



Leman  
SOLICITORS

# Banking Litigation Forum

*From Principles to Rules to Personal  
Accountability & Responsibility in  
FinServ*

**Friday 25<sup>th</sup> May 2019**

## Regulators – how they work



BANK OF ENGLAND

- Essentially – “conservatively” and on a “risk-based approach”
- Limited resources vis-à-vis their responsibilities
- Focused on outcomes
- Structures: unitary v separate central bank & regulators models
  - UK BoE - (PRA) & FCA
  - Ireland - Central Bank of Ireland
  - Australia - Reserve Bank, ASIC, APRA & ACCC



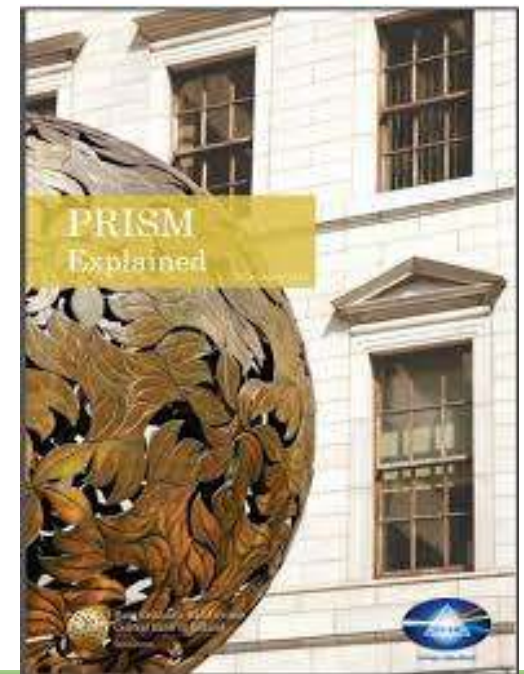
# Regulators – how they think

*Read into their publications!*

*“risk-based approach”*



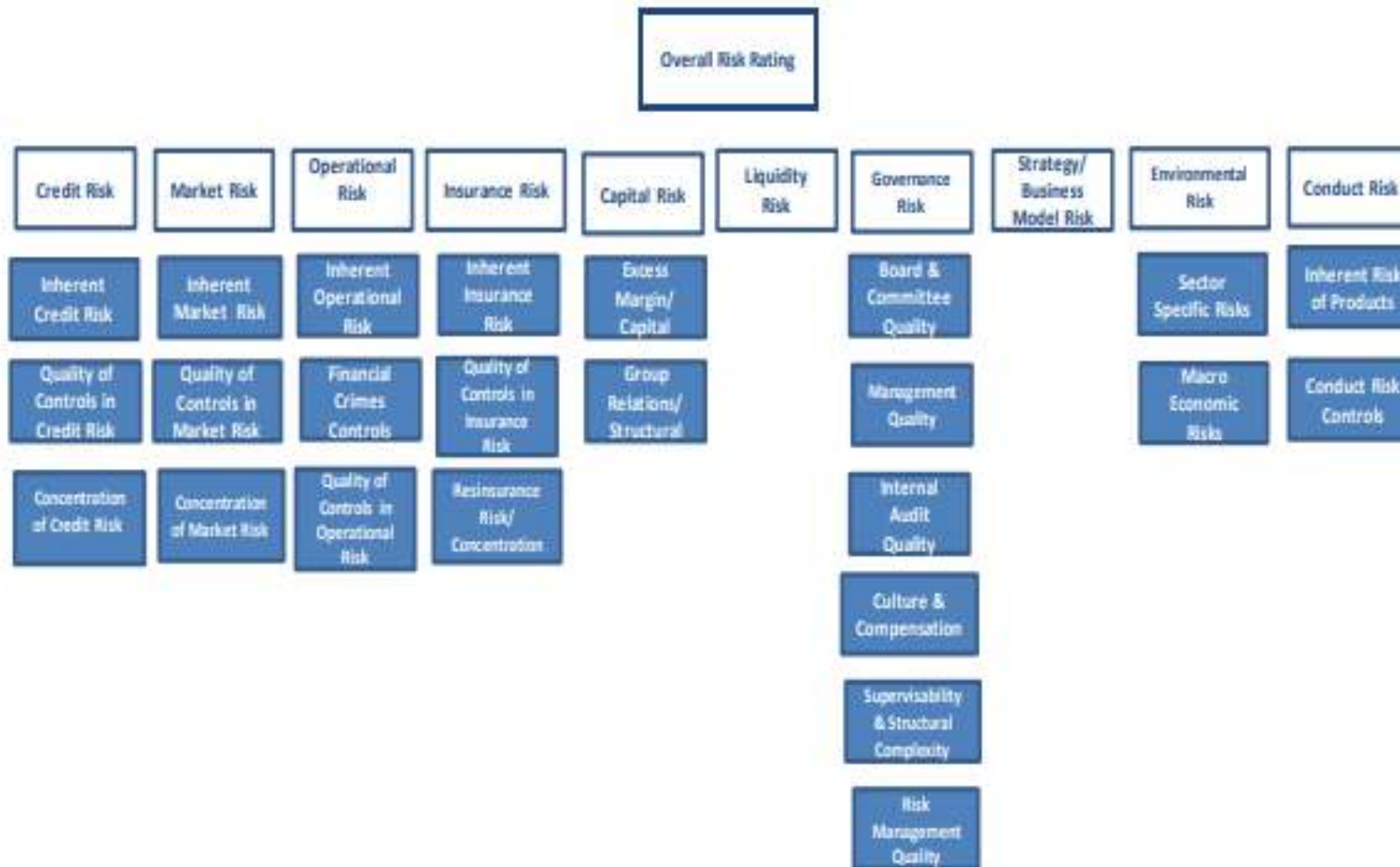
Challenge, Judge, Mitigate



## Regulators – how they think (Probability v Impact)

		Impact				
		Trivial	Minor	Moderate	Major	Extreme
Probability	Rare	Low	Low	Low	Medium	Medium
	Unlikely	Low	Low	Medium	Medium	Medium
	Moderate	Low	Medium	Medium	Medium	High
	Likely	Medium	Medium	Medium	High	High
	Very likely	Medium	Medium	High	High	High

# Regulators – how they think (categories of risk)



# Regulators – how they think (what they expect of Governance Structures)



# Understanding Central Bank and Regulators

- Three things Central Banks / Regulators care (deeply) about:
  - **Financial Stability**
  - **Market Integrity**
  - **Consumer Protection**
- Important for incumbents & disrupters to think carefully about what regulators care about!



# 2019 snapshot to date – US v EU regulatory enforcement actions

CORLYTICS REG FACT

So far this year US regulators have issued 49 enforcement notices, which total more than \$310Mn USD. EU regulators have issued just six, for over \$650Mn USD.

CORLYTICS: RISK RATING THE REGULATORY LANDSCAPE



Global - US & EU



CORLYTICS



# Increasing Regulatory and Litigation Costs - the “societal good” argument for RegTech!

- “Global banks’ misconduct costs have now reached over \$320 billion (AUD420) - capital that could otherwise have been used to support up to \$5 trillion of lending to households and businesses,” Mark Carney, Governor, Bank of England, Speech to the Institute for International Finance in Washington, April 20, 2017
- Global regulatory technology business Kyckr says that the figure will be closer to AUD\$525 billion in the next two years. June 5, 2018 to ABC News Australia
- That €5 trillion figure could increase by as much as 25%, i.e. to €6 trillion that could otherwise have been used to support lending to households and businesses



## Market Integrity Example - Banks use AI to catch rogue traders before the act

- Imagine if you could **stop rogue trading** when it was just the spark of an idea — a stray thought sparked by a trader's expensive divorce, a big loss suffered at a poker game, or growing disillusionment with the daily grind.
- They have set stricter limits on traders' activities, making it harder for anyone to make the kind of enormous bets **that led to one-off losses of as much as \$6bn** (in JPMorgan's "London Whale" scandal).
- **Losses and fines in the past decade across the top 13 global banks add up to more than \$10bn, according to analytics provider Corlytics.**

### Banks use AI to catch rogue traders before the act

Technology presents an opportunity to spot errant bankers before misconduct takes place



Loose lips: trader surveillance systems are becoming more sophisticated © Getty

Laura Noonan in New York 4 HOURS AGO



**CORLYTICS**

## Four themes regulators are focused upon

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- Conduct Risk – Drives Culture
- Senior Accountability – Drives Culture
- Financial Crime
- Cyber Security / Resilience

## Conduct Risk / Culture ( 1/2)

- This theme was announced by the UK FCA in April 2013
- Since then has gain traction in many countries,
  - Australia – Haynes Royal Commission into Misconduct in Banking, Superannuation & FinServ
  - Ireland – creation of a Financial Conduct top level Directorate
- Aim is to *create a culture of good conduct at every level* of the financial services industry *to make markets work well and to produce a fair deal for customers*

*“the reason we’re here today is to make certain that our boards and our senior management are taking a closer look at conduct risk. We want to see the businesses concentrating on consumer outcomes in all aspects of their business.”*

**FCA Conduct Risk Briefing, Robert Taylor,  
Head of Wealth Management & Private  
Banking, at the FCA**



# Conduct Risk / Culture (2/2)

Figure 1: Spotlight analysis: Global systemically important financial institutions



**Definition of conduct risk**  
Sixty-six percent of G-SIFI firms have a separate working definition of conduct risk

- 66% in 2017
- 68% in 2016



**Regulatory framework**  
Seventy-one percent of G-SIFI firms have a framework in place to address culture and conduct risk

- 71% in 2017
- 68% in 2016



**Accountability**  
Sixty-eight percent of G-SIFI firms think the regulatory focus on culture and/or conduct risk will increase the personal liability of senior managers

- 68% in 2017
- 87% in 2016



**Impact on business**  
Thirty percent of G-SIFI firms have discarded business opportunities due to culture or conduct risk concerns

- 30% in 2017
- 37% in 2016

Source: Thomson Reuters Regulatory Intelligence - Culture and Conduct Risk 2018 survey



<https://www.reuters.com/article/bc-finreg-risk-report-executive-summary/culture-and-conduct-risk-report-2018-executive-summary-and-regulatory-developments-idUSKBN1IA252> © Thomson Reuters

## The driver for change (UK & Ireland) from March 2010

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Time called on Principles Based Regulation:

- *"The old FSA's reactive philosophy focused on ensuring firms had the appropriate systems and controls,"*
- *"Judgements were rarely made on the consequences of management actions. In the new intensive approach to supervision the FSA is taking a view on management action."*  
March 2010





The FSA's mind was made up in 2009:

*"A principles-based approach **does not work with individuals who have no principles.**"* March 2019



<https://www.telegraph.co.uk/finance/newsbysector/banksandfinance/7431645/Hector-Sants-calls-time-on-FSAs-light-touch-regulation.html>

# Culture / Senior Executive Accountability Regimes

Country	Regulator	Regime
	FCA & PRA	Senior Managers & Certification Regime (extension Dec 2019)
	APRA	Banking Executive Accountability Regime (BEAR)
	Department of Financial Services (NY)	Part 504 Banking Regulations – AML focused
 (proposed)	Central Bank of Ireland	Senior Executive Accountability Regime (SEAR) – 2020?

# Culture / Senior Executive Accountability Regimes

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- **Ireland** (Central Bank of Ireland) - Ireland is currently debating the introduction into legislation of an individual accountability regime currently coined the 'Senior Executive Accountability Regime' ('SEAR') which has been proposed by the Central Bank of Ireland. SEAR will complement the separate Fitness and Probity Regime and Administrative Sanctions Procedure
- **UK** (Financial Conduct Authority, FCA) - FCA's has a regime for 'significant influence functions' under its Approved Person Regime. This complements its separate Senior Managers Regime and Certification ('SMR'). The SMR captures the heads of functions of both the 'Compliance Oversight' and 'Money Laundering Reporting' function, together with *other senior managers* across the business functions.



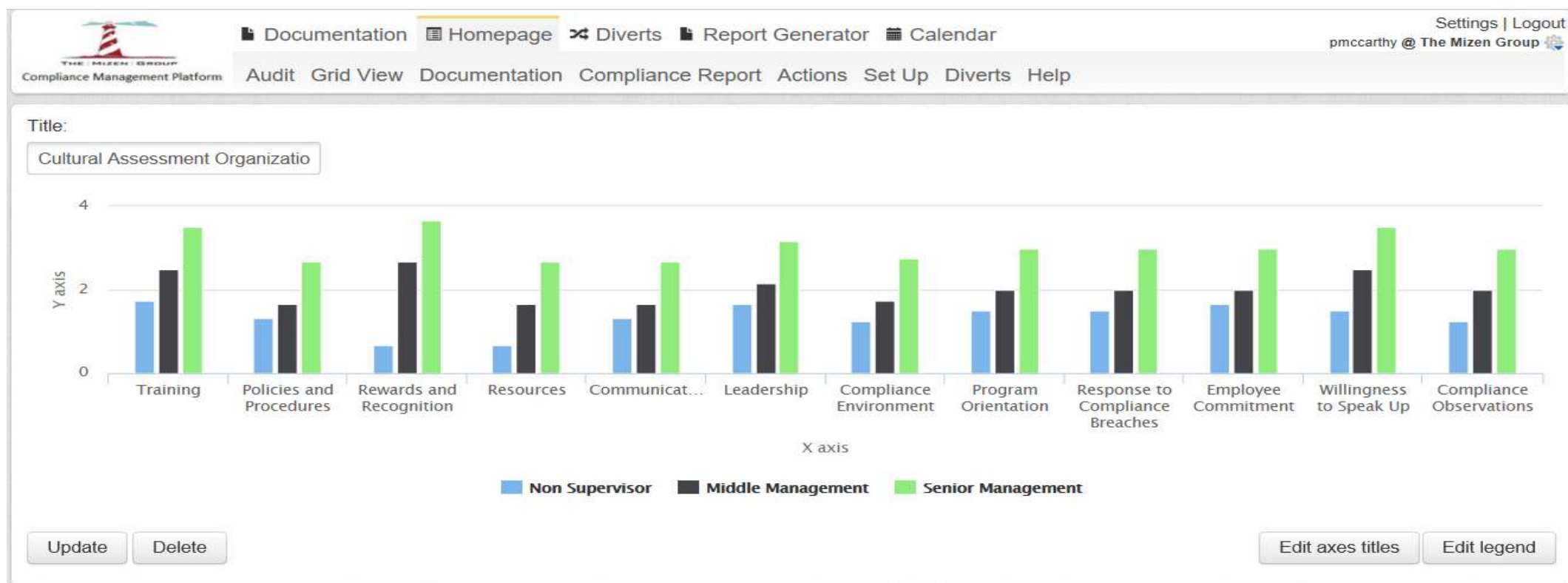
# Culture / Senior Executive Accountability Regimes

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- **Australia** (Australian Prudential Regulatory Authority, APRA) – a few months ago, in July, Australia’s PRA became responsible for administering the Banking Executive Accountability and Related Measures Act (‘BEAR’). Under the Act, a person holding senior executive responsibility for an approved deposit-taking institution’s (“ADI”) anti-money laundering function is an accountable person (e.g. the MLRO). In addition to penalties attributable to the ADI, where an accountable person breaches the Act, he/she faces a decrease in their variable remuneration or disqualification by APRA.
- **US** (DFSNY) – pursuant to Rule 504 (Transaction Monitoring and Filtering Program Requirements and Certifications), the Board of Directors or Senior Officers must, on an annual basis, certify that the financial institution is compliant with the new rule which is aimed at securing better compliance with the bank Secrecy Act/AML laws and regulations and OFAC requirements. This certification means that the senior executives become personally liable for breach of compliance to rule 504, with an incorrect certification leading to possible criminal penalties to be imposed on these executives.

# RegTech & Diagnostic Tools – Culture / Senior Executive Accountability

- Regtechs are providing diagnostic tool solutions to financial institutions seeking to comply with these new culture requirements



[Example: Mizen Group LLC <https://www.mizengrp.com/>]

# Regulatory Compliance Cradle to Grave

## On-going - (Enforcement Tools – Ireland)

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- Enforcement - wide range of tools to take action against regulated entities and/or individuals\* which fall short of expected standards of behaviour including:
  1. Administrative sanctions (under Part IIIC of the Central Bank Act 1942, and Securities and Markets Regulations)
  2. Fitness and Probity investigations
  3. Refusals and revocation of authorisations
  4. Cancellation and refusal of registrations
  5. Summary criminal prosecution
  6. Supervisory Warning
  7. Imposition of a condition
  8. Issuance of a direction
  9. Reports to other agencies (including Gardaí, Revenue Commissioners, The Competition and Consumer Protection Commission)

# Regulatory Compliance Cradle to Grave On-going - Proposed Individual Accountability Regime (Ireland)

- Central Bank *has 'recommended strongly ...reforms assigning responsibility to senior personnel be adopted' in Ireland*
- Primary purpose = driver for positive behaviours & the recognition of responsibilities by individuals.
- Senior Executive Accountability Regime ("SEAR") to ensure clearer responsibility and accountability through:
  - placing obligations on firms & senior individuals within them to set out clearly *where responsibility and decision-making lie for their business*
  - having every senior manager to *present a statement of responsibilities* that clearly states the matters for which they are responsible and accountable
  - firms providing a map setting out *responsibilities & accountabilities at an individual* and an organisational level
  - requirements will assist the Central Bank in assigning responsibility to individuals
- *There will be no doubt as to where responsibilities lie*
- *The ability for individuals to avoid liability for regulatory wrongdoing will be constrained*



Paschal Donohoe, Minister for Finance, plans to introduce laws for SEAR in 2019

## 180 individuals received enforcement notices in 2018

CORLYTICS REG FACT

Last year, 180 individuals received enforcement notices resulting in a market ban. Just one of the 16 types of non-financial consequences individuals can incur.

CORLYTICS: RISK RATING THE REGULATORY LANDSCAPE



Global - Individuals



CORLYTICS

## Financial Crime (AML)

- In **2018**, worldwide fines for **AML violations** grew to **US\$3.4 billion** from US\$2.12 billion the previous year, according to Dublin-headquartered global regulatory risk intelligence firm Corlytics. **Source: FinOps Report, 21 February 2019**
- As we see from the above, AML is a conduct risk - senior executive accountability issue



# Cyber Security / Resilience

- Firms have reported significantly more outages and cyber attacks over the last year
- Cyber security is not just a technology risk, **it is a human risk**
- According to our survey, nearly half of firms do not upgrade or retire old IT systems in time
- **Only 56% of firms say they can measure the effectiveness** of their information asset controls



Megan Butler, Executive  
Director of Supervision –  
Investment, Wholesale  
and Specialists - 27  
November 2018

## 2019 snapshot to date – Anti-Competitive Behaviour breaches lead the way in 2019

CORLYTICS REG FACT

So far this year the regulatory category where most breaches have occurred is anti-competitive behaviour, with fines totalling almost \$650Mn USD.

CORLYTICS: RISK RATING THE REGULATORY LANDSCAPE

Q1 2019

Global enforcement

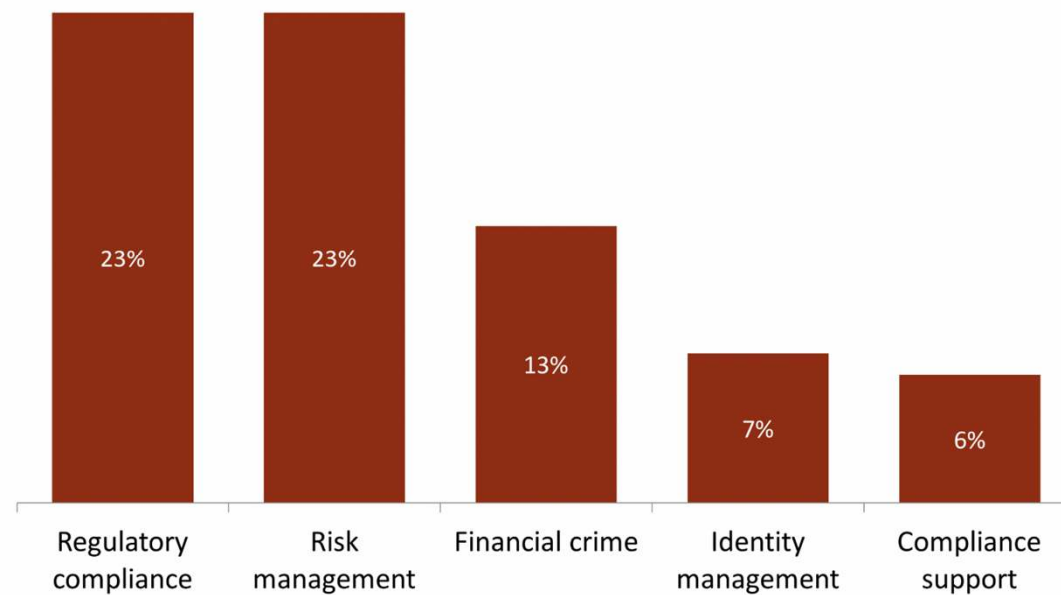


CORLYTICS



# RegTech landscape is evolving to address growing compliance needs (1/2)

**Growth In The Number Of Firms In Each Regtech Segment, 2010-2018**



Source: Burnmark

BI INTELLIGENCE

# RegTech landscape is evolving to address growing compliance needs (2/2)

REGTECH is the second largest sector of the indigenous Irish Fintech and it is exported across the world



# What do regulators say about the adoption of RegTech?

- “Just as FinTech is introducing changes to the way in which market participants offer their services, *so too will RegTech and SupTech alter the way in which financial institutions and regulators, respectively, comply with the rules and supervise markets.*”
- These technologies have the *potential to reshape the relationship between regulators and market participants*. **ESMA Report on Trends, Risks and Vulnerabilities, No. 1, 2019**

ESMA Report on Trends, Risks and Vulnerabilities No. 1, 2019 42

Financial innovation

## RegTech and SupTech – change for markets and authorities

Contact: [patrick.armstrong@esma.europa.eu](mailto:patrick.armstrong@esma.europa.eu)<sup>52</sup>

Regulatory and supervisory technologies are developing in response to various demand and supply drivers. On the demand side, regulatory pressure and budget limitations are pushing the market towards an increased use of automated software to replace human decision-making activities. This trend is reinforced by supply drivers such as increasing computing capacity and improved data architecture. Market participants are increasingly using new automated tools in areas such as fraud detection, regulatory reporting and risk management, while potential applications of new tools for regulators include greater surveillance capacity and improved data collection and management. With these new tools come challenges and risks, notably operational risk. However, with appropriate implementation and safeguards, RegTech and SupTech may help improve a financial institution's ability to meet regulatory demands in a cost-efficient manner and help regulators to analyse increasingly large and complex datasets.

# Connected to the Fintech Ecosystem

- Tracking 300 'fintech' companies – names, executives, business type
- 110 companies have completed the Fintech Ireland Survey
  - <https://fintechireland.com/fintech-survey.html>
- 1,300 subscribers to Fintech Ireland
  - <https://fintechireland.com/get-involved.html>
- 1,050 Members of the Fintech Ireland LinkedIn Group
  - <https://www.linkedin.com/groups/8321352/>
- 5,000 (almost) Twitter followers **@FintechIreland**
  - 12,000 total twitter followers across all Fintech handles



# Thank you

Peter Oakes

Non-Executive Director & Adviser



<https://www.linkedin.com/in/peteroakes/> - *always happy to connect, just include a note in the message!*

Join the Mailing List – <https://fintechireland.com/get-involved.html>

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