liquidity but within the industry these were only of secondary importance to the decisions on credit.

Then came the financial crisis of 2008 which tested the resilience and sustainability of not only individual banks but the entire financial system. The main issue here of course was the impact of poor credit decisions on bank capital and liquidity. Regulators have now responded to the financial crisis by significantly increasing said capital and liquidity requirements.

The impact of these increases has been such that they have changed the competitive nature of the industry. Consequently, strategy within banking and thus decisions on credit, are no longer about the business you want to do but what the regulatory capital and liquidity constraints will allow you to do.

There is no doubt that the Basel requirements on capital and liquidity have been a regulatory gamechanger. Just as banks have started to

come to grips with the Basel requirements another set of regulations have emerged to take centre stage. They are the regulations in respect of Financial Crime and what in effect those regulations are saying is this: it is no longer good enough to know your sources of funding and liquidity, you also need to know where that money originally came from.

We have another gamechanger.

The Importance of Financial Crime Compliance

Financial Crime is defined broadly into six categories:

- 1. Money Laundering**
- 2. Bribery & Corruption**
- 3. Terrorist Financing**
- 4. Sanctions Evasion**
- 5. Tax Evasion (Not Avoidance)**
- 6. Fraud**

If there is any doubt as to the importance of Financial Crime and Financial Crime Compliance (FCC) then one has only to read the financial press to see the enormous fines levied against banks. Big Bank 1 (let's call them) paid \$1.9 billion while Big Bank 2 has paid a whopping \$8.9 billion in fines. In the case of Big Bank 1 the fines were levied for allowing that bank



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to be used to facilitate the laundering of money by Mexican drug cartels. Big Bank 2 on the other hand got into trouble for facilitating payments to sanctioned countries including Iran.

... the FCC is easily one of the most significant challenges facing banks today

More importantly, the fines are not the end of the story. Big Bank 1 has been placed under a Deferred Prosecution Agreement (DPA)—meaning that criminal charges would follow if the bank did not undertake and effect

significant improvements in FCC. For Big Bank 2, the landscape is even worse. The bank had been advised that criminal charges will follow and that it will not be allowed to clear any dollar transactions in 2015.

Then there is the case of Big Bank 3, a bank which utilised Swiss secrecy laws to help thousands of US citizens evade an estimated US\$20 billion in taxes. The bank has since been fined US\$980 million and is now also operating under a DPA, while the former Chief Executive of its Global Wealth Management division has been charged with conspiracy to defraud the IRS and is now under house arrest awaiting trial. Another Swiss bank, Big Bank 4, was fined US\$2.6 billion and also faces criminal charges for aiding and abetting tax evasion by its US customers.

On a somewhat different note, a MENA bank has been held criminally liable for financing terrorism by a court in the US—because it provided bank accounts to individuals who were members of Hamas, the Palestinian militant group. The judgement was granted on behalf of US citizens who were victims of terrorist attacks for which they held Hamas responsible.

Huge and consequential fines, possible criminal convictions (both personal and corporate) and curtailment of business activities coupled with very negative reputational impacts all mean that FCC is easily one of the most significant challenges facing banks today.

The Industry Response to FCC

How have banks been responding to this immense challenge? How should they be responding? What should Senior Management, Compliance Officers and Internal Audit actually be doing about this?

Here are five ways banks have been responding:

1. Reviewing & Exiting of Certain Jurisdictions

There is no question that certain jurisdictions are more susceptible to Financial Crime than others. The Financial Action Task Force, an inter-governmental body also known as FATF (GAFI for some non-English speakers) regularly publishes lists of those countries which are either non-compliant or deficient in combating Financial Crimes.

Another very useful indicator of corruption is Transparency International's Corruption Perception Index (CPI). The CPI index ranks countries in accordance with the level of corruption on a scale of 0 to 100, with 0 being extremely corrupt.

Banks are using the information provided by the likes of FATF and Transparency International to determine jurisdictions they should be either reducing their business exposures or avoiding altogether.

2. Reviewing & Exiting Certain Industries & Relationships

Banks are also busy identifying industries where the risks of money laundering are considered greatest because of the amounts of cash involved and where there is an increased risk of disguising and integrating legal and illegal funds. Another consideration is whether or not an industry lends itself to bribery and corruption.

Examples of the industries/categories which are now being targeted by banks for either exiting relationships or enhancing due diligence includes:

- a. Charities
- b. Jewellery, Gems, Precious Stones
- c. Arms and Munitions
- d. Casinos
- e. Shell Companies
- f. Offshore Banking Institutions
- g. Money Service Businesses (MSBs)
- h. Transactions Involving Bearer Shares
- i. Politically Exposed Persons (PEPS)

3. Reduction in Correspondent Banking Relationships

There was a time when the major international banks had as many relationships with other smaller banks in as many jurisdictions as they possibly could. The fees earned from correspondent banking were of secondary importance—the general rule was that the more correspondent banking relationships a bank had the more it would attract deposits from those other banks and the greater its importance within the global financial system.

However, having finally realised that banks that reside in poorly regulated jurisdictions, offshore centres or those with less than transparent ownership structures are highly susceptible to Financial Crimes, the major international banks have been busy exiting a large number of correspondent banking relationships.

4. Greatly Increased Customer Due Diligence

Customer Due Diligence or CDD is at the heart of the new regulatory environment. The general principle is that the more an organisation knows about its customers the better it can avoid and reduce the incidents of Financial Crime. The concept of CDD goes well beyond simply identifying the name and residence of a customer—it actually requires an in-depth knowledge of their business including their customers and suppliers, as well as the source of their wealth and capital.

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The amount of resources being required for devotion to CDD, Know Your Client (KYC) and the onboarding of customers is now both exhaustive and exhausting—yet many banks feel that in light of the risks involved they simply have no other option.

5. Increased Investment in Compliance & Financial Crime Intelligence

The onerous and apparently unforgiving nature of FCC is such that it is vitally important that banks invest in both the requisite people and systems in order to ensure that they manage their business within the vast and ever-changing guidelines with a focus on both detecting and deterring Financial Crime.

In FCC, failure is simply not an option.

As such, as Financial Crime regulations are constantly being updated and new individuals, countries, groups and activities are constantly being added plus watch lists for money laundering and sanctions, the investment in IT and systems required to maintain pace is both immense and ongoing.

What This Means for Senior Management, Compliance Officers & Internal Auditors?

In the case of Financial Crime salespersons, relationship managers and others either in direct contact with customers or processing customer transactions and data represent the first line of defence.

Financial Crime Compliance is the second line of defence as it falls to this group to develop the knowledge, knowhow and capabilities to deter and detect Financial Crime.

Internal Audit represents the third line of defence and the

independence of its role in assessing and evaluating FCC is specifically recognised in the FATF guidelines.

Within this context there are several issues which Senior Management, Compliance, FCC and Internal Audit must focus on if banks are to reduce the very significant risks of getting it wrong. The most important of these issues are outlined below.

I. The Adequacy & Effectiveness of Financial Crime Resources

FCC regulations and guidelines are vast given the number of bodies involved in developing them. In addition to the transnational and multilateral entities such as the UN, EU and FATF, every single country will each have its own Financial Crime regulations. For banks that operate in several jurisdictions the task of interpreting, responding to and acting appropriately on these regulations is thus extremely demanding.

Consequently, Senior Management has the primary responsibility for ensuring that FCC has all requisite skills, systems and other resources necessary for executing their tasks and that these resources are consistent with the nature of the business, the jurisdictions in which it operates, the customers it will target and the products which it intends to offer.

In this regard, Chief Compliance Officers are responsible for ensuring that they develop, obtain management approval for and execute FCC plans that are comprehensive, sufficient and fully reflecting of both the business and regulatory environments.

Internal Audit should review and assess the adequacy, efficiency and effectiveness of the FCC strategy and



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plans. Internal Audit should also ensure that said plans are reviewed, approved by Senior Management and where appropriate revised on a periodic basis—in accordance with the demands of the operating environment.

2. Establishing Standards – Policies, Procedures, Documentation

Given the legal and regulatory requirements of FCC it is vitally important that suitable policies and procedures are established in order to consistently apply the appropriate standards. Having such standards is critically important in respect of demonstrating to regulators and if required the courts, precisely how the institution is fulfilling its obligations—including the determination of whether a Financial Crime is being committed or not.

Consequently, there is a need to ensure that not only are policies and procedures properly documented but that customer records, correspondence and employee workflows all fully reflect the onboarding and other decision making processes as they relate to Financial Crime.

It is the responsibility of the Chief Compliance Officer, working in conjunction with FCC, to ensure that standards are suitably implemented and that they are consistent with the nature of the business and the legal and regulatory environment.

In this instance the role of Internal Audit is one of ensuring that there is consistency in the application of standards and that they are subject to regular review in accordance with changes in both the business and the legal and regulatory environments.

3. Developing a Culture of Compliance

The best operating standards will prove inadequate if

they are not accompanied and supported by an appropriate culture of adherence and behaviours. The implementation and success of a suitable Culture of Compliance is dependent on the actions of both Senior Management and FCC.

Senior management has the primary responsibility for engendering a culture that both respects and exemplifies the Financial Crime governance framework. It can achieve this by:

- A. Ensuring that the overall strategic approach, in terms of the types of jurisdictions, customers and products being targeted, are consistent with stated cultural and behavioural objectives e.g. if the target markets include casinos in Macau or mining in the Congo then this would be sending the wrong message
- B. Communicating and reinforcing very clear messages in respect of what is considered as ‘good’ and ‘bad’ behaviours supported by appropriate training (see below)
- C. Providing Compliance and FCC in particular with the necessary resources and operational independence to fulfil all its obligations
- D. Ensuring that rewards and promotions are based on the right (‘good’) behaviours
- E. Ensuring that ‘bad’ behaviours are sanctioned and punished
- F. Ensuring that absolute remuneration levels do not negate cultural objectives
- G. Establishing an appropriate whistleblower policy

The Chief Compliance Officer in conjunction with FCC must ensure that:

- H. It has properly identified the universe of Financial Crime risks to which the institution is exposed and develops an appropriate strategy for addressing them



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- I. Resources notwithstanding, adequately and effectively implementing the stated strategy and programmes
- J. It provides consistent and proactive support to the business units
- K. It develops suitable risk-based programmes and approaches to:
 - i. CDD and the onboarding clients
 - ii. When, where and under what circumstances higher levels of due diligence and/or approvals are required
 - iii. The active monitoring and surveillance of customer accounts, data and transactions
 - iv. The escalation of FCC issues
 - v. Reporting suspicious transactions and activities
 - vi. Client reviews and exit
- L. There is an active, ongoing and consultative relationship with the relevant regulatory authorities as well as industry professional bodies

The role of **Internal Audit** in this instance is to ensure that:

- M. Compliance and FCC have properly documented programmes in support of the above
- N. Such programmes have been approved at the highest levels
- O. That said programmes have and are being implemented in accordance with the stated plans and business strategy
- P. That such programmes are regularly reviewed and approved in accordance with the changes in the business and legal and regulatory environment
- Q. That any variations or alteration in programmes or procedures are properly documented and approved

4. Financial Crime Education

As noted above Financial Crime education is a key and integral aspect of developing the right cultures and behaviours—but that is only part of the story. FCC is a complicated, ever changing and continuously expanding subject. It is therefore vital that all members of staff are aware of and know their specific responsibilities in respect of FCC. That awareness can only be achieved by way of a comprehensive and ongoing programme of education.

In addition, given that in most jurisdictions all employees working in regulated sectors are responsible for being aware of and taking the appropriate steps where necessary to prevent Financial Crime—from a legal

perspective it is absolutely vital that staff are made fully aware of their specific responsibilities under the law.

Given the above, the **Chief Compliance Officer in conjunction with FCC** must ensure that the training programme is consistent with needs of the business and the legal and regulatory environment. Such a programme of education must:

- A. Have the full support of Senior Management, who should also participate when and where relevant
- B. Make all members of staff aware of their specific responsibilities in respect of FCC
- C. Consist on online learning, classroom sessions and other learning resources such as websites and regular journals or newsletters
- D. Form part of each employee's annual review and assessment
- E. Form part of the employee onboarding process

In this instance the role of **Internal Audit** will be to:

- F. Ensure that the scope of the programme is adequate
- G. That the areas covered by each employee, business or operational unit is consistent with their roles and responsibilities
- H. That the programme is run in accordance with a predetermined schedule
- I. That attendances, non-attendances and test scores (if any) are properly recorded in employee records
- J. That the programme is continuous and thus reflective of ongoing changes

Summary

Financial Crime Compliance has moved to the forefront of the list of matters that financial institutions must get right as the possible penalties, both personal and corporate, are now so severe that failure is clearly not a good option. Senior management, Compliance, FCC and Internal Audit all have a vital role to play and it is important that they all perform well.

As the third line of defence, Internal Audit is tasked with ensuring that the other areas of the business and governance framework are performing at optimum levels. This is the ultimate backstop and safeguard to the business.

The author invites your comments via email to JL@riskrewardlimited.com



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Human Resources & Risk Management – A Risk Upskilling Case Study

Key Messages for People/Conduct Risk Implementation in Financial Institutions

People Risk and Conduct Risk are the latest trending terminology as financial regulators come to review not only a bank's capital adequacy and liquidity as vital to a bank's viability but more so how a bank operates as a business. People – as different from operating processes – are the latest focus by regulators who are expanding the integrity issues to a more general review of how people behave, make decisions and implement those decisions into actions and approaches that impact on the viability of the financial organisation, the financial consumer and society at large. Risk Reward Group Managing Director, Lisette Mermod shares some insights for risk and human resource teams when preparing for implementing People/Conduct Risk compliance and risk upskilling initiatives based upon her ongoing oversight of four such projects within the UK, two EU failed European regional banks, and a TARP-funded US regional bank arena. (The project details are an indication of the similarities amongst the projects in an EU setting.)

People Risk has been defined as different from risk management – the latter with its measurements and Basel rules – and seems to be looking for a home within an organisation and is often determined as 'owned' by the Human Resources function in financial institutions. But HR and risk management departments are often practically unknown to each other beyond senior level recruitment and exit functions (and those are more often than not using external Executive Search experts and not internal HR managers and staff.)

Therefore when the financial regulators looked to the financial institutions to correct or restructure their corporate governance and risk management teams, prepare risk roles job descriptions and risk community data, the HR departments were, with few exceptions unfamiliar with risk management and unprepared to participate in remediation solutions imposed by regional and national regulators.

This is a Case Study of one such remediation solution.

Background

Why was this remediation required? As a consequence of the global credit crisis and the regulatory response to protect the public from a 'run on the banks' a number of national and regional US, UK and European banks did not meet the new capital and liquidity rules - often suffering largely from massive losses due to holding bad debts and/or financial mismanagement – and were deemed 'failed banks'.

Remediation plans to attract and inject new capital and reduce costs (including large numbers of job lay offs) ensued. Some banks were effectively 'split' into 'good' and 'bad' banks with a view to attract new capital and investors to a 'cleaned up good bank' and the sell off debts and various assets of relatively low value from within the 'bad bank' to the open markets. In some cases the 'bad bank' ultimately was wound down and closed, its management and employees dispersed.

Regulators proposed strongly worded 'recommendations' for failed banks to invest in the professional and technical education of their management and employees – including Boards and Non-Executive Directors and specifically in the areas of risk management. Technical assistance budgets for the design and implementation of large scale (often global) training programmes followed suit, often the first of its kind being undertaken within a financial institution in association with the risk management function and the HR department together.

How to prepare then to upskill the risk management function bank wide in preparation to keep the bank business viable (not fail) while demonstrating to potential investors the bank's 'value' (its people) was a tall order to be achieved in a relatively short period of time.

This was the challenge for this particular regional bank. However the following Case Study offers key messages to all banks and financial institutions seeking to address the structural and operational issues of

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bringing the HR and risk management functions and teams together to work out a remediation, especially in light of impending Risk, HR and Compliance (Conduct Risk) rules and their implementation in all regulated financial entities.

Case Study: The Risk Academy

I Risk Upskilling Project Overview

A large, failing regional European bank with 10,000 employees distributed across 8 countries and among 22 legal entities was under regulatory supervision to 'turnaround' resulting ultimately in a 'good bank' and a 'bad bank', with wind-downs and business spin-offs planned within a 3 year timetable. A foreign investor to purchase the 'good bank' was a goal of the EU Commission and national regulator.

One of the foremost challenges was bringing its risk management teams up to international best practise and Basel II/III standards as quickly and effectively as possible as the bank was still trading. This involved nearly 2500 people dispersed among (initially) eight countries and later double that number.

With the regulators' approval a 24-month training initiative was conceived to cover training to competencies required for six

proscribed risk job roles at three different knowledge levels as determined by the Bank. The Risk Upskilling Request for Proposal (RfP) included 45 different training courses to cover for a budget of 10 days per employee over the 24 month period. There would be blocks of training days – 3-5 in one week - and a short 20-question examination to cover each course learning. At the end of year 2 a cumulative examination would be taken by delegates to demonstrate learning retention and capacity to implement their upskilled risk knowledge in the workplace. Result? A better bank.

The multi-million euro training tender (RfP) was issued by the Bank's Group Procurement team in association with the Group Risk and Group Human Resources teams. During the tender/bid process it became clear that the Chief Risk Officer (former Acting CEO) and his Number 2, a trained lawyer and Acting Head of Risk Champions for this project, made inputs into the RfP for risk training throughout the bank but specialist risk consultants were not engaged nor were the heads of the Bank's risk departments, business heads (Group and regional) or HR Heads (regional) consulted to produce the RfP. This was the first structural challenge to the success of the risk upskilling initiative.

Further, the Group Head of HR and his Number 2 were unfamiliar and unknown to the risk community within

the Bank and although experts in change management and highly respected as corporate HR professionals they were already at a loss as to literally who would be included in the risk upskilling project and who would not, what competencies were required and how to prepare for such a risk management project.

The role of the contracted risk specialist consultants and trainers would be to 'bridge the gap' between Group Risk and Group HR to achieve the risk upskilling goals among the Bank's employees and affiliates.

A closed RfP invitation to regional training firms was sent out with a March 2012 due date, bids subsequently placed, a shortlist achieved and ultimately the Tender Bid was won by a specialist risk consultancy and training firm to serve as the Main Risk Upskilling Consultants and Training Vendor (other training would be engaged in areas of legal and retail banking as part of the wider project).

The contracting process took five months to complete which included the usual document preparation and submissions, numerous conference calls, several training demonstrations at the Bank's headquarters and extensive contract negotiations with Group Procurement regarding project terms and conditions, payments, invoicing, software licenses, project



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management, interactive website tool development, third-party logistics and travel management, project management workshops and when contracts were signed a series of Kick Off Workshops for local CROs and HR heads in four cities.

The RfP included an aggressive timetable whereby the first 100 keyrisk managers would be trained by the end of the fourth quarter of 2012 and 1000 of the total 2500 risk managers and staff would have gone through the first level of training courses by end of Q2 2013. The entire risk upskilling project would be completed – all 1500 individuals would have received 10 days of training, some at only one learning level and others at Levels 201 or 301, most training to be attended at workshops in their location of employment, others travelling to the London for a Risk Study Tour with UK/EU regulators – by the end of Q2 2014.

II Key Governance Issues

The Bank’s Group HR and Group Risk as the Risk Academy Project Owners

For this project the Bank brought Group Risk and Group HR together as project team leaders for a risk

upskilling training initiative – the Bank’s Risk Academy - being among the first of its kind, driven by regulatory pressure, to do so.

Both owner groups faced difficult pressures. Group HR had to dedicate a full-time risk upskilling project team member to act as the Board liaison which impacted on his time and ability to manage the HR Heads throughout the Bank once the project was rolling out. Eventually he had to ‘force downward’ his management role to the local HR Heads very early in the project. It caused increased fees and travel expenses incurred by the risk specialist contractors to work directly with the numerous regional HR heads. Group HR also did not plan or budget for a finance liaison for the risk upskilling project which ultimately resulted in a series of regular project shut-down threats when invoicing and payments were not ‘owned’ by a central resource.

The Chief Risk Officer was particularly stressed spending most of his time with the national regulators. His absence as an active Key Stakeholder, Influencer and Project Leader for the Bank’s risk community was notable, especially when leadership to manage the Risk Champions was urgently required for

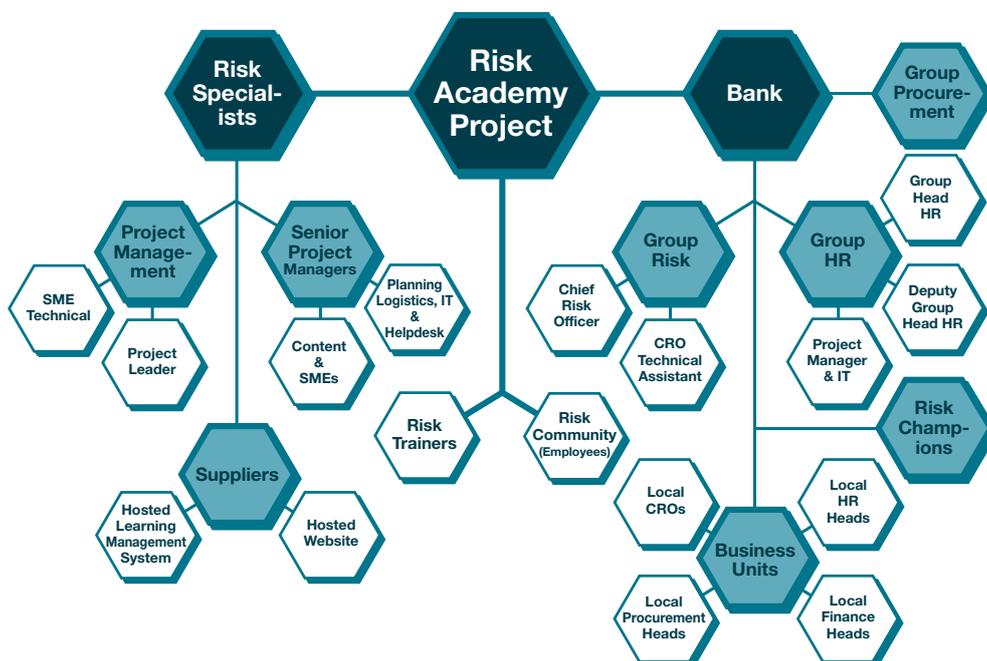
decision-making from his office. His Number 2 was unable to manage the dedicated project Risk Champions without frequent delays, cost overruns and acrimony among them; Group HR, regional HR heads and business managers and the risk specialist contractors were left to fend for themselves in a scrum.

The Bank’s Risk Champions

The role of the Risk Champions was created to support the Group CRO’s vision, serve as a channel to achieve the risk upskilling key messages throughout the Bank’s risk community across functional lines (credit and market risk controllers, credit back office processing, rehabilitation teams, etc) and cross-border (among geographic business units). They would be influencers and enablers to the risk upskilling project and remain as the ‘owners of the corporate memory’ for this upskilling initiative.

However much to our dismay Group HR presaged that the Risk Champions were ‘a dangerous bunch’ and that they should never be brought together as a group, an observation which rang alarm bells to the risk specialists and was an indicator of the ‘distance’ between HR and Risk within the Bank and a real threat to the success of the project. And this was the kick-off meeting.

Group HR’s perception of the Risk Champions - that their inputs will not be valued - cannot be discounted, and Group HR’s wish to avoid having to engage with the Risk Champions was clear. In fact the project was delayed one month while the risk specialists were wedged between Group HR and the Risk Champions to finalise their inputs, make changes to the training programme, redesign the training delivery schedule and begin risk upskilling training still on time. The Group CRO needed to ensure the Risk Champions would indeed drive the project internally as he was engaged with the regulator on a day to day basis, so whatever changes they wished for, they had a blanket approval from him. Again the problem of the incorrect risk roles and levels had not been addressed by the Risk Champions; they were concerned that their teams needed ‘practical, not risk



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management training’ and as a final push to get the project rolling the Risk Champions not only opted out for taking the risk competency on-line survey like all of their teams but had to be negotiated with – sometimes under heated conditions – to review course training course content and participate in the approvals process under tight deadlines.

Like the Group CRO and the Group Head of HR, the Risk Champions had their pressures too, and other banks facing similar challenges and projects will be wise to consider the time and energy required by these risk heads to not only perform their own work – under constant pressure raining downwards from the CRO and the regulator – but also to meaningfully participate in a project they were not initially consulted on. Early stage engagement with the Risk Champions, and indeed ideally the local CROs combined with strong leadership from the Group CRO could have greatly impacted earlier successful results.

The Risk Specialists (Contractors)

As previously mentioned the risk specialists emerged as not simply training contractors but were needed to ‘connect’ the Group CRO and Group HR, project manage the bulk of the project, and to serve as subject matter experts and trainers. While the global financial regulators offered guidance as to improvements in risk knowledge and better decision-making capacity the rules were interpreted by the national and regional financial regulators uniquely, not always adopting BIS guidance to the extent required. And this Bank, like others, must find the right balance between regulatory compliance and maintaining a sustainable commercial profit-making business. Hence the risk specialists were required to not

only advise on technical risk and related matters but also to interpret the bank’s business lines and how best risk roles can perform as is required and adapt the training needs as expressed by those in everyday risk roles and those of senior management, and the Board.

In response to this particular RfP for risk upskilling through training, the risk specialists recommended the entire project ‘sit’ inside a Risk Academy model which would allow for a variety of consultancy pre- and sub-projects to prepare for the risk upskilling and add value to its roll out, be an interactive project management tool for accessing training materials, booking course participation, taking examinations, report exam results, generate invoices and post project financial reports by individual user, business unit and country to deliver, monitor and report the desired outcomes.

The Risk Academy would be a project in its own right, with its own branding, messages and mobilisation; also serving as a repository for everything related to the risk upskilling project – from project management to planning to financials to examinations and reports to the Board and the regulators – in one location. This would take the form of a password-protected triangle of (1) intellectual property (training content, materials) and sensitive Bank personnel data (names, contact details, exam results, etc), (2) an interactive project management website and (3) a learning management system for interactive use by the learners and producing reports for both the finance and examination results requirements.

The Risk Academy would be designed

to allow multiple access for Group-, Business Unit- and Learners levels within the Bank and its affiliate legal entities. Compensation was made in the Risk Academy design to accommodate US, UK, EU and non EU multinational access and use, data protection laws relating to HR and examinations and reporting protocols aligned to national regulations.

In addition the risk specialists would prepare the course materials, examination questions and answers, and provide expert risk trainers to conduct most of the risk upskilling courses in six main cities.

The Risk Academy was designed to ‘pull’ the users to it, by email messaging, gaming, discussion and chat groups and a Risk Academy Membership Smartcard to track learning progress by the risk executive.

As the Main Vendor to the RfP, the risk specialists were ‘responsible’ to accommodate the learning materials and make the examination functions available to other sub vendors to ensure the total risk upskilling project was contained within the Risk



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Academy model. The Main vendors would meet with the subvendors to facilitate the transfers of data and its management (generating reports, etc) to the Bank as agreed.

III Key Project Skills, Determining Risk Roles and Identifying the Risk Community

The Need for Project Management Skills

Within a 3-month period after contract signing an initial kick-off meeting took place with additional, wider stakeholder meetings following in London and the Bank's headquarters over the ensuing 6 months. During the meetings it became clear that project management skills were light among the various Bank's HR teams; they were candid about this and when the risk specialists recommended a project management workshop for the combined Risk Academy Project Team Leaders and Key Stakeholders, it was the Risk Champions who worried that this would 'slow the project down' and this internal training among the top team did not take place. One observer later

noted that when the Bank's key project manager was removed and relocated to her home country (rather than at the Bank's HQ) the handover was delayed and the project ground to a halt 9 months into the project - the summer of 2013 - as the new project manager came on board having made major structural changes to the project without engaging the risk specialists or the entire project team both horizontally and vertically.

While this might still have occurred if a strong PM protocol had been in place it would have been less likely as key team members, Bank department heads, and the risk specialists would have engaged an agreed change order, standard operating procedures (SOP) and approval procedures which would have 'corrected' any project 'runaway' or 'drag' scenarios.

The risk specialists were ultimately able to propose a detailed training programme, project teams organisational chart, pilot and training roll-out timetable, travel, documentation and logistic plans and operational budgets, development and delivery of a hosted project website and learning management system to engage the delegates during the

actual learning, to sit exams, rate trainer performance and offer comments. This was delivered at the same time as the content outlines for the original 45 risk upskilling topics present within the RfP and distributed to the Risk Champions across the Group for comment/approval. As this group were responsible for promoting and enabling implementation of the risk upskilling project (but had deliberately not been consulted at the design stage) it is not too hard to envision what was about to happen next. Let us come back to this a bit later.

The Challenge of Determining Risk Jobs Roles and Levels

The next major challenge arose when it became evident that the Bank did not have risk job descriptions, competencies and training needs mapped to each job role and level. Part of the challenge was that the Bank prepared its risk upskilling to existing risk jobs roles and levels defined in the past (pre Basel) and clearly not in accordance with Basel II/III or international best practise. As these pre-existing risk job roles and levels had been pre-approved by the Chief Risk Officer and the Bank's Board, and an RfP had been published, it was considered 'inefficient' to suggest they return to first principles and start afresh by delineating the proper and updated risk roles compliant to the changing banking codes.

Hence the risk upskilling began with critical flaws which led to the omission of large numbers of people

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in risk and whole departments engaged in risk managed activities and subject to internal audit and compliance scrutiny.

In order to earn buy-in with the Risk Champions it was agreed to schedule an interview with each of the eight RCs to allow the external risk specialists to ‘take the brief’ on the training needs as perceived by the RCs. During this interviewing process the risk specialists – meetings accompanied by the Group HR Number 2 – it emerged that nearly 450 people in treasury and operational risk functions had been omitted from the original project headcount as they were not deemed part of the risk community. A budget to include this group had to be negotiated internally which was not approved as it would have had embarrassing implications. Parts of the operations group were not subsequently included into the risk upskilling. This was red-flagged to the Risk Champion responsible for this area and a message sent up the line internally to the Group CRO.

Another major result of the meetings between the risk specialists, the Risk Champions, local CROs and business heads was the deconstruction of the 3-5 days of training block for each risk community member annually (10 days in total) and change to a 1-, 2- and 3-day training programme throughout the year to allow for less time away from the workplace.

The ‘new’, shorter training events were now ‘stand alone’ learning experiences, not part of a week-long learning experience, and as such required complete deconstruction of the pre-approved course content. What began as 54 risk topics and individual courses emerged as 80 risk and remedial level upskilling topics. The entire training programme and schedule – the mapping of job roles and levels to competencies and training courses to achieve those competencies, and the dates and locations to deliver those trainings – had to be discarded and rewritten from scratch, effectively doubling the original ‘concept’ stage of the project both in budget and time. The business heads, local CROs and Risk Champions were able to redesign the

risk upskilling to meet some of their perceived critical learning/training needs for their teams including topics such as Business Mathematics 101, Business English 101 and Understanding Balance Sheets. They wanted more training for their teams, not simply risk management upskilling and they were able to achieve this in the end.

Data Requirements to Identify the Bank’s Risk Community

The fourth major challenge at the project outset was that the Bank did not have a database or means to produce a single report of names, contacts details, job roles and levels, company ID numbers, email addresses, business unit ID codes for their deemed risk community within the bank and within its regulated affiliate legal entities. This required another non-budgeted project and although only 2,500 individuals was extremely labor intensive and relatively slow to achieve (6 weeks) and in fact an on-going process as managers and staff were reassigned to different departments, were hired or left the Bank as part of the wind down process.

Once the risk community were identified it was possible to create a snapshot of where the risk knowledge existed within each department, team, geographic unit and individual and to produce an interim report to the Chief Risk Officer, Group HR and the Board (and later, to indicate improvement, the regulators).

Working within the Bank’s own defined six risk job roles and three levels, a 2,500-person on-line initial ranking survey was created. Five sets of 30 questions and answer banks were designed to measure how much of the knowledge required for each risk job role and three levels was actually known by the employees (credit and market risk were blended into one set of questions). It was considered to be the fastest, least expensive and most effective means to show the areas of knowledge and gaps, and with its results the risk specialists would design the techniques, skills and behaviour courses and learning pathways to achieve competency in risk management.

The key message here for banks and financial institutions preparing to engage their Risk and HR top teams is that should be a strong connection between the senior management risk teams and the business unit level CROs and risk teams. This gap in communication can manifest itself in unexpected ways during risk job roles identification and upskilling initiatives.

IV Project Challenges, Successes and Key Lessons Learned

A) What were the main risk upskilling project challenges?

Uncertainty: The regulator and the bank’s Board were making decisions which would make a profound impact as to the budget and planning for the 24 month long project which often had milestones unrelated to the training initiative; this resulted in a stop-go-stop-go scenario which caused delays and cancellation fees at short notice to the project for the first 12 months. There was a widespread climate of anxiety among the project participants as daily press reports promoted messages of massive layoffs and fear for managers and employees all levels at the Bank.

Unfamiliarity: The Bank’s Group Human Resources, led by a successful change management expert, had a relationship with the Group Chief Risk Officer but little knowledge of or working relationship with the risk management teams within the bank and as such was challenged to initially identify risk jobs/roles from amongst the headquarters and the numerous related affiliate legal entities. The risk specialists travelled with the bank’s HR Project Leaders to various bank divisions to help identify those employees who should be ‘counted in’ and become members of the Risk Community and budgeted to receive training. One benefit of this was that an entire operational risk team of nearly 450 employees had not initially been included in the Group HR’s headcount of the bank’s risk community. Without an understanding of Basel II and Operational risk, this vital unit was overlooked as was operational risk training for the credit processing units.

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Data Unpreparedness: There was no risk jobs/roles database at the bank in any of its functions at any level. Names, employee ID numbers, business unit/department/function names were different across geographic units and historically within the bank's HQ and required continuous assurance in order to produce detailed reports to the Board and the regulator that individuals were engaged in risk management training.

Technology and systems: In the absence of their own Learning Management System the Bank engaged the ACCADEMIA Programme which provided a hosted LMS for their use for this project to save time and resources. Access to the internet and issuing user names and passwords required clean data from a wide range of bank sources. These varied widely amongst and between the geographic business units and legal entities; spellings when translated into English, accent marks and symbols were not transferable between IT systems resulting in errors, inconsistent department codes, email server blocks, and general internet access were all addressed on a rapid response model to get the project rolling. The risk specialists Project Manager handled all the IT/Operations support and interface with the bank's IT manager and HR department heads as well as the total user group (approximately 1500 people).

Team Building/Project Buy-In: The bank's internal transition from Group HR/CRO to the business unit level HR/CROs was 'pushed down' to an operational level for the training roll-out requiring the risk specialist Project Managers to travel to each of the six countries to work with the local HR teams to apprise (often junior or new) HR staff of the procedures, costs and operational logistics of identifying, inviting and clearing employees to leave their desks to attend required courses. The Bank's business unit heads were challenged to let their teams go to training courses and there were numerous 'push me-pull you' moments between HR, the Risk Champions, risk specialists at Group and local levels.

Morale and Mobilisation: Ensuring a successful risk upskilling project meant the bank and its employees needed to feel 'this was worth it' which was difficult when press reports regularly appeared in national and international newspapers as the to bank's crisis and talk of massive lay-offs and wind-down of departments. Group HR was challenged once again when the HR policy – if you join the firm, get the benefit of 'free' technical training and then leave the bank within 24 months you would be obligated to repay the bank for the training - resulted in forcing a 'financial burden' on internal transfers and new hires into the risk teams. This 'burden' was a deterrent to getting good risk people in the risk teams. HR had to petition the Bank Board to change a company policy to accommodate the changing bank organisational structure and the risk upskilling project in parallel. The training project was ultimately classified as 'Strategic' and as such exempted from the Bank's HR policy.

The Group CRO was actively engaged with the bank Board and the Regulator on a daily basis and was not able to be an active champion internally for the risk training project or to the risk employees. Hence with Group HR and the risk specialists created a Risk Champions programme intended to train the business unit level CROs to qualifications and help them lead their risk teams and take advantage of the training programmes being made available to employees.

This proved to be a mixed blessing: these highly competitive young men and women were actually vying for leadership roles within the newly reforming bank and while running their divisions (credit risk, rehabilitation, credit processing, et al) only engaged with the risk academy project 'under duress' to approve course materials and local case studies to be presented to their teams. They were also not keen – and never did – take any exams themselves – nor was this pressed upon them.

Procurement and Finance: Group HR had little experience with either the Group Procurement or Finance functions within the Bank prior to this project. By the end of the tender there

was also little time available in preparing for this project to allow the bank's finance function to work with local procurement and the finance departments in each of the legal entities to disperse their training budgets to a single or multiple training providers and to standardise invoicing procedures, protocols and payments.

Payment policies and documentation requirements to process invoices varied widely within and outside the European Union locations (e.g. taxation) and business culture (e.g. originals, faxing, use of official stamps, postal vs electronic, e-signatures, etc). This resulted in inconsistencies in producing invoices and delays in collections often requiring 'payment catch up time' and training stoppages when open balances ran over six figures (Euros).

B) What were the main risk upskilling project successes?

Ultimately the external risk specialists were given the authority by the Bank to take the lead in consulting, designing, promoting, operating and delivering the training programme working closely with Group and the local HR teams. This involved periodic face-to-face meetings at the Bank's headquarters, regular weekly conference calls with the Group HR Project Manager and local HR heads to work out practical matters in a reasonable manner but with room to add terms and conditions as needed to meet new challenges as the Risk Academy rolled out and grew within the entire bank and among its affiliates.

Once the preliminary hurdles were cleared the training roll-out changed from a 3-city 'hub and spoke' model (bringing employees from 6 countries to 3 cities) to a localised training model. This was mainly as a result of higher than planned for travel costs and the lower, pre-established annual travel budgets set for training by the bank. Addendums to the Framework Agreement (contract) allowed for more efficient and 'back-to-back' training scheduling reducing travel expenses by more than 40% and keeping fewer employees spending valuable work time driving or flying between training centres.

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The project has been considered a success. Project Leaders and Managers – the Bank’s and the Risk Specialists’ – met a difficult fast-track timetable and delivery schedule. Between August 1 and October 31, 2012 the Risk Academy project was conceptualised, agreed, project ‘infrastructure – human and data/IT/systems – were developed and approved/tested, trainers briefed to the special needs of this project, language issues, travel from London and first pilot trainings delivered. Between late February and July 2013 nearly 2500 individuals were examined/surveyed as to their level of risk management knowledge relative to their risk job/role, risk job roles and descriptions written/approved, and 1500 individuals attended a selection of 100 different 1-3 day courses, previewed course materials and sat online exams in the classroom, and issued performance reviews of the trainers using the Risk Academy customised and hosted Learning Management System. Of the three level groups, nearly all 2500 attended the Risk Foundations series (101) and by end of September 2014, 1500 risk managers completed level 201 Risk for Professionals. Level 301 Measuring and Managing Risk workshops and seminars were scheduled for early November 2014 to complete the 100-person top risk management specialists employed at the bank.

Positive exam results of the employees/delegates ran very high in general, with pockets of underdevelopment of risk roles in specific geographic locations. Remedial programmes were underway in these areas to further support learning and skills development to take to their daily jobs/roles.

The additional budget and the support internally for the Bank’s Risk Academy has been enhanced both by a decision to continue funding by the European, the national regulator, and by the appointment of a new Group Chief Risk Officer appointed in September 2014 and the acquisition of the ‘good bank’ by a foreign group of investors ensuring the Bank’s viability and sustainability.

C) Key Lessons Learned

(1) Governance Preparation for

major multi-departmental change management project is critical, but circumstances may not always permit. The key to managing a successful outcome of a large scale project like this have a clearly defined top team, their leadership and enabler roles and responsibilities, professionalism, good organisation, good communications, clear goals and agreed methods and techniques to measure and monitor progress or flag when progress paths are de-railed, and with strategies in place to deal with de-railments quickly and effectively.

Group Risk and Group HR need third-party support to bring each other together, to understand each others’ pressures, challenges and drivers, and ultimately to ideally embed one of their own into the others’ camp in the earlier stages of an HR and Risk project. As co-promoters of a risk upskilling or People/Conduct Risk initiative a solid working relationship must be in place at the top of the organisational chart with dependable, reliable and accessible individuals having leadership capabilities and channels throughout the risk and HR communities within the organisation.

(2) Project Definition and Project Management skills are also critical and were found oddly ill-perceived: for a risk upskilling project Group HR did not know who were the members of the risk community in their organisation. How much does HR know about risk management, its job roles and levels? Shouldn’t they come to grips with the topic initially first, then work with the CRO to create the bedrock of relationships needed to manage the bank’s risk roles successfully, not just recruitment and exiting employees? When it was proposed to run a risk management workshop for HR teams and a PM workshop at the outset the response from the risk heads were ‘it will take too much time and distract us from the real project’. Lesson learned here? If you are in Group HR and don’t know the essentials of risk management or how to design and run a major project your risk upskilling, people risk or conduct risk project will suffer seriously and cost you possible penalties, consultant fees, overrun deadlines and as in one case on this

project, loss of your position (Number 2 to Group CRO).

(3) Leadership is key. Another lesson learned is that without top down leadership at the highest level within the bank there will be in-fighting and delays. The Bank struggled with leadership and eventually found it easier to allow the external contractor ‘to run the project.’ In this case it was the disconnection of the Group Chief Risk Officer from the project at nearly all levels. Often the Group CRO is a technical specialist and not a credible team leader. This means your project leadership may lay elsewhere. A strong, talented and effective Project Manager may leave the project: the sudden departure of the Bank’s Group HR Project Manager (who was maternity cover transfer into the project) when her contract was completed causing a 3-month delay to the project whilst the new PM executive came up to speed and brought new procedures and processes to an on-going project while in full flow. The Risk Champions had no time to act as the Group CRO’s emissaries and while professional and personable were not able to add value to the risk academy project. The Group HR Project Leader was will ultimately agreed to allow the risk specialists/consultants to take the project reins, permitting for a clear, strong direction focused on the goals and tangible objectives, including micro-matters such as manoeuvring the risk employees into the classroom with the risk trainers or cajoling the various finance heads to cooperate and work as part of a team.

(4) Ensure Good Project Teams As a result of this particular project and under these rushed and tight planning deadlines it became clear that going forward insistence should be made to bring together Group Risk and Group HR, Group Finance and IT/Operations early on. Allowing a

without top down leadership at the highest level ... there will be in-fighting and delays

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bank's Project Leaders to say 'we have run projects like this before, this/that will not be a problem' just will not suffice.

Key risk community data was not available within HR or the Risk functions in the aggregate. Recommending IT to join the project team was a vertical climb for the Bank to achieve with much resistance. Once the risk specialists were able to convince the Bank that they needed to engage an IT manager for this project – and the risk specialists' IT manager engaged with theirs – the data mining, data flows and report preparations went relatively smoothly. They spoke each others' 'language' so

to speak and delivered complex results effectively and efficiently.

beware of the 'heavy handedness' of top down decision makers and dispel the view that training is a 'perk' not be 'wasted' on the younger members of staff

Ideally the Group HR function should have insisted on having finance, operations and IT attend a 1-day Risk Management Workshop for HR Professionals for them to prepare for identifying risk functions and job roles and levels within their organisation

and to deal with operational and data/systems/IT issues. This is the natural progression driving the recent trend for HR Departments to search for risk specialists to join their teams as full time technical risk specialists and in preparation for the People Risk and Conduct Risk rules implementation within their organisations.

(5) Get Buy-In from Participants Internal marketing, messaging and mobilisation were key issues addressed early in the planning stages as industry reports indicate that while 70% of organisations internally market their training courses to their employees via intranet or external website this method has an very low

effectiveness rate. With the benefit of the risk academy design expertise in this area – earning professional CPD/CPE points on a smart card, gaming, chat rooms and social media channels, prizes and performance awards this was part of the Project Plan to optimise employee participation.

The mid-2013 replacement of the Group HR Project Manager had been brought in from the bank's marketing department, which under the turnaround plans, had managed an outsourced 100% rebranding of the entire bank, from its trading name to its full media. Graphics and sound packages were available to build into the Risk Academy Project Management website and Learning Management Systems to align fully to the re-branding.

The Bank missed opportunities to ensure uptake of the training by their internal risk community at various times. The Group HR department had an awards programme throughout the bank already in place and was not interested in 'duplicating' another or having 'their' programme 'touch' the training programme. Hence a rewards or competition – popular among young people at the bank – was nixed.

Use of technologies amongst both the non-EU bank legal entities was literally frowned upon for fear of misuse and a lack of familiarity with user technology habits of the bank's millennial generation employees. Gaming and training on hand held devices was declined (although well established in the banking and finance sector for training).

There was no plan accepted by the bank to mobilise or send 'sign up for the 'free training' messages by the bank (even once the 'strategic policy' was in place.) The Group HR Project Leaders also did not perceive value in the 'push-pull' mechanism of having delegates sign up for participation via the project website and chose instead, to press upon their subordinate HR

teams in -country to draw up the names of training budget approved employees and sent them in bulk to the risk specialist training managers for 'signing up' effectively overriding a website system they had bought and were paying for and taking the 'participant ownership' out of the equation.

The result was an unplanned for massive wave of data coming from 18 legal entities to the single dedicated risk specialist training managers resulting in delays in responding to delegates as to when, where they were attending a course which their HR manager told them they had to attend, often on very short notice (often on a Friday afternoon for a Monday morning course start in another city).

It was later made known to the external risk specialists that the fear of losing their jobs in the turnaround was so fierce that the HR teams took on any additional tasks they could be to be sure 'they were needed' even if it caused problems for the project and ultimately increased costs. Most of these were young working mothers in both EU and non-EU locations so the anxiety was very real to them and difficult to explain to the 'foreign' training contractor acting as the de facto Group HR leaders.

The lesson learned here is to beware of the 'heavy handedness' of top down decision makers (both in Group HR and Group Risk functions) and dispel the view that training is a 'perk' not be 'wasted' on the younger members of staff (as we observed). Explore the 'mission critical' project communications and messaging tools available, and avert fear by reassuring project teams and key stakeholders that by doing so the project will run more smoothly, efficiently, and ideally to engage your project participants in ways meaningful to and valued by them.

The author invites comments or questions on their related projects via email to LM@riskrewardlimited.com

Derivatives: Limiting Market Change

Author Flora Prieto, a senior risk management specialist based in Madrid, contributed this article, aimed to reflect on the role of debt in the current economic environment.

Taking a long look at the financial industry – the challenges it faces and the changes being pushed through – is a thoroughly interesting exercise, regardless of one's perspective. Because when a particular market experiences radical transformation, the urge to comment becomes an imperative.

The Derivatives Market

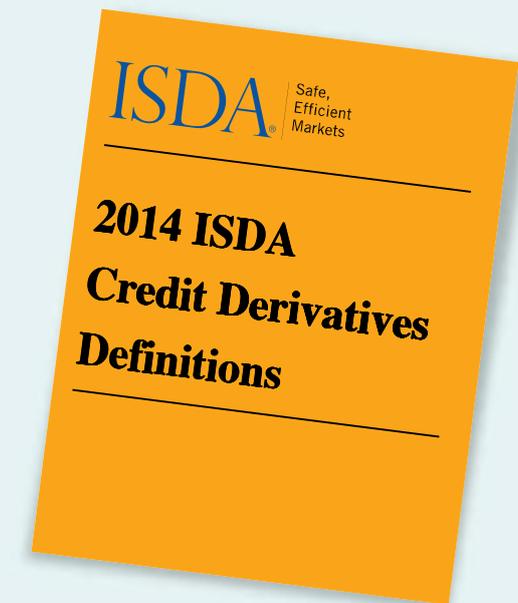
The great dynamism seen in the derivatives market is positive as well as encouraging. Bypassing criticisms to some of these products' features seems to be pushing forward new developments. Ethical drivers may end up creating different operating processes. However, it should be noted that these changes are being driven by investor demands.

Throughout this year, within the European Union context, the MiFID II Directive and the MiFIR regulation are in effect. At an industry level, the International Swaps and Derivatives Association (ISDA) has released its 2014 Credit Derivatives Definitions aimed to replace and update the 2003 ones, over the final quarter of this year. The driving forces for these changes can again be found at a supranational level, in particular, the G-20 formal declarations in 2009. During its meetings in Pittsburgh and London the G20, in response to what were considered as "major factors of crisis", insisted on the need for more transparency in financial markets and the application of risk mitigation techniques which would allow to keep (among other things) OTC derivatives under control. Recent changes in the regulatory frameworks of the leading economies like Japan or the US with the Dodd-Frank Act, have already set up requirements aimed to give response to most of these demands, completing the picture of a market and an industry, undergoing a radical reshape.

At the EU level, the efforts seem to be oriented towards building up stronger markets. There is no questioning on these products' characteristics or the important financial role they play for many corporations, financial institutions and governments worldwide.

Let us address some concerns on how the overall process is managed at the buy and sell side, by originators and investors. The EU Authorities' approach has followed a very logical sequence. First, they set up a regulatory and supervisory body, like the European Securities and Markets Authority (ESMA) in 2011, followed a few months later by the passing of the European Markets Infrastructure Regulation (EMIR) in 2012. Supposedly, if market participants are given clear guidelines with a strong commitment towards implementing the changes, the derivatives 'jungle' can be turned out into a friendlier world.

Both MIFID II and MIFIR regulate aspects of the derivatives' business. The first one is mainly focused on investors' protection issues. With this purpose, it establishes position limits to be held by one person on commodity derivatives as well as reporting requirements applicable also to emission allowances and other types of derivatives. The information to be disclosed should differentiate the positions aimed to outweigh commercial activity risks from other ones. This is a relevant distinction as limits do not apply to non-financial entities hedging their commercial exposure. Nothing has been said yet on the criteria to apply in order to differentiate hedging from speculative transactions. In any case, there are still many areas of this Directive, like this one, which need a more detailed development. This task is expected to be accomplished by ESMA by mid-next year through the drafting of regulatory technical standards.



The MIFIR Regulation, on the other hand, emphasizes the need for greater transparency in the market by imposing disclosing requirements on volumes and prices that would ensure a correct price's formation. Trading and clearing obligations for certain types of derivatives, portfolio compression or non-discriminatory access, are just some of the other topics covered by this law. It reaffirms the supervisory role on financial markets of ESMA, granting it even temporary intervention powers on the sale and distribution of financial products or the practice of financial activities, if deemed necessary. The corresponding national authorities would also share some of these responsibilities.

The goal of transparency is achieved by imposing reporting obligations of derivatives' contracts to Trade Repositories (TRs) as well as central clearing through Central Counterparties (CCPs) for a great number of them. For those, falling out of this scope, risk mitigation techniques should be applied. These last ones include daily mark-to-market, timely confirmation,

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portfolio reconciliation, portfolio compression, dispute resolution and exchange of collateral. Certain exemptions may exist depending on the nature of the transaction (e.g. intragroup) and, indirectly by the definition of clearing thresholds. Both financial and non-financial counterparties may be subject to this regulation.



The process is still ongoing and many have been accomplished in 2014 such as reporting to TRs started in February and the authorisation of the first CCP took place in March.

These new rules are not aimed to act as boundaries which would close the EU market to third-country providers

wanting to participate in it as CCPs or TRs, to the extent ESMA, as supervisory authority, would recognize them. The EU authorities' main concern lies on the potential negative impact derived from asking them twice to comply with the same requirements. This open attitude may end up playing a key role in ensuring that derivatives continue to be a global business. Its importance may be twofold: from an institutional standpoint, because it can contribute to the development of emerging markets as these participants need to get adapted to a certain set of requirements; and from a markets perspective, as mechanisms reinforce the desired transparency which should prevail everywhere.

The Impact of Change

Although there are many benefits expected from this transformation in the financial markets some concerns are also arising. Different ISDA research reports published throughout 2014 have highlighted the fact of an increasing market fragmentation along geographical lines as a consequence of the new rules being put in force by US authorities, and in response to the global demands for more regulation of the derivatives' business. The different regime affecting US and non-US persons, in terms of obligations of where to trade (trading platforms should register as SEFs or swap-execution facilities) and what to trade (the made-to-available trade or MAT rule defines the products which should

be mandatorily negotiated on SEF) have affected the way the market operates, leading to a higher preference for counterparties of the same geographical area.

In other words, European dealers preferably engage in derivatives' transactions with other European counterparties while US-based ones tend to do the same among themselves. As an example, just consider Euro interest rate swaps: data released by ISDA shows an increase in cleared European interdealers' activity from 75% in May 2013 to 93% one year later. European-US dealers' transactions during the same period fell down from representing 24% to just 6%. An ISDA Insight Survey on end-user's opinions on these facts revealed a perceived negative impact on firm's risk management activities as well as an increase in costs.

There is the risk that this market geographical disruption would tend to consolidate leading to the surge of differentiated areas where derivatives deals are arranged subject to specific and different conditions, regardless of the product type. Thus, when reviewing the scheduled implementation calendar applicable to 2014 ISDA Definitions, it can be seen that not all the same terms would apply everywhere. Well-established markets such as Europe, the US, Japan, Australia or New Zealand would lead the change from the beginning while emerging ones, such

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as EMEA or Latin America would not join this trend. In practice, this implies to acknowledge the fact that market differences go beyond counterparties' peculiarities and get, directly influenced by the existing economic and regulatory environments. It needs to be taken into account that some of the most relevant changes are related to the consideration of new credit events (e.g. governmental intervention) and widening of settlement facilities (e.g. asset-package delivery). As these definitions would mostly affect credit default swaps, preventing developing economies' parties from incorporating them, it can be understood like the acceptance of a two-level industry on the basis of their corresponding financial systems' stability. This poses a potential threat if understood as if OTC transactions would be questioning global financial system's presumptions. This has nothing to do with the unfortunate episodes of unethical behavior seen in this industry whose consequences are known to everybody.

The recent financial crisis is, undoubtedly, leaving its mark on these changes. It would be odd to neglect the importance that setting strong grounds have for the development of any market. A clear lexicon, capable of giving response to the new financial products stream, detailed regulatory technical standards defining the need and conditions under which technical processes such as portfolio compression or portfolio reconciliation should be undertaken or the parties' acceptance that, despite being OTC deals, they should be subject to certain enforceable terms and conditions, result necessary.

The imposed clearing obligation is a common feature in the laws being approved by the different countries, in response to G20 demands. However,

despite all the efforts being done, the results are evident that there would continue to be a part of non-cleared transactions. ISDA reports estimate that they would end up representing around 30% of the global OTC derivatives activity.

Non-cleared transactions have been tackled by regulatory authorities from a different perspective which is mainly focusing its interest in the application of risk mitigation techniques and definition of margin requirements. The overall purpose is to reduce counterparty risk. Financial experts agree on the fact that this is a necessary segment of the market which cannot be eliminated. The wide variety of types of existing derivatives, the need for their customization and stakeholders' interest in ensuring companies apply an active risk management strategy, make necessary their continuity. The existence of reduced levels of liquidity as a consequence of deal's features (like its unusual or long maturity periods or its denomination in non-frequently negotiated currencies,) should not imply lower levels of investor's protection or higher sources of market instability.

All these steps being taken up to now and the ones to follow over the coming years, confirm the critical role that adequate hedging strategies have for any company's financial success. As it has been mentioned above, a clear distinction is drawn between commercial risk's management and other risks' management. However, it should be kept in mind the fact that this is a financial alternative not suitable for everyone. Stricter margin demands, both in the form of variation and initial requirements, do not act taking liquidity out of the market, but rather the opposite by increasing participants' confidence and keeping basis risk at a minimum level. The challenge lies on the industry which

would need to find out other ways of giving response to customers' needs.

The new regulations have broken up existing prejudices by allowing the possibility of limiting positions, defining clearing thresholds, imposing stricter margin requirements or even, temporarily ban a product. There is no doubt that although this affects all participants, non-financial counterparties are the ones seeing how their way of doing business changes the most. The fact that the bulk of their hedging activity may fall under the category of commercial risk and, therefore could benefit more from clearing thresholds, would not prevent them from having to implement internal monitoring tools, which would ensure their compliance with the new rules. The consequence of this would be more control on their derivatives' activities. Over the long-run, it is even possible to think of the surge of a new managerial approach, the corporate portfolio one.

Any attempt to make the derivatives world a more manageable one should lead to positive results from a transaction's perspective, because the figures managed in this market are, simply, exorbitant. Companies and investors could just feel that they needed to be a part of it, despite not having at hand, all the necessary tools for correctly benefitting from them. From a dealer's perspective, because they have to manage simultaneously - the product, the customer and their risk - each of them with its peculiarities and demands, avoiding any overlaps while taking use of the capability to supersede some of them by applying some of the most sophisticated technical tools currently available in the market.

The author invites your comments and feedback via email to OS@riskrewardlimited.com

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NEW BIS Bank Corporate Governance Guidelines: Insights and Analysis

Risk Reward Group CEO Dennis Cox, BSc FCA CFSI, is a global banker, Big Four chartered accountant, risk management and bank internal audit specialist, as well as an international lecturer and noted published author. As an official Observer to the African Development Bank, Chairman Emeritus of the Risk Forum within the Chartered Institute of Securities and Investments (UK), former National Council Member of the ICAEW (UK) he is regularly asked to present positions and replies on behalf of financial services professional bodies to the Bank for International Settlements (BIS). In this article he offers insights and analysis on the latest BIS consultative paper on Corporate Governance for banks.

Corporate governance has been a prime concern for regulators and stakeholders since the start of the financial crisis. In response we have seen a range of pronouncements and revised sound practices papers seeking to change the way that banks operate. Now the Bank for International Settlements (BIS) has published new Corporate Governance guidelines as a consultative paper for response by 9 January 2015.

There are a number of issues that are interesting about the BIS paper in addition to the Principles that have been set out (a lucky? 13). The first is that the paper starts with a **glossary** that actually defines concepts such as Control Functions, Risk Appetite and Corporate Governance:

Control Functions

The first definition that is of interest is what they are referring to as Control Functions, which are defined as follows:

“Those functions that have a responsibility independent from management to provide objective assessment, reporting and/or assurance. This includes the risk management function, the compliance function and the internal audit function.”

It is perhaps interesting that they have highlighted risk management and compliance and actually not mentioned internal control or ownership of the second line of defence. Risk management and the Chief Risk Officer are generally

decision-making functions and therefore part of management so it is questionable the extent to which they can be seen as truly independent.



Likewise does compliance really provide the objective assessment, reporting and/or assurance that is suggested here? In many cases this may not really be the case. Clearly responsibility for compliance lies with the first line of defence and it is perhaps unrealistic to expect compliance functions to meet this objective. Indeed they should work with the business to find methods to comply with rules and regulations and therefore are unlikely to be fully independent.

That leaves internal audit, but they cannot really be a control function. Rather they bring periodic independent assessment to the Board and therefore to the Audit Committee as a committee of the Board.

Risk Appetite

Another definition worthy of consideration is risk appetite which is defined in the BIS paper as follows:

“ The aggregate level and types of risk a bank is willing to assume, decided in advance and within its risk capacity, to achieve its strategic objectives and business plan.”

We use the following general definition:

“The level of divergence from goals and missions which are unacceptable to the Board”

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However the definition provided by the BIS is clearly workable and the important thing here is the wording “decided in advance and within its risk capacity”. The risk capacity is defined as “The maximum amount of risk a bank is able to assume given its capital base, risk management and control measures, as well as its regulatory constraints.” Essentially this therefore links directly into the reverse stress test and the recovery and resolution plan. Within that capacity risk appetite as defined here is the level of risk that the Board are willing to accept and this clearly has a boundary at risk capacity. It is suggested that no firm should have a risk appetite that is higher than 70% of the risk capacity as defined in these terms.

Within the paper itself there is a discussion as to what a risk appetite statement really is with the following clarification as to what it should include:

“The [statement] should:

- Include both quantitative and qualitative considerations;
- Establish the individual and aggregate level and types of risk that the bank is willing to assume in advance of and in order to achieve its business activities within its risk capacity;
- Define the boundaries and business considerations in accordance with which the bank is expected to operate when pursuing the business strategy; and
- Communicate the board’s risk appetite effectively throughout the bank, linking it to daily operational decision-making and establishing the means to raise risk issues and strategic concerns across the bank.”

Given this definition of risk appetite and capacity that has been made this is seen as being potentially unhelpful because it brings in qualitative and quantitative measures. As capacity and appetite are both clearly values then it is necessary to change all of these measures into values. Not doing so would surely prevent appropriate risk correlation to take place. And note the alignment of risk appetite to the strategy of the bank. Risk management is not just about preventing losses; rather it is about ensuring that the goals of the bank are achieved within stakeholder expectations.

Corporate Governance

Corporate governance is an often discussed term but this new BIS consultative paper seeks to provide a definition. It states that:

“Corporate governance determines the allocation of authority and responsibilities by which the business and affairs of a bank are carried out by its board and senior management, including how they:

- Set the bank’s strategy and objectives;
- Select and oversee personnel;
- Operate the bank’s business on a day-to-day basis;
- Protect the interests of depositors, meet shareholder obligations, and take into account the interests of other recognised stakeholders;
- Align corporate culture, corporate activities and behaviour with the expectation that the bank will operate in a safe and sound manner, with integrity and in compliance with applicable laws and regulations; and
- Establish control functions.”

This raises the issue of corporate behaviour which is aligned to ethical standards stated as acting with integrity. The requirement to act in a safe and sound manner means operating above the minimum standards set by regulators. They remain a minimum but not a benchmark and need to be exceeded to meet these requirements.

The New BIS Principles: Insight & Analysis

Principle 1: The Bank Board’s overall responsibilities **The board has overall responsibility for the bank, including approving and overseeing the implementation of the bank’s strategic objectives, governance framework and corporate culture. The board is also responsible for providing oversight of senior management.**

Risk management is not just about preventing losses; rather it is about ensuring that the goals of the bank are achieved within stakeholder expectations.



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The paper discusses the **duty of care** and what they refer to as a **duty of loyalty** which they apply to the bank (of course this really means to relevant stakeholders.) To achieve this “Accordingly, the board should:

- Establish and monitor the bank’s business objectives and strategy;
- Establish the bank’s corporate culture and values;
- Oversee implementation of the appropriate governance framework;
- Develop, along with senior management and the CRO, the bank’s risk appetite, taking into account the competitive and regulatory landscape, long-term interests, exposure to risk and the ability to manage risk effectively;
- Monitor the bank’s adherence to the risk appetite statement, risk policy and risk limits;
- Approve and oversee the implementation of the bank’s capital adequacy assessment process, capital and liquidity plans, compliance policies and obligations, and the internal control system;
- Approve the selection and oversee the performance of senior management; and
- Oversee the design and operation of the bank’s compensation system, and monitor and review the system to ensure that it is aligned with the bank’s desired risk culture and risk appetite.”

Notice the level of concentration on risk appetite within this principle highlighting its importance, a trend we have seen in other papers. By trying to deal with it at this level the monitoring that needs to be conducted by the Board is enhanced. Periodic internal audit is surely not sufficiently regular to achieve this for the Board and accordingly they will need to have a structure of reporting metrics which they are able to monitor to achieve these goals.

The background to the principle continues with the following important statement on the role of the Board: **“In order to promote a sound corporate culture, the board should take the lead in establishing the “tone at the top”** by:

- Setting and adhering to corporate values for itself, senior management and other employees that create expectations that all business should be conducted in a legal and ethical manner;
- Promoting risk awareness within a strong risk culture, conveying the board’s expectation that it does not support excessive risk-taking and that all employees are responsible for helping ensure that the bank operates within the agreed risk appetite and risk limits;
- Ensuring that appropriate steps are taken to communicate throughout the bank the corporate values, professional standards or codes of conduct it sets, together with supporting policies; and
- Ensuring that employees, including senior management, are aware that appropriate disciplinary or other actions will follow unacceptable behaviours and transgressions. ”

So the Board needs to be seen to be doing the right things and minimising excessive risk taking. Risk management is not about not taking risks; it is about taking appropriate risks aligned to the risk appetite of the firm. Risk is the real currency of banking but imprudent risks are now clearly unacceptable and are to be avoided.

Corporate Values

There is also a discussion regarding this important topic. Changing corporate culture and developing values is never easy and the paper proposes the following to deal with this matter:

“The bank’s corporate values should recognise the critical importance of timely and frank discussion and escalation of problems to higher levels within the organisation.



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- Employees should be encouraged and able to communicate, confidentially and without the risk of reprisal, legitimate concerns about illegal, unethical or questionable practices. This can be facilitated through a well communicated policy and adequate procedures and processes, consistent with national law, which allow employees to communicate material and bona fide concerns and observations of any violations in a confidential way (e.g. whistle blower policy). This includes communicating material concerns to the bank's supervisor.
- There should be direct or indirect communications to the board (e.g. through an independent audit or compliance process or through an ombudsman independent of the internal "chain of command").
- The board should determine how and by whom legitimate concerns shall be investigated and addressed by an objective independent internal or external body, senior management and/or the board itself. "

Notice this is bringing the Board directly into the process for dealing with inappropriate conduct. The use of the term ombudsman is also interesting since it suggests almost a judicial process of independence which most likely does not exist in many firms. Clearly the goal is effective and open communication of key issues related to ethical standards and this is to be encouraged.

Principle 2: Board qualifications and composition
Board members should be and remain qualified, individually and collectively, for their positions. They should understand their oversight and corporate governance role and be able to exercise sound, objective judgment about the affairs of the bank.

This is further clarified with the following explanation:

“Board members should have a range of knowledge and experience in relevant areas and have varied backgrounds to promote diversity of views. Relevant areas of competence include financial and capital markets, financial analysis, financial stability, strategic planning, risk management, compensation, regulation, corporate governance and management skills.”

What is clearly needed is for Boards to assess the extent to which the skills needed to achieve these goals are met by the existing board membership. We would, for example, recommend that a non-executive risk specialist be added to the Board and indeed provide such people. We also undertake training to enhance Board skills in key areas which also is important.

Too often the recruitment process within banks has not taken full account of ensuring that the necessary balance

exists on a Board. This clearly now becomes of increasing importance.

Principle 3: The Bank Board's own structure and practices
The board should define appropriate governance structures and practices for its own work, and put in place the means for such practices to be followed and periodically reviewed for ongoing effectiveness.

The explanation discusses the periodic review of Board performance and the role of chairs of committees, for example. One of the key issues is the role played by the internal audit function. Reviewing internal governance processes is clearly important yet difficult for the internal audit function to undertake them. The risk for the internal auditors is that they may be producing what might best be called 'career limiting' audit findings. Sometimes delegated to third-party internal audits governance audits and the findings have generally resulted in changes to structures, roles and memberships. (On one notable occasion the findings report resulted in that the entire Board resigned.) The role is important and needs to be undertaken carefully and with strategic outcomes planned for. This section also highlights that the **financial reporting process** is a key responsibility of the audit committee, replicating the comments in the revised BIS paper on internal audit in banks. However in looking at the risk committee the following is shown:

"The risk committee of the board:

- Is required for systemically important banks. For banks of large size, risk profile or complexity it is strongly advised. For other banks it remains strongly recommended.
- Should be distinct from the audit committee, but may have other related tasks, such as finance.
- Should have a chair who is an independent director and not the chair of the board, or any other committee.
- Should include a majority of members who are independent.
- Should include members who have experience in risk management issues and practices.
- Should discuss all risk strategies on both an aggregated basis and by type of risk and make recommendations to the board thereon, and on the risk appetite.
- Is required to review the bank's risk policies at least annually.
- Should oversee that management has in place processes to ensure the bank's adherence to the approved risk policies. "

What is new here is the **requirement for the members to mostly be independent directors and for the Chair to also be independent.** This is an extension to existing guidance and follows the logic of the internal audit

One of the key issues is the role played by the internal audit function.

risk is the currency of the firm

NEW BIS Bank Corporate Governance Guidelines: Insights and Analysis

committee being made up of independent members. However there is clearly a difference. The risk committee within its area of responsibility does look at key limits and is part of the executive management team. It designs limits and structures aligned to the goals and missions of the firm being as interested in making money as preventing the firm from losing money. While it is agreed that some external input can improve the quality of the debate at such a committee, risk is the currency of the firm and therefore the majority of this committee should in our opinion be executive.

Principle 4: Senior management
Under the direction and oversight of the board, senior management should carry out and manage the bank's activities in a manner consistent with the business strategy, risk appetite, incentive compensation and other policies approved by the board.

There is nothing new in this area of guidance.

Principle 5: Governance of group structures
In a group structure, the board of the parent company has the overall responsibility for the group and for ensuring that there is a clear governance framework appropriate to the structure, business and risks of the group and its entities. The board and senior management should know and understand the bank's operational structure and the risks that it poses.

Again this is hardly surprising. However there is some important information in the key clarification statement provided:

“In order to fulfil its responsibilities, the board of the parent company should:

- Establish a group structure (including the legal entity and business structure) and a governance framework with clearly defined roles and responsibilities, including those at the parent company level and those at the subsidiary level;
- Define an appropriate subsidiary board and management structure to contribute to the effective oversight of businesses and subsidiaries, which takes into account the different risks to which the group, its businesses and its subsidiaries are exposed;
- Assess whether the group's corporate governance framework includes adequate policies, processes and controls and addresses risks across the business and legal entity structures;
- Ensure the group's corporate governance framework includes appropriate processes and controls to identify and address potential intragroup conflicts of interest, such as those arising from intragroup transactions;
- Approve policies and clear strategies for establishing new structures and legal entities, and ensure that they are consistent with the policies and interests of the group;
- Assess whether there are effective systems in place to facilitate the exchange of information among the

various entities, to manage the risks of the separate entities as well as of the group as a whole, and to ensure effective supervision of the group;

- Have sufficient resources to monitor compliance of subsidiaries with all applicable legal, regulatory and governance requirements; and
- Maintain an effective relationship with both the home regulator and, through the subsidiary board or direct contact, with the regulators of all subsidiaries. “

Nothing here is revolutionary but it certainly is evolutionary. The most important sentence here is that the Board should monitor local compliance. That is quite a challenge. The existing structure of compliance will need to be enhanced to achieve this perhaps with internal audit also changing their role. However to get internal audit to understand local regulation in sufficient detail to undertake this role will also require training and some changes to the nature of their personnel.

Principle 6: Risk management
Banks should have an effective independent risk management function, under the direction of a Chief Risk Officer (CRO), with sufficient stature, independence, resources and access to the board.

This section is a reiteration of the existing requirements.

Principle 7: Risk identification, monitoring and controlling
Risks should be identified, monitored and controlled on an ongoing bank-wide and individual entity basis. The sophistication of the bank's risk management and internal control infrastructure should keep pace with changes to the bank's risk profile, to the external risk landscape and in industry practice.

The important point again to notice here is the emphasis on the entity basis. The obligations of entity Board directors should be enhanced to meet these requirements.

The paper does in some ways duplicate the sound practices papers including the one on stress testing, which is perhaps surprising. However there is little here which is actually new.

The remaining principles are as follows:

Principle 8: Risk communication
An effective risk governance framework requires robust communication within the bank about risk, both across the organisation and through reporting to the board and senior management.

Principle 9: Compliance
The bank's board of directors is responsible for overseeing the management of the bank's compliance risk. The board should approve the bank's compliance approach and policies, including the establishment of a permanent compliance function.

Principle 10: Internal audit
The internal audit function provides independent

NEW BIS Bank Corporate Governance Guidelines: Insights and Analysis

assurance to the board and supports board and senior management in promoting an effective governance process and the long-term soundness of the bank. The internal audit function should have a clear mandate, be accountable to the board, be independent of the audited activities and have sufficient standing, skills, resources and authority within the bank.

Principle 11: Compensation

The bank's compensation structure should be effectively aligned with sound risk management and should promote long term health of the organisation and appropriate risk-taking behaviour.

Principle 12: Disclosure and transparency

The governance of the bank should be adequately transparent to its shareholders, depositors, other relevant stakeholders and market participants.

Principle 13: The role of supervisors

Supervisors should provide guidance for and supervise corporate governance at banks, including through comprehensive evaluations and regular interaction with boards and senior management, should require improvement and remedial action as necessary, and should share information on corporate governance with other supervisors.

Again much of this actually duplicates more detailed guidance provided within existing sound practices papers with little additional information.

What is Missing

The question perhaps is what if anything is missing. Notice that there is a lot of focus on risk appetite and risk management, together with compliance and financial reporting. What there is less focus on is the strategy and profitability of the firm leading to long term survival. In the current climate given the level of change that is currently taking place it is clear that Boards need to be forward looking not only in their risk management but also in their strategy. To an extent the paper is rather negative and this is perhaps understandable (if disappointing). However there are clear messages here which any firm should take into account.

Take away message

Whilst this is a consultative or discussion BIS paper we would not anticipate major change prior to finalisation. Hence we recommend that firms consider their governance practices against this benchmark and begin to develop a programme to deal with any gaps that are perceived to exist.

*The author invites comments via email to
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The Implications of Climate Change Risk

David A. Thompson, FCA is a chartered accountant and turnaround business leader based in the UK for more than 30 years. As part of a fund raising unit for technology firms seeking to exploit innovations in the global environment and energy sectors he sees climate change risk impacts firms and their funders alike. In this article he explores how an awareness of the existence of Climate Change Risk in all its guises is essential for all financial institutions investing in or to lending to businesses wherever located but particularly those businesses operating in parts of the world that are subject to greater climate change regulation and/or frequent extreme weather events.

Whatever your views on Climate Change – natural or man-made or a bit of both - it is clear that no business (or government) can ignore recent extreme weather events and the momentum that is starting to build amongst world governments towards more action and regulation aimed at reducing carbon and other greenhouse gas (GHG) emissions which are thought to contribute to climate change. Whilst much of the impact of additional regulation is likely to fall on the major emitters in the energy and power generation sector, there is no doubt that climate change in all its aspects will become of greater import to the wider global business community.

Although great efforts are being made on the global stage through organisations like the United Nations on the need to combat climate change by reducing the Greenhouse Gases (GHGs) emissions, the lack of global action is the wrench in the wheel slowing this battle against climate change. On September 23rd 2014 more than 120 Heads of State attended the United Nations Climate Change Summit in New York under the mantra of catalysing action for the run up to the 21st Conference of Parties (COP) in Paris 2015 and post 2020 commitments. Although this summit generated mass media coverage of the awareness that further action must be taken to combat climate change, it yielded little in the way of new commitments which only increases the uncertainty in the international regulatory environment. Furthermore, key political leaders in China, India, Russia, Germany and Australia emissions failed to attend this summit in New York which sends a signal of a lack of global consensus leading to further uncertainty at the global level.

It is clear that ‘something’ must be done to reduce GHG emissions however, the what and the how is still a topic open to wider debate and varying opinions which have led to divergences in the response of countries to climate change. These divergences have led to risks facing businesses due to climate change varying from country to country.

In this article we consider the various aspects of climate change risk facing UK businesses – all 4.9 million of them – trading domestically and internationally.

In general, for each aspect of Climate Change Risk all organisations will have to consider:

- a) The potential impact
- b) Timeframe involved
- c) Whether or not the Risk is Direct or indirect
- d) The likelihood of occurrence and
- e) Magnitude of the impact

For the purposes of this discussion Climate Change Risk can be categorised into 2 main areas which we will examine in turn: the impact of regulation and the impact of extreme weather events.

The Implications of Climate Change Risk

I The Impact of Regulation

The UK is one of the 28 member countries part of European Union Emission Trading Scheme (EU ETS) which means that the UK businesses with installations that meet European Commission (EC) criteria¹ are subject to the rules and regulations dictated by the EC. These regulations relate to issues surrounding the Cap-and-Trade system for example the cap of the installation, the monitoring, reporting and verification (MRV) process, the allocation of allowances which all fall under the National Allocation Plan (NAP). In addition to this the UK has its own country specific regulations on climate change stemming from the Climate Change Act 2008 which set a legally binding target to reduce UK's GHG emissions by at least 80% by 2050.

With regard to UK businesses one of the most pressing regulations is the recent introduction of mandatory carbon reporting for companies listed on the London Stock Exchange (LSE) to publish full details of their GHG emissions². The idea is that creating more transparency through the financial statements, will allow public perception to shape the decisions of investors and consumers by employing the forces of public pressure. The perceived risks to business is linked to reputational risk where companies with activities that damage the environment and inadequate steps are being taken to mitigate this, these companies will suffer from a loss of business as investors and consumers choose other cleaner companies. At the times of this article mandatory carbon reporting only applies to companies listed on the London Stock Exchange however there are talks of extending this beyond listed companies.

In July 2014 the new Sentencing Council Guidelines came into effect where a tariff-based approach to the sentencing of environmental offences was introduced where criminal courts will be required to take account of the guideline when sentencing wrongdoers. Also the size of the penalties for environmental offences³ has increased⁴ for example for large organisations where turnover is greater than £50 million can face fines up to £3 million. Furthermore, fines in the hundreds of thousands will become more the standard rather than the exception. Therefore the risks of non-compliance to business are the loss of revenue and the potential of reputational damage following the sentencing.

There are a number of issues that businesses need to be aware of to avoid the implications of climate change risk but also benefit from the changes in regulations;

- a) Changes being needed in product ranges and associated production technology and facilities due to changes in demand for certain items (low carbon v high carbon – e.g. the motor vehicle industry),
- b) Product specifications needing to be reviewed to

- comply with new regulation,
- c) Increase in the cost of R&D into low carbon products
- d) Changes to the skill sets required by employees
- e) Changes in local government planning requirements resulting in higher standards being set for building projects leading to development projects being delayed or shelved.
- f) Increased capital expenditure costs to meet new standards,
- g) A move towards greener energy solutions (which are generally more expensive),
- h) Reduction in government subsidies for Green energy further increasing the cost to business
- i) The introduction of carbon pricing schemes (e.g. Cap & Trade as in the EU Emissions Trading scheme, the Auctioning of Carbon Allowances or Taxation), leading to additional administrative burdens and costs,
- j) More regulation giving rise to increased monitoring by the authorities and stricter enforcement and higher penalties for failure to comply fully with regulations.
- k) Reduced public expenditure on waterways, coastal management and other projects intended to mitigate the effect of Climate Change resulting in weaker flood defences leading to increased risk to businesses and communities located in coastal, low lying and other vulnerable areas.



The risks and opportunities stemming from climate change policy are increasingly becoming more perception based, therefore companies which invest in greener technologies and have more environmentally friendly activities can benefit from a boost in its corporate social responsibility image which improves the brand status.

However, before taking any action, businesses should seek to quantify:

- The potential financial implications of the risk
- The methods proposed to manage the risk
- The costs associated with such proposed methods

This process is critical to mapping the extent to which embedding a green culture within a company can benefit or

¹ These include power stations, oil refineries, offshore platforms and industries that produce iron and steel, cement and lime, paper, glass, ceramics and chemicals. Also depending on the level of combustion, universities and hospitals may be included. Lastly, aviation operators flying into or from a European airport are also covered by the EU ETS.

² Starting in October 2013

³ The unlawful deposit of waste and the discharge of polluting matter into the air, freshwater or groundwater

⁴ Subject to the nature of the offence i.e. no culpability, negligent, reckless or deliberate

The Implications of Climate Change Risk

cost the company which will ultimately determine the pace at which the 'green' pivot will happen for the UK businesses.

II Risk driven by changes to the weather or climate

There have always been extreme weather events however it does seem that these have been occurring with greater frequency. No business, wherever located, can afford to discount the possibility and ignore the consequences of an extreme weather event. The challenges that UK businesses face stem largely from flooding and coastal erosion, increased competition for water, energy and materials; and the disruption of transport networks and communication link.

In recent years we have seen searing heat waves over the summer months with falling levels of rainfall to some of the coldest, fiercest winters in decades and the worst flooding in a century. Changes in the frequency and intensity of rainfall and with trends indicating increasing the flooding frequency, businesses previously used to operating in relatively benign climatic conditions, particularly those located in near river systems or in low-lying and/or coastal areas, should consider how to mitigate the risk of damage to infrastructure and disruption to the business operations.

Businesses that rely largely on fixed assets especially near main rivers or the coast, or have complex supply chains or

rely substantially on natural assets have a particular acute risk to changes in the climate dynamic. Although, it is likely that the risk of operating in such extreme conditions has been a major part of operating considerations for many years but with climate change the frequency, duration and magnitude of weather events have changed and businesses must have the ability to accurately risk assess these changes to weather.

For UK business the main risks factors⁵ are:

- Possible decrease in output for UK businesses due to an increase in supply chain disruption as a result of extreme events.
- Risk of increase in monetary losses as a result of interruption to business from flooding.
- Greater variability in the availability of water.
- Potential loss of staff hours due to high internal building temperatures (assessed as being of particular relevance to health, education and retail sectors, which have large workforces).

Businesses that are not directly subject to the main risk factors should be aware of the interconnectivity of the domestic to the international economy. For example disruptions to the transport links can have a knock on effects that ripple through the economy or businesses with international supply chains have to be ever vigilant of how climate change is affecting other parts of the world.



The Implications of Climate Change Risk

In planning for such extreme weather events, businesses should consider:

- a) The Impact on operating costs
- b) The Impact on Capital expenditure on defensive/protective measures
- c) Loss of productive capacity
- d) Employee welfare and safety
- e) The possibility of damage caused by an extreme weather event to business infrastructure resulting in environmental damage/pollution due to key systems failures, the direct cost of rectification, compensation to local population and loss of reputation.

In the face of all these risks due to weather changes there are also some opportunities which businesses can be leveraged for example warmer summers in the UK can provide market opportunities to especially the tourism and leisure industry.

Investors and Lenders

Awareness of the existence of Climate Change Risk in all its guises is essential for all financial institutions investing in or to lending to business wherever located but particularly those businesses operating in parts of the world that are subject to greater climate change regulation and/or frequent extreme weather events.

An examination of Climate Change Risk and the impact of an extreme weather event on a business, its profitability, cash flow and its ability to recover operations following such an event i.e. the insurance policies surrounding weather damage should be included in Due Diligence process alongside the more usual risk considerations. In high risk businesses it is likely that Investors already plan for these eventualities in their risk assessment. In addition to this investors also need to be aware of the inter-connections between businesses and understand how sectoral responses to climate change may lead to changes in the risks that they have to manage⁶ when considering where to invest their money.

Corporate Governance

With the onset of mandatory carbon reporting for UK businesses listed on the LSE businesses will be required to include carbon information within their director's report which one or more committees will need to sign off internally. The predicted effect of this is that mandatory carbon reporting should raise the profile and importance of climate change to senior level executive.

In addition mandatory carbon reporting will ensure that the work that environmental

managers do to measure, collect and report on sustainability data will gain greater recognition from a variety of departments. This will largely be due to the requirement to publish this data within annual reports, rather than only within standalone sustainability reports⁷.

Mandatory carbon reporting will improve the status and importance of Climate Change Risk and the management of GHG emissions as a routine item on the agenda of Board level and Senior Management meetings. However, the question is whether mandatory carbon reporting alone will be enough to change the climate change culture of a company which is of course dependant on how climate change risk can be embedded into the corporate governance structure.

What is sure though is that businesses seeking to expand into new geographical areas along with their funders will have to give major consideration to the possible impact of Climate Change Risk.

Conclusion

Climate change is upon us - whatever the cause - and the impact is being felt now. Without action it may only worsen for future generations for many years to come. In the meantime, all businesses and lenders must ask if their organisation has considered the impact of Climate Change and the current and future Climate Change Risks that may result in major changes to compliance, operations and profitability.

*The author invites feedback via email at
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⁵ HM Government UK Climate Change Risk Assessment: Government Report (January 2012)

⁶ Ibid

⁷ Source: Laura Paddison - Mandatory carbon reporting: can it address climate change? (July 2013)



Client Money: Don't Be in a Bad Place

Julian Sampson is a Compliance expert with a respected track record as both a financial regulator, Chairman of the Chartered Institute of Securities and Investment Compliance Forum and consultant. In this article for the GRU he tackles the challenges of separating FCA 'reality' from 'perception' by banks and regulated entities while confirming that the FCA latest rules are in fact meant to be taken seriously and on time – or else.

Don't Be in a Bad Place

If your firm has Financial Conduct Authority permission to hold client money or assets you should, by the time you read this, be well on the way to completing the changes to your procedures and documents in the light of the FCA's recent rule changes.

It's well to give this area close scrutiny. Client money continues to be a hot topic for the UK regulator, with a constant stream of fines handed out to firms for failures of process. As is usual with the FCA discipline, it doesn't have to be the case that someone's actually been caught with his or her hand in the till, or that the money has gone "missing".

It's simply enough that your procedures were not sufficiently robust to prevent the possibility of such an event – or any other infraction – from happening.

And again with FCA discipline, there's little value in arguing with the FCA once they've made up their mind to that effect. You may think, with good reason, that your procedures are sufficiently robust and point to a blemish-free track record. But if the FCA disagrees with your analysis, you're in a bad place.

So it's good policy to pay close attention to the new rules in this area. Some of them have already passed their implementation date, but most come into effect by the end



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of 2014 or mid 2015. And the most difficult to implement will be those which require the co-operation of parties outside your firm, and those which require a degree of lateral and green field thinking.

Here are some of the new rules which may be more than a simple challenge to overcome:

Letters

In the former camp come the new requirements for the letters to banks holding client money. These "acknowledgement of trust" letters are intended to confirm the beneficial ownership of the funds in the account and show their segregation from any other funds held in the bank.

Historically, this area has been rife with poor practice. When these letters did exist (and there have been significant cases where they did not) they had often been done poorly. The FCA pointed out in its Policy and Consultation papers issued in the run up to the new rules that often the most basic of execution formalities were not observed – letters were not dated, signed, or even when they were it was impossible to tell who had signed them.

On a more substantive basis, banks had inserted wording into the letters that undermined the letters' substance, and the FCA often found cases where firms were holding client money in accounts which were not covered by the provisions of the letter.

All should be much clearer now. The new rule, and associated guidance, gives firms a number of template letters to complete, with specified optional text to be deleted or retained as appropriate. The guidance specifies in some detail how the letters are to be executed, right down to the seemingly obvious points, such as this - don't do it in pencil. Thus many firms have made a start with their banks in agreeing these letters.

But beware. When dealing with large banking organisations – especially those headquartered overseas – there can be a time lag. There are a number of cases where the FCA's new rules and template letters have yet to filter down to the relevant level in their organisation where their staff face off to the regulated firm. As such, firms are still being presented by banks with old-style and soon-to-be-non-compliant letters. This can be immensely frustrating for the firm, but only goes to re-enforce the case that firms should be on the front foot with their banks as soon as possible.

Reconciliations

The new rules also embody a number of seemingly minor clarifications on process and procedure, for example, those on the central process of performing the client money

reconciliation. These rules require firms to carry out some lateral and green field thinking. Firms are still free (largely) to choose the process that best fits their business but they must now define, for example, the frequency with which they carry out their reconciliations and their materiality threshold when dealing with differences. The FCA has stated that it expects firms to set out in their Client Money processes just how and why they do things the way they do.

For firms who have been used to a routine process over some years, this may induce a certain amount of head scratching. Just how often should client money be reconciled? What risk is posed by the volumes of transactions passing through the client money accounts? What is the link between the two? It's a reasonable assumption that in the absence of detailed metrics to guide the firm to an answer, the default position of reconciling on a daily basis will satisfy the FCA. However, for the smaller firm, this would be likely to impose significant administrative costs.

Material Breach

It's the same when considering materiality and the requirement to notify the FCA of a breach. Again, these requirements aren't new, but firms need to consider what they would regard as a material breach and when they would report that to the FCA. Early engagement with the firm's auditors will assist this process, given the auditor's own role in reporting to the FCA on whether the firm has or has not adhered to the rules.

Diversification

Similar thinking needs to be concluded in the matter of the choice of bank used to hold the client money. The requirement to consider both the soundness of the bank, and the need for diversification, are neither of them new.

However both have been given added edge in the new rules. It may no longer be sufficient for firms to put their money with a major UK high street clearer on the grounds that they are who they are, thinking that if that bank fails then the FCA – and UK government – will cover the risk. This leads to a much wider problem than just client money.

So some rationale and documentation of thinking is required. It is likely that those high-street banks will still be the chosen client money bank for most UK investors. But this needs to be a considered process. It's also likely that most firms will only have a requirement for one client money bank, notwithstanding the FCA's comments on the advantages of diversification. For smaller firms, the administrative overhead of running parallel banking systems will not be in the client's best interests. The FCA has more or less acknowledged this, saying that it will be monitoring the diversification in those firms classified as "medium" and "large" client money firms – the implication being that smaller firms are not quite in this spotlight.



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While no new rules have been issued by the FCA about the following it is good sense to ensure these areas are under scrutiny alongside compliance to the new rules:

Governance

Beyond the detail of the rule changes – and not specifically referred to by the FCA – firms need to consider the overall governance framework within which client money rests. Governance remains a critical area for the FCA across all areas of firm's activity, and they will want to know that the client money operations are adequately overseen by the firm.

All firms holding client money will already have either a senior member of staff holding the "Client Assets / Money Oversight" controlled function (CF10A) or a specified director responsible for this area. Their knowledge of the firm's processes and controls will be critical in convincing the FCA that this area receives adequate scrutiny.

But it can't end there. There's an extent to which the FCA will assume that this person knows their job - after all, if they're a CF10A they will have already been approved by the FCA. The FCA are just as likely to question fellow directors/non-executives on what they know about client money. For this to come off well for the firm there will need to be a regular routine of reporting from the CF10A or director responsible to the Board on client money matters,

and not just once a year. The Board will be expected to know how the firm comes to hold client money, where it is held and some details of reconciliation processes. It's particularly important that the Board should be fully briefed on any process failure from late reconciliations to unexplained differences on the reconciliations themselves.

Training

All firms holding client money will have already recognised the need to ensure that their direct client money team are properly trained in the new rules. But consider casting the training net wider and giving all staff a general overview of the issues involved. Any FCA visit may involve interviews with staff from all levels of the organisation, most of whom will be remote from the day to day client money process. It's important that they know what to do if, for example, they open a letter which includes a client cheque. It would be unforgivable if they were allowed to think that they were acting within the scope of the firm's procedures by merely locking such receipts, however securely, in their desk drawer overnight.

And whilst you're looking at all of this, spare a moment to check on the Client Asset Resolution Pack. The rules in this area have not changed, but the FCA have recently carried out a review of Resolution Packs around a sample of firms. There's nothing inherently complex about the Pack – the information content should all be relatively attainable. The difficulty is making sure that it is up to date. Most firms will hold their Packs in electronic format, so take care to ensure that links to relevant folders / directories are all up to date and working properly.

Timetable

So what should firms be doing in the time still available to them before the implementation date? There is certainly still time to get everything in place – but that time should not be wasted. The first step should be to draw up a gap analysis setting out the changes required to be made to the firm's processes and policies. Once these have been identified, specific individuals / groups can be identified and tasked with drawing up the revised processes.

The culmination of this exercise should be the approval by the Board of the new processes and policies. This should certainly be at the macro level, in order for the Board to grasp the strategic issues of why the firm is holding cash or assets at all, and the control environment around them.

Once that process is complete, the firm can relax - but not for long. Central to the client money and assets regime is that the firm reviews its relationships and processes on at least an annual basis. The higher the volume of transactions or level of balances the more frequent such reviews should be. Such reviews will generally be conducted by or for the director responsible, CF10A, and will be reported to the Board. But there is a consolation: having put so much effort into the initial re-drafting of procedures and policies, such subsequent reviews should be a breeze!

*Julian Sampson invites your questions via the GRU Editorial Team
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The Value and Management of Intellectual Property, Intangible Assets and Goodwill

When a company buys another company, how does it value its brands? When an investor is assessing the value of a technology business how does it value its assets? What's a biotech asset worth? In this article valuations expert Kelvin King takes GRU readers through the legal and accounting principles that govern the valuation of intellectual property rights, intangible assets and goodwill, a crucial problem for legal, accounting, banking and venture capital professionals and the owners and managers of IP assets.

Intellectual capital is recognised as the most important asset of many of the world's largest and most powerful companies; it is the foundation for the market dominance and continuing profitability of leading corporations. It is often the key objective in mergers and acquisitions and knowledgeable companies are increasingly using licensing routes to transfer these assets to low tax jurisdictions. Accounting Standards have traditionally not been helpful in representing the worth of intellectual property rights and intangible assets (IPR) in company accounts.

Future winners will be those who own and effectively manage intellectual capital which, an asset such as a brand, patent portfolio, etc. has become possibly the most critical success factor. No sector has been untouched by IPR.

It is impossible to 'manage' without having some understanding of value and the benefits of good IPR management. Critical issues include:

- Increased returns on capital invested in the business, particularly capital tied up in intellectual property
- Increased shareholder value
- A thorough understanding of the alignment of intellectual property development or acquisitions and business strategic objectives
- The ability to make informed decisions about intellectual property development or acquisition
- The creation of new and diverse revenue streams from intellectual capital and especially from

- underused intellectual capital
- The ability to know the valuable intellectual capital (perhaps within a large portfolio) and so protect it fully, and the intellectual capital of no significant value which, might be sold or abandoned
- Achieving lower overall costs associated with intellectual capital development or acquisition, protection, and utilisation
- Creating internal awareness of the importance of intellectual capital to success

It is fair to say that the role of IPR in business is often insufficiently understood. It may be under-valued,

under-managed or under-exploited and enjoying little co-ordination between the different professionals dealing with an organisation's IPR. It is often commonly perceived as the domain of the legal profession, costly and difficult to easily and readily access when required. Whether part of a C-Suite, an accountant, a corporate finance professional, investor or a venture capitalist a thorough understanding of intellectual capital especially IPR is required to do your job better. IPR are both important and complex.

A good start is by asking the following questions:



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- What are the IPRs used in the business?
- What is the value (and hence level of risk)?
- Who owns it (could we sue or could someone sue us)?
- How may it be better exploited (e.g. licensing in or out of technology)?
- At what level do we need to insure the IPR risk?

Legal and Accounting Issues Impacting IPR Valuation

The current big five issues for IPR valuation include Accounting Standards, Corporate Governance, Litigation (Defence and Attack), Fairness Opinions and in-process Research and Development. Let us review the first two here:

Accounting Standards

IFRS 3 business combination valuation allocations, IAS 38 recognition of IPR in accounts and IAS 36 valuation impairment tests

Purchase accounting must be applied to all acquisitions (business combinations are also treated as acquisitions, and there is no more merger accounting). Many intangible assets that would previously have been subsumed within goodwill must be separately identified and valued. Explicit guidance is provided for the recognition of such intangible assets and IFRS3 includes a list of assets that are expected to be recognised separately from goodwill.

The valuation of such assets is a complex process and nearly always require specialist IP valuation skills and frequently an IP lawyer to undertake the categorisation the valuer requires. Examples of intangible assets to be separately recognised and categorised within the purchase cost are set out in the regulations and include those marketing related (trademarks, brands, domain names, newspaper masterheads): customer related (customer lists and contracts): artistic related (television programmes, photographs, films, publications): contract basis (e.g. licensing and royalty agreements, contracts for numerous situations such as advertising, construction and supply): technology based (patents, computer

software, databases, trade secrets etc.).

Additionally under IAS 36 valuations need to be independently tested for impairment by the valuer on a regular basis. Obviously one of the valuers first questions will be, with advice from the IP lawyer, patent or trademark attorney; has there been any diminution of the legal nature of the originally categorised IP.

Corporate Governance

There is developing statute and case law which will compel boards of directors to accept that they must undertake and lead IP decisions rather than leave them to management.

- Sarbanes – Oxley. The provision of valuation services for audit clients is prohibited.
- Caremark International Inc. 1996 imposed on directors the duty to ensure adequate reporting.
- A Walt Disney case in 2003 and Research in Motion (the Blackberry case) establish the potential liability of directors in respect of IP.

The Valuation Expert

For the valuer, this process of understanding is not usually a problem when these rights have been formally protected through trademarks, patents or copyright. This is not the case with intangibles such as know how, (which can include the talents, skill and knowledge of the workforce), training systems and methods, designs, technical processes, customer lists, distribution networks etc. These assets are equally valuable but more difficult to identify in terms of the earnings and profits they generate. With many intangibles a very careful initial due-diligence process needs to be undertaken together with IP lawyers and in-house accountants.

Overall risk affects valuation analysis, corporate valuation must reflect risk and most importantly risk assessment should reflect IPR value.

One of the key factors affecting a company's success or failure is the degree to which it effectively exploits intellectual capital and values risk.

Management obviously need to know the value of the IPR and those risks for the same reason that they need to know the underlying value of their tangible assets; because business managers need to know, or should know, the value of all assets and liabilities under their stewardship and control, to make sure that values are maintained. Markets (restricted or otherwise), institutions and shareholders need to be educated. Exploitation can take many forms, ranging from outright sale of an asset, a joint venture or a licensing agreement. Inevitably, exploitation increases the risk assessment.

The Valuation Procedure

Valuation procedure is, essentially, a bringing together of the economic concept of value and the legal concept of property. The presence of an asset is a function of its ability to generate a return and the discount rate applied to that return. The cardinal rule of commercial valuation is: the value of something cannot be stated in the abstract; all that can be stated is the value of a thing in a particular place, at a particular time, in particular circumstances. The questions 'to whom?' and 'for what purpose?' must always be asked before a valuation can be carried out. This rule is particularly significant as far as the valuation of intellectual property rights is concerned. More often than not, there will only be one or two interested parties, and the value to each of them will depend upon their circumstances. Failure to take these circumstances and those of the owner, into account will result in a meaningless valuation.

Value Concepts

There are four main value concepts, namely, owner value, market value, tax value and fair value. Owner value often determines the price in negotiated deals and is often led by a proprietor's view of value if he were deprived of the property. The basis of market value is the assumption that if comparable property has fetched a certain price, then the subject property will realise a price something near to it. The fair value concept, in its essence, is the desire to be equitable to both parties. It recognises that the transaction is not in the open market

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and that vendor and purchaser have been brought together in a legally binding manner. Tax valuation has been the subject of case law worldwide since the turn of the century and is an esoteric practice. There are quasi-concepts of value which impinge upon each of these main areas, namely, investment value, liquidation value, and going concern value.

Methods for the Valuation of IPR

Acceptable methods of the valuation of identifiable intangible assets and intellectual property fall into three broad categories. They are either market based, cost based, or based on estimates of future economic benefits. In an ideal situation, an independent expert will always prefer to determine a market value by reference to comparable market transactions. This is difficult enough when valuing assets such as bricks and mortar because it is never possible to find a transaction that is exactly comparable. In valuing an item of intellectual property, the search for a comparable market transaction becomes almost futile. This is not only due to lack of compatibility, but also because intellectual property is generally not developed to be sold and many sales are usually only a small part of a larger transaction and details are kept extremely confidential. There are other impediments that limit the usefulness of this method, namely, special purchasers, different negotiating skills, and the distorting effects of the peaks and troughs of economic cycles. In a nutshell, this summarises my objection to such statements as 'this is rule of thumb in the sector'.

■ **Cost based methodologies**, such as the cost to create or the cost to replace, assume that there is some relationship between cost and value and the approach has very little to commend itself other than ease of use. The method ignores changes in the time value of money and ignores maintenance.

■ The **method of valuation flowing from an estimate of past and future economic benefits** can be broken down to four limbs; 1) capitalisation of

historic profits, 2) gross profit differential methods, 3) excess profits methods, and 4) the relief from royalty method.

Discounted cash flow ("DCF") analysis sits across the last three methodologies. DCF mathematical modelling allows for the fact that 1 Euro in your pocket today is worth more than 1 Euro next year or 1 Euro the year after. The account of the time value of money is calculated by adjusting expected future returns to today's monetary values using a discount rate. The discount rate is used to calculate economic value and includes compensation for risk and for expected rates of inflation.

The capitalisation of historic profits arrives at the value of IPR's by multiplying the maintainable historic profitability of the asset by a multiple that has been assessed after scoring the relative strength of the IPR. For example a multiple is arrived at after assessing a brand in the light of factors such as leadership, stability, market share, internationality, trend of profitability, marketing and advertising support and protection. While this capitalisation process recognises some of the factors which should be considered, it has major shortcomings, mostly associated with historic earning capability. The method pays little regard to the future.

■ **Gross profit differential methods** are often associated with trade mark and brand valuation. These methods adopt

the differences in sale prices, adjusted for differences in marketing costs. That is the difference between the margin of the branded and/or patented product and an unbranded or generic product. This formula is used to drive out cashflows and calculate value. Finding generic equivalents for a patent and identifiable price differences is far more difficult than for a retail brand.

■ The **excess profits method** looks at the current value of the net tangible assets employed as the benchmark for an estimated rate of return to calculate the profits that are required in order to induce investors to invest into those net tangible assets. Any return over and above those profits required in order to induce investment is considered to be the excess return attributable to the IPR's and while theoretically relying upon future economic benefits from the use of the asset, the method has difficulty in adjusting to alternative uses of the asset.

■ **Relief from royalty** considers what the purchaser could afford, or would be willing to pay, for the licence. The royalty stream is then capitalised reflecting the risk and



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return relationship of investing in the asset.

■ **Discounted cash flow analysis** is probably the most comprehensive of appraisal techniques. Potential profits and cash flows need to be assessed carefully and then restated to present value through use of a discount rate, or rates. With the asset you are considering, the valuer will need to consider the operating environment of the asset to determine the potential for market revenue growth. The projection of market revenues will be a critical step in the valuation. The potential will need to be assessed by reference to the enduring nature of the asset, and its marketability, and this must subsume consideration of expenses together with an estimate of residual value or terminal value, if any. This method recognises market conditions, likely performance and potential, and the time value of money. It is illustrative, demonstrating the cash flow potential, 'or not', of the property and is highly regarded and widely accepted in the financial community.

The discount rate to be applied to the cashflows can be derived from a number of different models, including common sense, build-up method, dividend growth models and the Capital Asset Pricing Model utilising a weighted average cost of capital. This appraisal technique will probably be the preferred option.

These processes lead one nowhere unless due diligence and the valuation process quantifies remaining useful life and decay rates. This will quantify the shortest of such as the following lives: physical, functional, technological, economic and legal. This process is necessary because just like any other asset IPR has a varying ability to generate economic returns dependant upon these main lives. For example in the discounted cashflow model it would not be correct to drive out cashflows for the entire legal length of copyright protection, which may be 100 plus years, when a valuation concerns computer

software with only a short economic life span of 1 to 2 years. However patent legal protection of 20 years can prevent infringement situations which may be important as often illustrated in the pharmaceutical sector with generic competitors entering the marketplace at speed to dilute a monopoly position when protection ceases. The message is that when undertaking the discounted cashflow modelling never project longer than what is realistic by testing against these major lives.

It must also be acknowledged that in many situations after examining these lives carefully, to produce cashflow forecasts, it is often not credible to forecast beyond say 4 to 5 years. The mathematical modelling allows for this in that at the end of the period when forecasting becomes futile, but clearly the cashflows will not fall 'off of a cliff', by a terminal value that is calculated using a modest growth rate, (say inflation) at the steady state year but also discounting this forecast to the valuation date.

Valuation is an art more than a science and is an interdisciplinary study drawing upon law, economics, finance, accounting, and investment. It is rash to attempt any valuation adopting so-called industry/sector norms in ignorance of the fundamental theoretical framework of valuation.

Conclusion

As mentioned earlier, IPR valuation is more of an art than a science, and while important it is clearly complex. The following general principles concerning the management and valuation of intellectual property allow for making some sense of it all to both the practitioner and the newly inducted.

■ **Principle 1** - Make intellectual capital a part of the business strategic thinking and planning. For example risk control, maximising value, being aware of emerging technologies, seek appropriate legal protection etc.

■ **Principle 2** - Understanding the role of intellectual capital. Involves assessing the importance of

intellectual capital now and in the future to the market position and future success of your business. Part of this is the challenge to identify the intellectual property of others and avoid infringing the associated legal rights.

■ **Principle 3** - Be aware of competing intellectual capital.

■ **Principle 4** - Know your own intellectual capital. Imply rigorous processes to identify and evaluate the existing intellectual capital in the business, creating a comprehensive record of results and developing a process for identifying future IPR being developed. Positive due-diligence. Successes or not is dependent upon a management process to do just the aforementioned.

■ **Principle 5** - Identify required intellectual capital which is a process of forecasting future needs.

■ **Principle 6** - Acquire any required intellectual capital.

■ **Principle 7** - Think tax and balance sheet.

■ **Principle 8** - Be ready to protect your rights.

■ **Principle 9** - Measure improvements as an essential part of good intellectual capital management to develop measures of success of the management and evaluation of IPR.

■ **Principle 10** - Spread the message because just as important as measuring improvements is communicating a strategy and process, not least via financial PR etc.

■ **Principle 11** - Know the cost and value of your intellectual capital.

Kelvin King invites feedback and questions via email valuations@riskrewardlimited.com

MoneyScience's Jacob Bettany Interviews Dennis Cox on Anti-money Laundering Deterrence Rules and Practises from Albania to Vietnam

On the occasion of the publication of his latest book, the International AML Handbook (Wiley Finance) Dennis Cox shares his 30 years of financial forensic experience and expertise in this first book of its kind, a compendium of more than 37 global financial markets – featuring the New Markets - their AML regulations, deterrence rules and practises for the practitioner. Eagerly awaited during its 24 month development and September 2014 publication the Handbook has been ranked among the top ten books on Google's Legal rankings. In this interview Cox touches on some of the key challenging specialists - such as MLROs, Nominated Officers, senior bank management through to Business Analysts - are faced with in everyday client transactions and offers insights and practical wayfinding for those active in anti-money laundering and deterrence roles.



Jacob Bettany: Perhaps you could begin by telling us a little bit about your background and how you became interested in this particular topic.

Dennis Cox: I'm a chartered accountant with a mathematics degree and I got involved in the banking industry with one of the Big Six accountancy firms in the late 1970s early 1980s. I had an interest in forensic work and that leads quite closely into money laundering deterrence. When I joined the banking industry itself, initially with Midland Bank and later on with HSBC and Prudential, financial crime was very much one of those key risks that any financial institution has to try to avoid. Trying to mitigate that risk to the maximum extent possible clearly becomes quite a major issue, and it was a major concern for us working within the risk and audit areas so I clearly had an interest.

JB: You've previously written about Risk Management from the more mathematical side, is that right?

DC: Yes, I've written a book with Wiley Finance on The Mathematics of Banking and Finance, with the intention of trying to get people to understand the limitations of the mathematical techniques as this was one of the problems of the financial crisis - but I also did a book with Wiley Finance and the CISI An Introduction to Money Laundering which has been out now for a few years and is a good introductory book for non-specialists with quite a relaxed non-technical style of writing. This book is slightly more technical, though I've tried as far as I can to maintain a relaxed style so it is actually readable.

JB: Why did you feel this latest anti-money laundering handbook was necessary, and what distinguishes it from other titles in the subject literature?

DC: It's the level of depth and the style of approach which I think differentiates this book. It takes up to date rules and regulations from the various regulators including the Financial Actions Task Force, the Wolfsberg Group and the EU and puts them into a single context, which I don't think anyone's really tried to do before. It then looks across to the individual countries and details the things that are different in the way they have implemented the rules and regulations – because even with all this standardised recommendations including the recent papers for example from the Bank for International Settlements - there are differences between countries in the way they've done it. Clearly the Introduction to book, is very good for the person who just wants to get an overview for generalists, but the Handbook is a very in-depth work for people already working in that industry.

JB: So the book is targeted at financial practitioners?

DC: Yes, people that are either Money Laundering Reporting Officers or advising those officers or heads of law or compliance; people that really need to know a reasonable amount about the issues and rules. This is not a book for someone who just has a passing interest in financial crime, it's for someone who is really trying to deter it. Perhaps you are a director in the retail banking or wealth management and you're wondering how to apply these rules somewhere

MoneyScience's Jacob Bettany Interviews Dennis Cox on Anti-money Laundering Deterrence Rules and Practises from Albania to Vietnam

like the Cayman Islands for example, then that will actually be included here and you'll be able to think about the key issues, think about the nature of the controls and for people who are at that level of seniority. The Business Analysts who are designing products and trying to think through approaches and controls will also be interested in this text. Also, as a tool it's affordable and it's designed to be a flexible with online text available in individual sections so you can access them only as you need.

JB: How did you choose which countries to cover?

DC: Those selected are the major financial centres, countries which banks are most likely to be dealing with. It's also the ones which produce the best information. In Europe you don't get massive differences between countries as you do in other areas that don't have the same commonality. I've included the major African financial centres which are also some of the ones which have the most interesting rules and regulations or the ones that other countries would look towards as a source of information. We can't cover every single country in the United Nations – the book would be enormous and it's pretty large as it is! It was even harder to try to finish it because the challenge is to try to be as up-to-date as we possibly can at the point of publication so there's a mixture of things that come into choosing but we cover the most important major financial centres.

Trying to find examples where there have been prosecutions in countries which we could discuss – that means completed prosecutions not open ones where there is still potential court action – was quite difficult. There aren't as many public cases available once you look towards the developing world as compared to countries like the UK or the USA. It was a challenge finding completed public cases that we were able to refer to without any risk. Some cases had not been well publicised so we were looking at newspaper reports and regulatory reports.

JB: How did you tackle the ever-changing regulation when writing?

DC: Slowly and carefully I think is the answer! It was certainly a challenge when suddenly a major change would come through just before publication. Actually there was a change between the first and second edits which was quite significant and required us to redraft while sections. The Financial Action Task Force to replaced their recommendations unexpectedly for example and that caused obviously change to come through that then rippled through the rest of the book. So the change of regulation is a key issue and trying to keep ahead of it and keep it as fresh as you possibly can, with the number of regulations we are dealing with in a single text, was a pretty daunting challenge.

JB: How much innovation, shall we say, is there to keep up with in financial crime?

DC: Well, financial crime itself is clearly a growth industry. Any techniques used by money launderers tend to stay one step ahead of the regulators. I would draw a distinction between professional and amateur money laundering.

Regulations in countries are very good at picking up amateur money laundering but the connected transactions trail of a professional money launderer is much harder for the organised agencies to try to find their way through. Does the approach of the money launderer change? They are always seeking to exploit a weakness within the banking sector in an identification process or a payment service and will go to the area where they think they can most easily disguise the source of funds. At the end of the day they want the funds to be in a legitimate market. As you can see from the cases covered in this book, it tends to be errors or greed that results in the money launderer being found out. The difficulty for the financial institution is particularly where you have illegitimate and legitimate funds mixed into the same account so that when they start to ask their enquiries they find about the legitimate but they can't then differentiate between the legitimate and the illegitimate. Those kind of areas are very difficult to financial institutions and it's always about really trying to understand your clients. Areas where the client is not understood so well and there is more distance become the kind of areas which money launderers can start to exploit and target. The regulation and the rules and the guidance are all trying to reduce as much as possible the amount of risk but it can never eliminate it, that's just not plausible. As long as there's crime there are going to be money launderers.

JB: Could you give us a brief overview of the topics that the book covers?

DC: The first section covers the process of money laundering and the layering process from the initial funds coming in from the drug trafficker or thief or extortion specialist, and then coming in towards the actual process which will be layered to try and disguise the initial source of the funds and then placed back in the market. The book then talks about regulation, whether that comes from the Financial Action Task Force, or the EU or the UN and then the change and the depth of the UK regulator with the Joint Money Laundering Steering Group having produced some of the most detailed rules in the world. Even for countries which are not having to comply with UK regulations the information is quite important and we highlight the key parts of it in about 20-odd pages.

Then we go into the Wolfsberg Principles which are another set of high level principles before we move to look at the US regulatory framework which is a nonstandard framework. The way they have organised things in the US at present is quite different to any other country. We then cover the sanctions regime and that is also quite different because it is not risk based and if someone is on the sanctions regime then you must not deal with them and that's it.

We focus on each of the main areas that would exist in a financial crime deterrent regime. That is in know your customer, the training, or the identification of retail or corporate customers or whatever, and lead each of those areas through to how you should investigate a suspicion. One of the difficulties that many of the banks have is that utilisation of software means you get quite a lot of false positives, transactions that would be reported to the investigational agency within the firm which could be money

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laundering but when you actually do the investigation you find that they're not, so the investigation process and how you would go about swamping the reporting bodies with a whole load of information which is no use to them whatsoever, is being included.

We go into areas regulators are most concerned about like corresponding banking where there's been a lot of publication and we think about that ending up talking about software. Then we go through 37 different countries in terms of how money laundering has happened and been dealt with. We cover countries from Albania to Vietnam, and you're probably wondering why Albania; it's the nature of the country and its positioning at the edge of Europe that made it important. We've got a mixture there of big international financial centres through to smaller institutions perhaps used for tax minimisation strategies, together with some interesting ones that people might be surprised we bothered to look at. In places like South America you immediately go and look at somewhere like Brazil, which is the driver there, and in Africa you want to look at somewhere like Nigeria and Kenya and South Africa, we tried to hit those main markets but of course you can't do absolutely everything.

JB: What is it about the US regime that is so different to the rest of the world?

DC: Essentially many of the laws they have predate the Financial Actions Task Force guidelines – the Bank Secrecy Act 1970 is effectively an older act which has been amended, so they come from a different source when trying to come up with a regime. The rules are also broken up in a number of places between different Acts so it's just a different way of doing things.

JB: Are there grey areas in money laundering where people can get tripped up without even realising?

DC: I think that if someone is moving money from a criminal source that is very clearly money laundering. But then you have to ask the question what is a crime? Coming from the United Kingdom, if you fail to pay your TV licence in principle that is a crime with proceeds which in principle is money laundering. Clearly that is not what we are seeking to identify.

Another would be tax avoidance and tax evasion. Tax avoidance is clearly seen as a typical thing that companies do although that's been challenged by exploitive tax avoidance perhaps on one or two jurisdictions. Tax evasion is clearly illegal. If you're looking at someone that may be paid in cash like a plumber or taxi driver, is it plausible that they might not disclose all of their income to the tax

authorities? Well if they fail do so that is criminal activity and therefore those funds are potentially going to be laundered but of course they are comingled with the legitimate funds, so that's quite difficult. The difficulty with terrorist financing is identifying who is actually a terrorist? How do you decide where a freedom fighter stops and a terrorist starts? So there are those kinds of grey areas.

Another problem is the definition of a politically exposed person. I try and encourage firms to go beyond the rules of the country and always say the rules of the country are there to make sure you are not committing criminal activity but that may not be sufficient to fully protect the firm from reputational risk. When you end up with a headline on the newspaper it doesn't tend to say "oh and by the way, they complied with the laws of the country". So there are some grey areas particularly in the area of how a crime is defined.

JB: You used the term layering, could you explain what that means in this context?

DC: Well a layering process would be for example, when there is a theft at your house and someone now has all of your electrical goods. They now want to turn those into cash and will do that probably by selling it at a market and turning it into physical cash. But for them to spend that money potentially they want to try to get it into a legitimate-looking bank account if they are doing this as a volume activity. The banking market gets touched when the proceeds are turned into physical cash, though it will not end up there, particularly if it's organised crime when the layering process will be used. It is similar to putting layers of veneer onto a piece of wood, it tries to disguise the original asset by moving it from place to place from asset class to asset class and then at some stage it is going to end up in the place the criminal is going to try to extract the money from. At that stage it will go into an apparently legitimate looking bank account but there could be 15-20 different paths it goes through before that.

We're not going to stop crime by stopping money laundering but what we can do is make it more difficult for the criminal to extract their funds.



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JB: Typically money laundering is associated with organised crime, but cases cover a much wider spectrum.

DC: Yes, organised crime is the area agencies are concerned with most because that tends to have the greatest public impact. These are large networks. Tax authorities pick up tax evasion cases. You have to think about the amount of terrorist activity that's going on around the world. There are a lot of arms being purchased for terrorists and that all comes through this same set of rules and regulations and the terrorist financing part is a separate section. Clearly it is very bad news when a firm is involved in that. Again, it's not that the terrorist phones up the arms manufacturer and says look, I'm a terrorist working in a certain country and I need a couple of tanks please! Much more likely there is an intermediary approaching the manufacturer who will be pretending to represent a country. The level of plausibility is really the thing that enables money laundering or terrorist financing to be successful. Much more interesting for the investigators to find something that really makes a difference – drug trafficking, child pornography, those kinds of areas are really high risk in terms of the impact on the public.

JB: How big a problem is money laundering in the UK?

DC: It is a big problem everywhere including in the UK. Money laundering and terrorist financing grows as crime and terrorism themselves grow. When someone wants to acquire armaments they have to get across to the legitimate economy in some way with those funds. That's obviously really an unpleasant for a bank to be involved in and, everyone does what they can to avoid being involved with it. In the case of inappropriate pornography, or countries where all pornography is inappropriate, that again is clearly unacceptable activity. Child trafficking, slavery, extortion, those heinous crimes are of course the things people try

most to prevent, however, all the stats are showing us as areas of activity they are certainly not declining. We've seen quite recently the UK GDP figure changed for some activities which might be considered as inappropriate now added into the figures and money laundering is, of course, one of those.

JB: Is it possible then that all banks are involved to some extent?

DC: You have to be realistic – there is crime, and criminals have bank accounts. People do say that the fear of crime exceeds the probability of crime, but you see these things in the press all the time. A person may open a bank account and be doing perfectly legitimate activity at the time and then at some stage they start doing something or get paid to do something criminal – perhaps they lost their job and their needs changed, they can be pressured into getting involved with something – the bank is not easily going to spot this. In some countries there are secrecy regulations which actually get in the way of this. You are only really allowed to hold data for the purpose which it was originally intended and this is going beyond that. In some countries you are not even allowed to really link the customer with their spouse or their parents, you have got to look at them as an island and how are you ever going to know as a bank the people that someone is really dealing with and who they know – you don't get that data. The banks can only look at the information that they have and they are ever only part of the story. Do they have people that they would rather not deal with inside their client box? I'm sure the answer is going to be yes. The question is what they knew when taking on the customer – are there things they ought to have done. That's where the rules come in, to try to encourage them to think through and really understand. They offer to do things like check the source of funds, but if you turn around and say okay you've put a thousand pounds into a bank account where do these funds come from? You'll look at me and say well it's sort of leftover money really from my job. What am

I supposed to do with this? If you say, I've sold a car, do you expect me to go and check who you sold it to? It starts to become unrealistic and that's one of the difficulties. Often a bank is recording so they can give the trail to the FIUs and they are questioning under the risk-based approach if they have gone far enough and really understand their customer. It is quite different if someone is depositing to if someone is borrowing – if you are borrowing I want to know a lot about you because I want my money back but depositing, it's your money. There's a level I can ask for and that's perhaps not quite what the public might expect.

JB: How effectively have approaches to dealing with money laundering been in the past in the UK?

DC: Approaches have changed. Initially when the anti-crime rules came through it was tick boxes, trying to come up with checklists. The Joint Money Laundering Steering Group produced a series of coloured books. The



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change that's come through now is to move towards a more risk-based approach so that you really try to understand your client and the likelihood that they might be a money launderer. It's more investigative and it's trying to place the balance where it will add most value. If for example a wealthy businessman comes to you with a legitimate business to bank some funds with you, you shouldn't have to kill yourself trying to find out information about them unless you think they may be taking bribes or something of that sort which of course is criminal activity. On the other hand if someone comes in with a large sum of money and perhaps they're a mid-level government employee and that kind of sum is not commensurate with the income I would expect this person to have then you start to ask questions under the risk-based approach. It's now about trying to think a bit more. There has also been better use of technologies and better investigative techniques encouraged by the regulations.

JB: So does Big Data make it easier for banks to identify anomalous behaviour?

DC: The larger banks systems will parameterise the customer and then identify a transaction that is not consistent with the expected behaviour for that type of customer. That happens a lot on cards, and as someone who is travelling quite a lot around the world it can be quite annoying to find my card is not working and that I then have to speak to a nice card company on the phone! I have been defrauded on my card before – once someone tried to buy a painting, and somebody else tried to buy a whole load of iron ore in Brazil. Now that was picked up by me finding my limit had gone and asking questions and on those particular occasions the card company didn't find it, which I was a bit shocked by – I haven't bought a museum quality painting before and I certainly haven't bought any iron ore or been to Brazil! So the advent of Big Data and the data mining techniques that are available do facilitate better work. The data helps you find out quicker if you have been the subject of attempted money laundering and what they do to reduce it is to reject suspicious transactions when they come through. It's never going to be fool proof.

JB: How optimistic are you that current approaches will be effective, or is it a constant battle?

DC: It is a constant battle and there is always a limit to how far you can go. As a customer wanting to use the bank there is a limit to how much intrusive questioning you're going to be willing to put up with and that is the key balancing issue because I don't have to go to a bank to deposit my funds, I could go and buy another asset. I could use electronic systems like PayPal or I could just go to an antiques market or something and pay cash for an item, sell it for cash and say I have sold an antique. It doesn't have to go through the bank. So many things can be the subject of money laundering it just depends on the mind-set of the money launderer and how patient they are going to be and how much money they are willing to spend on the costs of layering. The area of terrorist financing is one where I think we can probably have a more successful approach. Crime is such a broad term and organised crime is very difficult to prosecute. The complexity of it means that trying to put it

through an ordinary criminal court is always going to be quite difficult.

JB: So processes in banks are activated by a suspicion?

DC: Yes and it leads to a report being given to the organised agencies because you are just one among many institutions and if there is a complex money laundering scheme a lot of other institutions will be involved and you won't see the whole story. Once you've made that report the Money Laundering Reporting Officer in pretty much every jurisdiction gets it. That overrides bank secrecy rules and data confidentiality and you have that protection as a Money Laundering Reporting Officer to enable you to do this. It is not easy to put the story together, some cases are very complex. The obligation on the firm is to do what they can to assist the investigating agencies to do their work effectively. A lot of our work within money laundering deterrent is to try to identify information that needs to be reported. Also you don't want some of the headlines that we've seen in newspapers. You don't want your brand associated with the word money laundering – or terrorist funding, or sanctions busting. So you do what you can to reduce as much as possible the probability that that's going to occur. Can I eliminate it totally? I can't. I remember one investigation we were involved in where we were looking for a particular person and there was a political thing, there'd been a problem and we were asked to do the investigation and I think we found \$12,000 USD worth which was not significant in the great scheme of things but we were still in the list and we still got the adverse publicity. Life isn't always fair and you do the best you can in this field and the people that know financial crime deterrents well and know their way around the systems and controls are very valuable people to the financial institutions in that they will reduce the incidence and likelihood of them being found guilty. Of course you also have a defence and a story because you've done what a reasonable bank ought to have done to try and make sure that you're not caught by money laundering terrorist financier.

JB: Do you have a view on the emerging cryptocurrencies such as Bitcoin and whether we are equipped to deal with any potential threats they may pose?

DC: Well, if you take internet banking, when you open up a credit card or bank account and you're not seeing the bank, there's not a lot of point in me having your photograph now is there? I'm never going to see you so what you look like isn't relevant to me and I'm going to have to think of a way of being more analytic in trying to understand you as an individual. I'm probably going to have to call up more independent reports than before and change the way that I work. Clearly anything that separates the customer from the bank and creates barriers is going to increase the probability that it's going to be exploited by a money launderer, so internet banking becomes a preferred route of action. We have rules for non-face-to-face customers and a mixture of things that you must do and things you might like to do. The thing about Bitcoin is the lack of registration that is the concern and it does make various things quite difficult such

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as for a government to know the true money supply and how your economy is moving so that is not a great thing. If I've got some Bitcoins, where do they come from? They are not registered anywhere. Well if you think about the pound coins in your pocket, they're not registered anywhere either are they. It's another set of thought processes you just need to go through and think about what additional challenges it presents to you. Quite a high percentage of the coins in your pocket are probably forged – I've heard various percentages. It's about one in ten. You can tell by the weight and quality.

Of course if you spend that money, then you've laundered it. The Bitcoin is just another anonymous information source with the difficulty that it is international. We've always been worried about the payment services cross-border and Bureau de Change, those kind of areas. There are rules and regulations about that already, it's just another one of those I'm afraid.

JB: Mr Cox, thank you very much for talking to us.

Notes

Dennis Cox is CEO of Risk Reward Limited (link to <http://www.riskrewardlimited.com>), a specialist risk consultancy, training and recruitment firm serving the global banking and financial services industry, and thought leaders in the world of risk management, audit, governance and compliance. He is a well known international expert in financial services risk management and has held senior management positions at top banking and accountancy firms, including HSBC and Prudential. Dennis has authored several publications, including *Banking, Audit and Accounting* (Butterworths 1993), *The Mathematics of Banking and Finance* (Wiley 2011), *An Introduction to Money Laundering* (CISI, Wiley) and *The Frontiers of Risk Management. The Handbook of Anti-Money Laundering* is his fifth book.

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