Risk and Regulatory Review
It’s time

Financial Services
October 2014 – March 2015
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Executive summary

In each of the articles we feature in this 2014 issue of Risk and Regulatory Review, the consistent underpin is a heightened focus on regulation from both the regulators’ and the consumers’ perspective. Each ‘hot topic’, whether wholesale conduct risk, liquidity, the protection of client assets, FATCA, or privacy and data governance, is demanding more from financial institutions right now and into the future.

Creating a ‘business as usual’ approach to these competing regulatory demands is absolutely essential if organisations are to develop a framework and approach that is sustainable as markets shift, further demands are made, and the pace of change increases.

Operationalising acting in the ‘best interest of customers’, as well as developing and constantly monitoring the organisational culture is mandatory and always challenging. To assist you in these tasks we have collected the knowledge, experience and expertise of our practitioners who are in the market advising clients on how to do this well at a local, regional and global level.

Not all the articles here are comprehensive. They are intended instead to trigger ideas, to offer some clarity and to support your thinking around these demanding issues. We refer you to Risk as an Enabler on page 18 and Regulatory Productivity on page 11, they are both short, high-level thought pieces designed to assist you checklist your approach.

The more detailed articles on Managing Conduct Risk page 8 and Advice Quality in the Spotlight page 12, tease out some significant themes for consideration. Seven in the case of Conduct Risk and eight key themes in the case of Advice Quality, which are informed by the Senate Inquiry and our experience locally and globally.

And as Australia moves towards the Basel III capital framework deadlines, our detailed article on Liquidity, calls out APRA’s intention to adhere to implementing the Liquidity Coverage Ratio on 1 January 2015. Instead of adopting the Basel Committee’s phase-in arrangements, the implication is for an accelerated timetable, as reflected in APS 210, which will apply to all ADIs.

In the context of timelines we have also developed a high level regulatory timetable as a ready reckoner to act as a guide to keep across what’s coming up when. See the centre spread.

We also draw your attention to two detailed articles on industry stalwarts – IFRS9 and our guide for ASX Principle 7. Both regulations were updated and changed in response to the Global Financial Crisis – which in the case of IFRS 9 is imminent.

The GFC also triggered the current Government to call for Australia’s first financial system inquiry in almost 20 years – to ensure we have the regulatory systems in place that will be sufficiently robust and with appropriate rigour to support shifting markets, consumer demands and competition. Deloitte has developed its own detailed submission – however in this 2014 Risk & Regulatory Review we carry an extract only from it - outlining six likely future scenarios that are already beginning to define the future for financial institutions.

We also cover ASIC and APRA updates and finally in the run up to the G20 meetings of the world’s Finance Ministers and leaders, we reproduce an article first published by one of our Directors in the Lowy Institute journal for the G20 titled: The G20, financial regulation and ex ante regulatory impact assessments.

We trust you find this comprehensive review stimulating and useful. And trust you to reach out to your Deloitte contact or any of the contacts listed for more information and support.
STRUCTURAL REFORM OF THE FINANCIAL SYSTEM
The Financial System Inquiry is examining how the Australian financial system can best meet the country’s evolving needs to support economic growth. The final report is due in November 2014. Many hundreds of submissions have been made, which financial institutions will closely monitor as they anticipate the strategic implications of the potential policy initiatives. The intent is that any recommendations will enhance Australia’s global competitiveness, domestic competition, innovation and economic growth.

ENFORCEMENT: FEAR VS GREED
Whether tougher penalties will induce fear and overcome greed is likely to stir debate following ASIC’s proposal to the Financial System Inquiry that Australia’s current penalty structures and approaches be reviewed. This call to action to strengthen preventative controls to mitigate compliance breaches at source, means that financial services entities should continue to reassess their risk and compliance framework in their ability to early identify and rectify compliance issues.

CLIENT CENTRICITY
Recent regulatory trends encouraging financial institutions to align values and operating models to the needs of their clients are critical for long-term success.
As regulators consider further strategic, cultural and behavioural changes they are proposing behavioural economics as a potential shaper to ‘nudge’ organisations towards evaluating consumer behaviour. Financial institutions will need to consider digitising, innovating and tailoring regulatory documentation such as the PDS and terms and conditions, to account for consumer behaviour and achieve more effective disclosure.

MANAGING MIS-SELLING RISKS
International mis-selling scandals have highlighted how badly things can go wrong for the Australian market. Australian regulators are watching the higher benchmarks of acceptable behaviour currently being set in the UK with interest. Recent ASIC publications on selling complex products, as well as increased surveillance on product, marketing and consumer credit insurance demonstrate this interest. Firms will need to examine their conduct and metrics around developing, marketing and distributing products and services to mitigate any mis-selling risks, particularly those sold under general advice.

REGULATORY PRODUCTIVITY
Financial institutions continue to strive for a more ‘business as usual’ approach to regulatory change. The capability to leverage data to meet multiple new compliance requirements means that organisations can achieve economies of scale, particularly around client onboarding and product suitability assessments.
Therefore financial institutions will look to underpin this capability with an enhanced framework approach that evaluates upcoming regulatory obligations and aligns these with existing obligation sets and business processes. Having this type of capability will be necessary to manage de-regulation, with ASIC leading the way with its May 2014 report on de-regulatory initiatives.

PROTECTING CLIENT MONIES AND ASSETS
With heightened regulatory activity around protecting client money and assets at the end of 2013 and the release of the final IOSCO report on ‘Recommendations Regarding the Protection of Client Assets’, we expect the regulatory focus on protecting client monies and property to intensify this year. Financial institutions will need to continue to assess their activities across the client money and assets lifecycle to identify and protect them according to regulatory requirements as well as to mitigate and better manage client money and asset risk.
RISK AS AN ENABLER

The challenges of modest revenue growth, cost pressures, new competitors and continuing waves of regulatory change mean that financial organisations will have to enhance capital, operational, technological and risk management efficiencies. They will need a strategic platform to analyse capabilities, a holistic view of risk and an integrated approach to meet business needs. The forthcoming CPS220 standard will require full integration between strategy, risk appetite and risk management. This will also mean there needs to be a shared strategic vision between Finance, HR, Operations, Technology, Risk and frontline businesses all underpinned by an organisation-wide risk culture.

WHOLESALE CONDUCT RISK

The focus on wholesale conduct risk will intensify over 2014 with rate setting practices likely to receive even more focus as ASIC continues to probe rate setting activities in Australia off the back of global scandals. Financial institutions should conduct a value-chain analysis inclusive of governance, procedures and controls to ensure that conduct risk is managed appropriately. In particular, financial institutions will need to have a clear view of culture and controls which can either support or threaten market integrity. There is a shift in regulatory expectations for banks to ensure that acting in customers’ best interests also extends to wholesale counterparties.

LIQUIDITY

As financial institutions move into an era where liquidity is likely to be the new capital, banks will need to continue to manage the effects on profitability from Liquidity Coverage Ratio and Net Stable Funding Ratio requirements as well the associated governance, process and technology impacts. With OTC derivative reforms introducing further liquidity risks for both the buy-side and sell-side, insurance companies, wealth managers and superannuation funds will also need to manage the liquidity risks resulting from central clearing and margining requirements.

CAPITAL MANAGEMENT

Historically wealth management operations have been high growth and low cost, but the wave of regulations impacting the industry, mean change. Wealth managers are re-assessing their wealth strategies and looking for opportunities to lower their overall cost of capital. This is proving to be a challenge in an environment where there is limited investment capacity to increase efficiencies. Wealth managers will therefore need to be selective and ensure their investments enhance governance, product development, distribution channels and investment risk management.

FINANCIAL AND CYBER CRIME

Financial crime continues to be a threat in a volatile, uncertain, complex and ambiguous world. Financial institutions need to assess how they better manage their overall exposure to financial crime. This needs a holistic strategy with an operational design that covers managing fraud, market abuse, money laundering, terrorism financing prevention, sanctions and cybercrime.

With advances in technology leading to an outbreak of sophisticated cybercrime around the world, organisations need to ensure their risk management systems are sufficiently granular to achieve the right level of cyber-resilience.

PRIVACY AND DATA GOVERNANCE

In the run-up to the March 2014 privacy deadline, many organisations worked hard to design and implement the relevant changes required. As with all major regulatory change, there is further work to do in fully operationalising all of the new privacy requirements.

A priority for many financial institutions is managing user access and the ability to resolve ‘toxic’ access combinations (i.e. where a user, for example, has the ability to both initiate a trade and perform certain back-office functions). Again those financial institutions which have focused on high risk systems to meet shorter term deadlines will now have to extend those out to 2014 / 2015 and operationalise user access governance in a more efficient and effective manner.
Financial System Inquiry
Future Scenarios

Below we describe six scenarios as a guide for the Murray Financial System’s Inquiry to consider when structuring the nation’s regulation blueprint for the future.

The scenarios are designed to anticipate future issues and stress test our thinking about the future.

The mega trends that will impact Australia’s economy over the next few decades are the rise of Asia, digitisation, population ageing, and continued volatility and uncertainty. Regulation is a very important part of the picture, however the future of the financial system will also be shaped by market forces and disrupters.

Our system of banks, insurers, super funds and networks of payments systems are already being disrupted by these trends and because history tells us that change is rarely gradual and predictable, we don’t anticipate an orderly one at a time scenario.

The question is: Is our regulatory system sufficiently robust enough to cope with the future?

Steady as she goes

This scenario extrapolates some existing trends whereby:

• Superannuation balances continue to grow along with the growth in the number of pension-phase retirees
• The number of entities operating outside the prudential perimeter expands, targeting niche customer groups
• High levels of concentration remain in banking and insurance products, and concentration levels in superannuation increase
• The trend towards vertical and horizontal integration increases
• Technology progressively eases entry in certain parts of various market segments
• The trend of increasingly costly and frequent natural disasters continues
• Financial institutions expand into aged care related financial services
• As financial institutions focus on profitable customers, enabled by analytics and technology, a growing proportion of the population encounter financial exclusion, or can only access basic financial products at a high cost.

Potential regulatory considerations
Sustainable retirement income; need to improve consumer choices through better advice, products and financial literacy

Competition vs protection, ensuring prudential regulation does not stop risk taking and innovation, keeping barriers low

Increased regulatory focus on financial exclusion

Asian acceleration inbound

There is an increased economic footprint in Australia by foreign financial institutions, particularly Asian banks.

• A Chinese G-SIFI acquires one of the 4 pillars
• Core financial infrastructure are outsourced, e.g. with Australian securities listed on an Asian central exchange
• Increased outsourcing of core technology and operations services offshore.

Potential regulatory considerations
Globalisation vs contagion and stability
Effectiveness of recovery and resolution plans operating across borders
Transfer of personal data offshore
Consumer protection with an increase in offshore financial products sold in Australia
Continued growth in Asia prompts Australian financial institutions to significantly expand their operations in Asia.

- Acquiring banks that are inherently more exposed to economic and asset market cycles in Asia than currently
- The banks follow Asian clients as they expand into the Middle East, Africa and Latin America.

Digital and technological progress accelerates leading to:

- Non-financial institutions offering traditional banking products and services
- Stored Value cards issued by retailers and telecommunication companies become customers primary transaction account
- Organisational value being increasingly driven by data and the information about clients
- Disintermediation of the core banking system
- Real-time financial services
- Passive data collection
- Peer-to-peer retail lending and insurance
- Greater automation of processes and the digital bank
- Personal financial advice is provided by ‘robo-advisers’ based on big data
- Airline frequent flyer points become a default currency and become convertible to cash and can be used to pay for goods and services.

Digital and retail revolution

Potential regulatory considerations

- Regulatory integration, mutual recognition of legal and regulatory standards
- Impact of local prudential regulation on Australian firms entering competing in overseas markets
- Transfer of personal data offshore
- Conduct risk and reputation risk increase with blurred boundaries on acceptable business practices in different cultures

A Global Financial Crisis II is triggered by a combination of a:

- Global sovereign debt crisis
- Natural disasters
- Technology crisis that destroys asset values
- A flight to quality challenges the business model of niche players and smaller financial institutions
- The contagion spreads damage across insurers, lenders and investors. The scope of damage is intense and this time, Asia doesn’t escape the worst of the damage.

Super revolution

The growth of superannuation funds leads to a ‘super-sized’ superannuation sector.

This causes funds to move into traditional banking services, including direct deposit-taking and transactions.

As funds focus on retirement outcomes as opposed to investment for retirement, this leads to:

- Increased role in aged care, health insurance
- Increased use of alternative financial products including reverse mortgages and annuities
- Increased focus on managing sequencing risk.

Banks begin to operate more as service providers, offering mortgage origination and SME lending, while lending is securitised and sold on to superannuation funds.

- Develop new instruments to get funds from super to borrowers, e.g. SMEs, infrastructure, start-ups.

Potential regulatory considerations

- What products and infrastructure are needed for superannuation to take a greater role in funding activity
- Increased provision of aged care and health insurance related products and services with focus on retirement outcomes v retirement income
- Sheer size of superannuation requires tax redesign, challenge of micro-reform
- Relatively larger superannuation to make financial system more stable?
- Increased investment offshore by superannuation funds

Managing Conduct Risk

There has always been a focus on ethical conduct by financial services. However recent events highlight the need to do better, with a robust framework tailored to organisational operations that both understands and manages conduct risk.

Overview
Addressing conduct risk is an increasingly necessary step in response to heightened regulatory and community expectations about the behaviour of financial firms and their employees, and the rising propensity of regulators globally to impose substantial fines on firms for breaching those expectations.

Conduct risk is the risk of an action, by an individual, financial institution or the industry as a whole, which leads to customer detriment or, undermines market integrity. This can bring sanctions and negative publicity.

Australian firms should be considering if, and how their risk frameworks address conduct risk, and whether current settings are adjusted appropriately to meet organisational operations and emerging regulatory expectations.

Increasing regulatory expectations
Recent high profile events have attracted regulatory attention to the behaviour of organisations and their employees. These include the LIBOR rate fixing scandal, the London whale trading issue, the misselling of complex products and payment protection insurance to retail customers, the provision of poor financial advice, and the failure to safeguard client assets.

The regulatory response to these events is at both a global and domestic level. They are manifest by increasing standards through new regulatory policy and financial sanctions at levels that can seriously impact the bottom line.

For example, at the global level, the Financial Stability Board and the International Organisation of Securities Commissions (IOSCO) have both recently worked on standards of behaviour around rate fixing. These standards affect firms engaged in rate setting processes. IOSCO also released significant new policy on complex products. Under this policy, wholesale and retail clients would be subject to suitability assessments, and regulators given the tools to regulate products along the value chain. National regulators will take cues from this work.

International regulators have also imposed new expectations on firms, particularly around how they engage with the retail customer.

New and proposed product intervention powers give EU regulators the ability to ban products or product features. The UK Financial Conduct Authority (FCA) recently used these powers to ban selling CoCos (contingent convertible instruments) to retail investors on the grounds that the products are complex and not designed around retail investors’ needs. The FCA also continues its push to treat customers fairly, releasing regulatory guidance on product governance that exhorts firms to ensure products are fit for clients.

There are similar regulatory initiatives in Asia, particularly in Hong Kong and Singapore in response to the Minibonds misselling episode for instance. And regulators have also imposed significant fines on some financial firms, with London School of Economics’ research showing that just 10 banks were fined a total of GBP100 billion between 2009 to 2013. This figure is expected to increase substantially by the end of 2014.

Australian themes
In Australia, these themes of increasing regulatory standards and sanctions powers are playing out through the recent Senate Committee inquiry into ASIC and the ongoing Financial System Inquiry.

The Senate Committee report makes recommendations to increase ASIC’s enforcement budget and regulatory powers, while the FSI interim report has received a significant number of submissions in response to asking for feedback on how to improve customer outcomes including the option of giving ASIC intervention powers and requiring firms to take more responsibility for their products and how they are sold. ASIC has also drawn the FSI’s attention to the gap between the sanctions it may impose and those which foreign regulators can impose.

These emerging themes are being overlaid on existing Australian regulatory changes that have raised behavioural standards. Examples include the Consumer Credit Act, the Future of Financial Advice reforms and the new privacy principles.

1. These results are available here: http://blogs.lse.ac.uk/conductcosts/2014/07/01/conduct-costs-projects-findings-2009-2013/
Addressing conduct risk is the next evolution for the regulatory environment.

The challenge
Increasing regulatory standards, coupled with greater sanctions powers increase both the likelihood that firms will breach regulatory standards and the consequences of such breaches.

The way to reduce this inherent conduct risk is to implement frameworks that result in defined levels of acceptable residual risk.

Organisations need to begin thinking about how they are going to do this. This will be challenging for many, particularly given the lack of guidance from regulators, the need to prioritise projects, managing increasing costs, and the availability of capable resources.

At the same time, ADIs have to understand their risk culture in response to the Prudential Standard CPS 220 on Risk Management that was issued by APRA in May 2013. Our view is that culture and conduct are inextricably linked. Organisations need to ask themselves how they can tackle this in a smart and efficient way.

Key focus areas of conduct risk
Ensure the overall framework for the management of conduct risk is fit for purpose.

Take into account the scale, scope and complexity of your firm’s activities as each framework design will vary.

Consider the following when managing conduct risk:

- **Define** conduct risk in your particular business, your conduct risk appetite and how it should be managed.
- **Assess** by gap analysis any current arrangements where conduct does and does not line up with risk appetite.
- **Remediate or enhance** the areas identified in the gap analysis.
- **Demonstrate** through measuring, monitoring and evidence the effectiveness of these activities.
- **Reassess and refine** current arrangements.

If properly considered and embedded, addressing risks of poor behaviour can support strategic decision making and influence long-term positive, and profitable relationships with consumers and counterparties.
Organisations must focus their understanding and management of conduct risk on all aspects of their business. Figure 1 represents some key themes for consideration.

**Conduct Risk**

**Key themes for consideration**

**Culture and conduct**

- Culture and conduct is vital to the success of an organisation and firms must translate intent into concrete practices
  - Code of Conduct
  - Challenge and escalation
  - Remuneration and incentive arrangements
  - On-boarding of right people
  - Training and minimum competency requirements
  - Whistleblowing
  - Tone from the top
  - Tone at the Middle.

**Governance and oversight**

- Setting a conduct risk appetite
- Top down setting of standards and values
- Values incorporating and emphasising good conduct and fair treatment.
- Consequence framework including the escalation of serious misconduct incidents
- Managing conflicts of interest
- Creating one common purpose including product governance.

**Products and clients**

- Client and consumers in the centre of the firm’s corporate culture and business activities
  - Clear and simple product disclosures
  - Fairness and robustness of the product design and distribution process
  - Culture of integrity not sales
  - Consistency and fairness in complaints handling and remediation
  - Suitability and appropriateness of products or services
  - Understanding customer needs and their financial literacy.

**Continuous improvement**

- Ability to demonstrate that all activities undertaken are sustainable and effective
  - Past concerns being actively addressed and sustainable outcomes achieved
  - Proactive in identifying and managing conduct risks
  - Ongoing monitoring of the effectiveness of actions taken to address risk events.

**Market integrity**

- Impact of business activities and behaviours on market integrity
  - Managing the risks posed by evolving technology
  - Strengthen controls to prevent mis-conduct
  - Manage abuse of information asymmetries
  - Manage conflicts of interest
  - Apply appropriate Chinese walls.

**Integrity of records and data**

- Accessibility and retention of records and client data
  - Demonstrating client centric culture
  - Identifying client assets from firm assets, and the assets of other clients
  - Retaining records of client identification
  - Protecting the handling of client data and sensitive information.

**Robust measurement and assurance**

- The monitoring, review and reporting of conduct risk processes and controls
  - Clear roles and responsibilities across three lines of defence
  - Understanding what the post-sales customer experience should be
  - Recognising trends and recurring patterns from complaints, claims and incidents
  - Consistency of monitoring effectiveness across all business streams
  - Cultural Indicators.
Regulatory Productivity

Given the volume, pervasiveness and focus on regulatory change and how it is implemented, financial institutions are continuously looking for a productively strategic ‘business as usual’ approach to implementing regulatory change.

To achieve this, and enhance existing regulatory change practices, financial institutions need to leverage data and refine regulatory strategic decision making. The big wins come by aligning upcoming regulatory obligations with strategy and existing risk management frameworks.

Regulatory productivity is achieved by:
- Having the ability to leverage data to help shape how regulatory requirements can be tailored and implemented
- Efficiencies from pooling together regulation and required outputs that apply across multiple layers of an institution in a strategic and holistic way, as opposed to a traditionally siloed regulation by regulation approach.

This ‘portfolio view’ of managing regulatory change is consistent with global ‘better practice’.

By adopting a portfolio view, institutions are better equipped to leverage data and refine their frameworks to assess regulatory change. The three common approaches are:
- By function – managing regulatory change centrally and filtering down to the relevant business area (which is the traditional model)
- By product – linking regulatory change to specific product or comparable group of products
- By output – focussing on system outputs where they link across several different regulatory changes, e.g. customer data outputs which overlap anti-money laundering and privacy requirements, as they share similar characteristics.

While a ‘top down’ functional approach remains industry practice, the focus is increasingly on driving productivity from the ‘bottom up’ to better link products and output, and correctly place accountability on the business, as owners of the change (with group risk functions acting as an advisory and support function).

Directly linking regulatory change accountability to business owners encourages both greater awareness and a better impact from the changes. The concerted effort to be productive reduces both the cost and complexity of implementing regulatory change.

What are the challenges / issues to consider?
While some institutions have been more successful than others in managing regulatory change, there are multiple challenges contingent on the nature of the business. Our Australian and offshore examples include:
- The volume of regulation and difficulty in developing a clear and thematic regulatory strategy given the uncertainty of the changes and finalisation of supervisory interpretations
- Obtaining a holistic view of regulatory change from different parts of the business for the whole business
- The many regulatory ‘unknowns’ with continued rule revisions, implementation timelines and changing interpretations, leading to uncertainty in business planning, strategic thinking and capital allocation
- Conversely, the regulatory change impact of deregulation. For example, should the Financial System Inquiry result in substantial deregulation or change in the Australian financial services regulatory framework, this will potentially compound current regulatory change initiatives.

What next?
Given the cost of compliance and potential business impacts, it is vital that institutions consider how they manage regulatory changes more productively. Looking at how best to leverage global better practice and a portfolio view provide opportunities to be more agile and predictive in managing regulatory change impacts.
Advice quality in the spotlight

Given the heightened intensity on advice quality and regulator and consumer scrutiny, the industry has a prime opportunity to revisit, revamp and even revolutionise their strategies and operating models. There is no single cause for poor quality, there are instead many contributing areas. Consider where you stand along the eight key themes in this article that are well-known and understood by the industry.

Questions for advice providers:
• Has the inherent risk of providing advice increased?
• Are your resources adequate?
• Are your processes and governance effective?
• Given other priorities such as advice transformation programs, cost rationalisation and efficiency enhancements, is there sufficient focus, transparency and management of the risks in your quality of advice?

The intensity of the obligation to provide advice ‘efficiently, honestly and fairly’ is without question, front of mind. Professional indemnity insurer Vero exiting the advice market and claiming that risks have become too great, gives a clear indication that many financial services providers are re-evaluating their risk appetite and position.

So where is the risk?

The level of licensee general obligations, the adequacy of financial, human and technological resources, and risk management systems are all called into question under the eight themes below. In the context of each theme, consider how your resources are prioritised; how robust your processes used to identify, evaluate and manage the relevant risks are; the data points and evidence that demonstrate a level of comfort; and whether your focus on advice quality is loud and clear.

Eight advice quality themes

The eight themes to advice quality are illustrated in our Advice Quality Wheel.
1. **Demonstrable change**: Where concerns have been identified (internally or by the regulator), and controls enhanced to address their effectiveness, these controls should be regularly retested to determine their sustainability. Advice risks should also be identified and continually managed and mitigated proactively.

2. **Robust monitoring and supervision**: Monitoring and supervision has always been in the spotlight and is featured regularly in enforceable undertakings. Advice providers have been heavily investing to improve their monitoring effectiveness and design early warning systems, and to achieve a single adviser view. The focus continues to be on timeliness to both identify issues and report any breaches as well as determining significance. Strong file management remains critical to ensure integrity and complete advice records.

3. **Governance and oversight**: The strength of governance arrangements is vital to ensure adequate Board oversight of both advice quality and client remediation programs. There is an expectation that actions to identify and act on riskier advisers are transparent.

4. **Ethical conduct**: There is a distinction between inappropriate advice and unethical adviser conduct. The upmost importance is placed on an advice providers’ ability to encourage an ethical culture and to identify unethical behaviour and fraud. A useful lever is an organisation’s whistle blower arrangements and protections.

5. **Client centric culture**: Having a culture that puts the client’s interest at the centre of strategy, decision models, behaviour outcomes, and approach to appropriate conduct, is essential. To promote and instil such a culture of integrity, the right remuneration and incentive arrangements is critical to be effective, there must a balanced and honest correlation between adviser revenue, compliance ratings, and consequence management.

6. **Fair client remediation**: Where client financial remediation is required, remediation programs should consider the:
   - robustness of the remediation methodology
   - relevance of any comparative portfolio used to calculate any compensation;
   - consistency of remediation outcomes for clients; and
   - involvement of a client advocate to act as the ‘voice of the customer’ in any compensation process.

7. **Adviser professionalism**: Recently the debate on adviser education reached a crescendo, with a number of large advice providers announcing their new heightened minimum training and competency requirements to be set at CFP-level (or equivalent). Appropriate background checks and behavioural assessments at the adviser recruitment and on-boarding stages, are also important for gauging adviser professionalism.

8. **Client care**: Under the theme of fair client remediation, a truly effective end-to-end complaints process requires the ‘voice of the customer’ to generate genuine client care. The definition of wholesale and retail clients can remain an issue if clients can be adversely impacted with little subsequent client care recourse. A licensee’s role in assessing product suitability for each client demographic also needs stronger client focus in demonstrating client care.

**Key enablers for Quality Advice**

For those with the strategic foresight and drive to reshape the future for advice, these eight key themes succinctly summarise the learnings and critical principles for the advice profession. The industry has now a prime opportunity to revamp and even revolutionise advice, and truly make a difference to the future standard of living in retirement for all Australians - a standard worth fighting for.
Managing liquidity risk for ADIs

As Australia moves towards the Basel III capital framework, liquidity risk management by Authorised Depository Institutions will continue to be scrutinised.

Final release of APRA’s position on Basel III Liquidity Rules implemented in Australia
In its submission to the Financial System Inquiry on 31 March 2014, APRA promoted stronger liquidity buffers and more stable sources of funding given Basel III Liquidity reforms. APRA noted that in its international discussions on liquidity reforms, it had proposed a pragmatic approach to implementation given the shortage of high-quality liquid assets in Australia.

When the Basel Committee assessed Australia’s capital framework in March 2014 as compliant with its framework, it emphasised the need for Australia’s ADIs to continue to be proactive in managing their liquidity risk, and how liquidity requirements will impact on business, governance and technology.


APRA has not made any material amendments to these standards since its draft released in May 2013. However, in response to industry submissions, APRA clarified the final liquidity rules and their impact on ADIs.

Liquidity framework
The Basel III liquidity framework imposed two quantitative measures on ADIs to measure and monitor liquidity risk, a:

1. Liquidity Coverage Ratio (LCR) to survive an acute stress scenario over a 30 day horizon with sufficient high quality liquid resources

2. Net Stable Funding Ratio (NSFR) to promote longer-term resilience through stable sources of funding on an ongoing basis.

Depending on the nature, size and complexity of the ADI, APRA intends to apply the Liquidity Coverage Ratio to the larger and more complex ADIs and maintain the minimum liquidity holdings (MLH) regime for simple, retail-based business models. However, depending on an ADI’s liquidity risk appetite, an LCR approach to managing liquidity risk may be considered, in addition to the minimum liquidity holdings, as an important measure for preparedness in the event of a liquidity stress scenario.

APRA will continue to adhere to implementing the LCR on 1 January 2015, as originally proposed in May 2013, instead of adopting the Basel Committee’s phase-in arrangements. This will require an accelerated implementation timetable than that required by the Basel Committee. Qualitative requirements of the Basel III liquidity framework, as reflected in APS 210, will apply to all ADIs. The NSFR rules have been removed from APS 210 until the Basel Committee’s review is finalised, with a proposed effectiveness date of 1 January 2018.

Liquidity Coverage Ratio – High Quality Liquid Assets (HQLA)
APRA defines two components for ADIs to determine the LCR in line with APS 210:

1. The value of stock of HQLA
2. Total net cash outflows.

Despite the broader range of liquid assets permitted under the Basel III liquidity rules, APRA’s criteria limits the highest quality liquidity assets (i.e. HQLA1) to include coins and notes, balances held with the Commonwealth Government, semi-government securities and the Reserve Bank of Australia.

APRA also advises that no other assets in Australia qualify for the second (i.e. HQLA2) and third categories (i.e. HQLA2B) of eligible high quality liquid assets introduced by the Basel Committee, to be a reliable source of liquidity during stressed market conditions. It will continue to take into account relevant market developments.
Committed Liquidity Facility (CLF)
The Committed Liquidity Facility is an alternative liquid asset treatment for holding HQLAs under the Basel III liquidity framework for jurisdictions with an insufficient supply of HQLAs. This treatment allows banking institutions to establish contractual committed liquidity facilities provided by their central bank, (subject to an appropriate fee), which will form part of their LCR requirement.

Given there are inadequate HQLAs in Australia to satisfy ADIs’ LCR requirements, the RBA and APRA announced in December 2010 that an ADI will be able to establish a secured CLF with the RBA, subject to a 0.15%p.a, fee based on the size of the commitment, in order to meet its Liquidity Coverage Ratio requirement in Australian dollars. Under this facility, the RBA commits to purchase eligible securities from an ADI under an RBA repurchase agreement (Repo) to the extent required for the ADI to be liquid as dictated by APRA.

In a separate letter to ADIs on 30 January 2014, APRA highlighted some key observations from its late 2013 trial across 35 ADIs to project a total notional Committed Liquidity Facility that would be sufficient to allow them to comply with a notional Liquidity Coverage Ratio for the calendar year of 2014. The key observations were:

- **Stock of HQLA**: Based on this trial exercise, the RBA determined that approximately 30% of the outstanding stock of Commonwealth Government securities and those issued by state and territory governments could reasonably be held by LCR ADIs. During the trial exercise, APRA assumed a suitable buffer of a CLF to be within 10-15% of net cash outflows.

- **Appropriate composition of CLF Collateral**: The current and projected future CLF collateral mix of each ADI will be considered by APRA as part of its annual CLF process to assess the appropriate degree of diversification and debt concentration. The proportion of self-securitised assets that form part of CLF eligible asset will be a particular focus for APRA.

- **Related party transactions – locally incorporated ADIs**: APRA raised two categories of related party deposits, highlighted by locally incorporated ADIs, as having the potential to reduce cash outflows. This raised prudential concerns. These categories included related parties having the discretion to withdraw funds in a stress scenario but were assumed not to have this by ADIs. Related parties that enter into contractual arrangements that would significantly impede their ability to withdraw funds in a stress scenario without there being any obvious compensating benefit to that related party. Accordingly, APRA will not accept assumptions relating to the potential conduct of directors or trustees in a stress scenario that contravene or are inconsistent with their fiduciary and legal duties.

- **Related party transactions – foreign banks**: When applying for a CLF, APRA will require foreign branches to make assumptions when projecting their Australian dollar net cash outflows. These assume that projected cash outflows from commitments to, or transactions with, related parties are zero (regardless of contractual tenor), and that projected cash inflows are no greater than 50% of projected cash outflows. APRA’s intends to exclude net cash outflow projections that disappear when the parent balance sheet is consolidated for CLF purposes.

- **Remuneration**: APRA expects that remuneration for key personnel should meet its requirement for ADIs to minimise reliance on the CLF by structuring variable remuneration to meet the objectives of both prudent balance sheet stewardship, and the HQLA funding profile.

- **Statement of Liquidity Risk Appetite**: APRA’s general observation on applying a best practice approach would be for ADIs to include both quantifiable metrics and qualitative statements in their statement of Liquidity Risk Appetite.

- **Foreign exchange derivatives**: As part of their CLF application, ADIs may request a ‘customised assumption’ for their projected FX derivative cash flows, where their Australian dollar net cash outflows are greater than the all-currency net cash outflows that arise from their FX transactions. Until 30 May 2014, APRA accepted formal applications from ADIs to establish a secured Committed Liquidity Facility with the RBA. This facility allowed ADIs to meet any shortfall of their HQLA holdings against the LCR requirement by holding both Australian dollar repo-eligible assets and HQLA. APRA is due to confirm the size of each ADI’s CLF by 30 September 2014, subject to an assessment that ADIs have taken ‘all reasonable steps’ to meet their LCR requirements through their own balance sheet management.

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2. Refer to APRA’s separate letter to all ADIs subject to the liquidity coverage ratio on 30 January 2014.
Recap on changes to net cash outflows

APRA accepted the Basel Committee’s revision of its assumptions underlying cash inflow and outflows rates for LCR calculations, subject to the following clarifications3:

• **Intermediated deposits**: These are funds placed by a person with an intermediary, which are then placed with an ADI. These deposits continue to be treated differently from retail deposits due to the fiduciary duty an intermediary has to the underlying customer in a time of liquidity stress.

• **Modelling 31-day notice period deposits**: APRA intends to allow ADIs to model 31-day notice period deposits that are in a grace period, on the same basis as demand deposits, until the ADI receives notice that deposits will be withdrawn on maturity (when a 100% run off rate will be applied).

• **Collateral postings arising from adverse market valuation movements**: When determining net cash outflows for which collateral may be posted, an ADI must consider the impact of adverse market valuation movements on its positions during the 30-day stress scenario. For currency-related collateral flows, APRA will provide further clarity on the most appropriate treatment for LCR purposes.

• **Event-dependent commitments**: Committed facilities with an undrawn portion are to be included as a cash outflow if the portion can be contractually drawn within 30 days.

• **Foreign currency derivative transactions**: In the absence of a master netting agreement in line with Basel III rules, no additional relief will be provided by APRA for the netting of derivative transactions arising from foreign exchange derivatives and transactions settled through a Continuous Linked settlement bank.

• **Head Office Funding**: Working capital deposits placed with a foreign bank branch by Head Office will be treated under the terms and conditions it is provided. Accordingly, for funds that can be repatriated by Head Office in the event of liquidity stress, a 100% run-off rate is applied. However, funds that can only be withdrawn by Head Office, subject to a notice period that exceeds 30 days, can be assumed by the branch as remaining in a liquidity stress event.

• **Operational deposits**: Lower run-off rates are applied only to the operational proportion of any deposits i.e. deposits that customers place, or leave, with an ADI to facilitate their ability and access to payment and settlement systems.

• **Trade Finance facilities**: ADIs are required to use modelling that is based on actual experience and includes trade finance inflows to derive a run-off rate for trade finance facilities. APS 210 has been amended to allow for the netting of trade finance facility flows.

**Expected impact on banks**

For the financial year ending on 31 December 2014, it will be the first time that APRA’s APS 210 will be included when determining net cash outflows for which collateral may be posted in a limited assurance review performed by the ADI’s appointed auditor under APRA’s APS 310 Audit and Related Matters.

This review covers the design of an ADI’s internal controls to ensure that the ADI has complied with all applicable prudential requirements and provided reliable data in reporting forms to APRA.

Until the LCR becomes effective on 1 January 2015, the review will largely centre on the qualitative requirements that apply to all ADIs to maintain a robust liquidity risk management framework and strategy to measure, monitor and manage, liquidity risk according to the scale, nature and complexity of the ADI.

The practical application of daily calculations of the LCR may present challenges and need consideration when embedding liquidity ratios as part of ‘business as usual’ processes. They include:

• Work with the business to ensure accurate and complete categorisation of cash inflows and outflows, particularly the run-off rates applied by the standard to derive the net cash outflow

• Set internal liquidity ‘trigger’ ratios above the LCR to provide an early warning system when HQLAs should be reassessed re ADI’s net cash outflows

• Report internal liquidity risk to the Board to provide transparent liquidity measures in line with the liquidity risk management framework and overall Board Risk Appetite Statement

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• Ensure accurate and complete liquidity data is reported externally to APRA and is supplemented by the new liquidity ratios. For example both the extension of existing IT systems to ensure the required granularity of data and automated LCR calculations.

The impact on the business model of ADIs will also be important when complying with APRA’s liquidity standards with key considerations to:

• Impact on the pricing, terms and conditions of banking products such as 31-day notice period deposits

• Investing in low-yield securities for the liquidity buffer which may reduce the profitability of the banking sector

• Opportunity costs arising from prudential regulation, such as the costs of holding liquidity

• A potentially reduced dependency on capital markets in favour of retail funding.

These liquidity considerations signal the importance of ADIs to keep the business ‘talking about liquidity risk’ and communicating the impacts of APRA’s prudential requirements across all departments.

Australia’s compliance with the Basel III Liquidity standards - the liquidity ratios and the framework for systemically important banks - will be assessed by the Basel Committee’s Regulatory Consistency Assessment Program at a later date once those standards become effective per the phase-in arrangements.
‘Risk’ as an enabler

Understanding how risk management both guards and sustains institutional success and competitive advantage is vital. Given regulators are raising the risk management bar across financial services, knowing how best to both lift and operationalise risk management capabilities will successfully enable your strategy.

The regulatory landscape is evolving
Risk management is increasingly seen as an objective ‘guardian’ of an institution’s strategy, balance sheet integrity and reputation. More and more, regulators are advocating for integrated risk management frameworks as they support conscious and profitable risk-taking to minimise the risk of catastrophic failures.

Recent evidence shows the disparity between the risks institutions take, and the risks their Boards think they take, as well as the inability to see risk as a whole – the blind spot of most organisations.

Risk Framework uplift
Risk management functions are being pressured to do ‘more with less’ in an environment of modest revenue growth and cost constraints. This requires making smart investments in people - in culture and competencies - in processes, and technology enablers.

Successful financial institutions have made strategic decisions to implement risk management programs that are focused on improving their risk talent. By clearly articulating roles and responsibilities across the business, risk and audit functions, as well as leveraging technological capability across the institution, they have raised their own bar.

Through more focus on a ‘bottom-up’ risk management approach – an uplift - business and product owners are taking greater ownership of the risks in their business, and by using their enterprise risk functions to oversee and advise, these functions are more strategic and targeted in delivery.

The primary benefit of the uplift is that institutions are now more focused on risk based assurance activity in line with their risk management frameworks, risk governance procedures and well defined risk appetite settings.

Making correct business decisions quickly
Thoughtful and fit-for-purpose risk management frameworks play a critical role in providing confidence to financial institution’s boards and management to enable them to make strategy decisions quickly and without over-prescriptive due diligence and reassessment.

Regulators are increasingly focused on institutions building robust risk appetite statements along with their boards, to agree and set a principle-based governing document on how the institution views and manages risk. If the risk appetite is neither articulated nor understood by management and the business, it can easily lead to unexpected losses, volatility of revenues and impact on profits.

As an institution grows and begins to make any material changes to its operations, it must regularly assess whether its risk appetite statement is understood and remains appropriate in the context of its size, its business mix and complexity.

Challenges
There is no one-size fits all approach to managing risk. The current challenges to overcome that we are seeing include:

- Ensuring the Board gets deeper and more transparent oversight across the institution’s risk management framework, without duplicating or stepping into management duties
- Positioning the business and enterprise functions into a risk framework model to meet regulatory compliance which, due to the nature, scale and complexity of the institution, is often unclear and may well vary
- Prioritising new and existing technology to empower management to make risk decisions that are based on timely facts and meet strategic objectives
- Developing a sound risk culture and measuring it to ensure the organisation meets the increased focus and expectation of regulators and the industry. Even the best designed risk management framework is only as effective as its people doing the right thing.
Protecting client assets

Given the heightened regulatory activity around protecting client money and assets at the end of 2013 and the release of the final IOSCO report on ‘Recommendations Regarding the Protection of Client Assets’, we expect the regulatory focus on protecting client money and property to intensify.

Overview
The well documented failures of Lehman Brothers and MF Global placed client money and client asset protection regimes in the spotlight. In Australia, ASIC’s focus on client money has largely been around over-the-counter (OTC) and exchange traded derivatives.

Following the IOSCO ‘Recommendations Regarding the Protection of Client Assets’ and the publication of the Financial Conduct Authority’s ‘Review of the client assets regime for investment business’, we consider it likely that ASIC will review and, if necessary, pass new laws or regulation to enhance the domestic framework.

Regulators in most jurisdictions have been seeking to address risks associated with protecting client assets particularly when it comes to ensuring the transfer or return of client assets in the event of default, resolution or insolvency.

Firms should expect ASIC’s regulatory focus to also increase in other sectors including asset management and insurance. This is especially relevant given the expanded remit and work undertaken by the Financial Conduct Authority in the UK in asset management and insurance.

What have we learnt from past failures in regard to asset managers?
Several failures and breakdown in controls and processes to protect client assets have been identified at a number of large and high profile asset management firms both in Australia and the UK.

The key themes identified include:
- Withdrawing client money from trust accounts without required written authorisation
- Paying client money into accounts not designated as trust accounts
- Paying firm money into client trust accounts
- Failing to identify and therefore properly protect, client money
- Failing to designate an account as a trust account or segregated client account
- Inconsistent naming conventions when setting up client money accounts, leading to confusion as to what money was actually in the account.

Given the often complicated nature of asset management arrangements, it is imperative that firms take note of identified failings and consider their relevance to ensure they are adequately protecting client money and assets.

What should asset management firms be doing next?
Assess your client money and asset controls across your client money and assets value chain.

We acknowledge the challenges faced by multi-jurisdictional institutions given differing client money requirements.

Therefore the first key step in the process should be to correctly identify where client money or assets will arise in the business at each firm, and ensure that sufficient controls are in place to enable correct identification.

Once identified it is imperative that client money and assets are correctly protected in a trust account or segregated account (as required) which is named clearly to indicate it is client money in accordance with applicable regulation.

In addition, with respect to asset managers, it is important to ensure that client money and assets held with custodians are sufficiently protected.

It is a regulatory requirement to protect client money and assets. A strong client asset protection regime promotes confidence and stability in the financial system.
Privacy and data governance

The March 2014 Privacy Amendment Act significantly increased business obligations around Personal Identifiable Information. Customer demand for faster and more digital services has accelerated the take up of cloud-based services as well as the need for sophisticated data analytics. These trends in turn increase the risk of breach or PII data loss.

This increased risk highlights the need to improve data governance and personal identifiable information (PII) data management. Financial institutions now need to clearly know what they have, where it resides, who has access to it, and how it is managed through its lifecycle.

Privacy and data governance are business issues
Under the Australian Privacy Principles, companies are obliged to safeguard the confidentiality of customer PII data. Proper data governance requires the policies, processes and technology of an organisation to ensure the integrity, confidentiality and availability of customer data.

As financial institutions change their business models to incorporate new ways to engage with their customers, outsource their technology and processes, and mine customer data, they significantly increase the risk of PII data loss, theft or misuse. This is heightened when delivering operations in multiple international jurisdictions.

Online self-service, growing use of mobiles and the internet to engage with business, means that Australian banks are leading the industry, digitally transforming customer sales and service. Insurers and superfund providers are also increasingly adopting digital business models to stay relevant and meet internet-savvy customer demand.

Third party cloud-based service providers have pushed the issue of data residency to the fore, as some subscribers are unsure where their data actually resides, and can be unclear as to how and when it is accessed, secured, and stored.

However, under the Australia Privacy Principles, PII data which is stored offshore will be subject to the same level of compliance as that processed in Australia. In other words, the organisation holds the risk wherever the data resides.

The likelihood of privacy policy gaps, weak PII data access management, or inadequate security controls over the data increases as FIs implement more sophisticated data analytics tools to engage end-users.

The costs to a financial institution of real data breach include notification, remediation, increased and potentially more stringent regulatory action, and lower company valuation due to decline in reputation.

Achieving Privacy compliance requires an end to end focus on data governance
In reviewing privacy compliance and data governance within an organisation, it’s important to understand the complete lifecycle of the data, its collection, storage, usage, retention and destruction.

In each step, the PII data governance policy and processes that need to be considered include:
• appropriate accesses
• and authorities consistent with the principle of authorised users having the lowest level of access privileges necessary for their role
• appropriate data retention and destruction policies that are aligned with the business need for data to be retained
• appropriate disclosure policies including who the data will be disclosed to and why
• policies to notify the individual and allow for individual-driven changes to their PII data
• executive level accountability for PII protection
• policies to govern cross border movement of data
• internal and third party provider awareness of Privacy policies and processes.
The first step is about assessing the risk

To get started companies should consider a privacy assessment on how they apply the Australian Privacy Principles and adhere to APRA’s Prudential Practice Guide CPG 235 Managing Data Risk.

Key assessment outputs include:

• Cataloguing key applications and unstructured data management systems e.g. email and file stores
• Defining data elements which constitute PII e.g. name + address, or name + birth date, etc
• A matrix of PII data elements to applications and unstructured data
• Identification of Privacy policy gaps
• Identifying gaps in PII data security, protection, retention, and their de-identification and destruction throughout the information lifecycle
• A risk assessment of identified gaps based on the organisation’s risk appetite
• A roadmap for closing high risk gaps.

An ongoing commitment

Ensuring privacy compliance and enabling data governance is not the result of a single improvement effort. As new applications and new business models are adopted, any impact on PII data must be continuously assessed and incorporated into the data governance framework. Data governance is a core business process which needs visibility and ownership from the business if it is to be successful.
Maintaining focus on FATCA while looking to the future

Four years after it was enacted the first FATCA obligation began 1 July 2014. But there is more to do, including aligning the upcoming FACTA changes and the much broader OECD Common Reporting Standard which is on the horizon.

Under the weight of hundreds of pages of notices, regulations and guidance from the U.S. Treasury and the IRS, various intergovernmental agreements, delays and limited detailed local implementation guidance, the first FATCA obligation for on-boarding new individual account holders started 1 July 2014.

The next two FATCA obligations are the on-boarding of new entity account holders and registering required Australian financial institutions with the IRS by 1 January 2015. This is followed by pre-existing account holder due diligence over the next two years, as well as starting to report on U.S. accounts. The timeline below provides a summary of the FATCA deadlines for Australian FIs.

The OECD’s Common Reporting Standard (CRS), endorsed by the G20 in February 2014, and modelled on FATCA, also released detailed commentary and technical information on 21 July 2014. It should be possible to leverage existing and planned FATCA processes and systems to meet the CRS requirements, but, the data required is different. Also the volume of reporting is likely to be significantly greater under the CRS.

Although the Australian government has not yet made any final decisions on implementing CRS - releasing a discussion paper for industry input - many Australian FIs are considering the impact of CRS, anticipating implementation, and so contributing to the consultation process.

Australian FIs can look to the future and consider what might be required for the CRS and whether changes for CRS can be built into changes for FATCA, as extending FATCA projects, rather than establishing a new project, should minimise costs and leverage resources and knowledge.

The opportunity for Australian FIs is to limit their costs by leveraging the information and resources involved in FATCA projects and align them with the changes necessary for CRS and other customer data-related regulatory changes like AML and the CDD rules.

Significant FATCA progress, Australian IGA signed and more...

Signing the Australian IGA on 28 April 2014, and the subsequent legislation, were key FATCA developments for Australian FIs which are now required to comply, unless exempt or deemed to comply with all or part of FATCA.

The anticipated exemption for superannuation funds is set out in Annex II of the IGA. For many other FIs, the decision to apply a deemed compliant classification or choose to be a reporting FI involves practical, as well as technical considerations, including achieving and monitoring compliance for deemed compliant status vs the expected number of reportable accounts.

The ATO released draft FATCA guidance in late June, and revised final guidance on 11 September which expands on the previous version by providing new sections, examples and clarifications.

Other FATCA developments in the last six months include:
- The start date for entity on-boarding is delayed to 1 January 2015, but the de minimis threshold for due diligence on pre-existing entity accounts is unavailable for accounts opened between 1 July and 31 December 2014, so FIs can elect whether or not to apply the delay
- Some U.S. forms and instructions have been released including W8-BEN-E, though many instructions are yet to come
- Regulations have been made to amend, coordinate and correct the U.S. regulations
- A number of jurisdictions that have substantially agreed an IGA are treated by the U.S. as having an IGA “in effect”, although the IGA is yet to be signed
- The IRS now publishes the list of registered FFIs each month. June’s list had more than 77,000 registered FFIs, including 1,865 Australian FIs.

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- The IRS now publishes the list of registered FFIs each month. June’s list had more than 77,000 registered FFIs, including 1,865 Australian FIs.
Don’t stop now … a number of actions still required for FATCA implementation

Australian FIs should:

• Monitor onboarding of new individual accounts and clarifications provided in the ATO guidance as it is refined and finalised

• Complete entity classifications and submit registrations with the IRS for reporting FIs by October or November to ensure that the registration is approved and the global intermediary identification number (GIIN) is issued before the 1 January 2015 deadline

• Implement entity on-boarding, maximising the additional time provided by the delay to deal with the complexities of entity on-boarding and consider aligning with the AML CDD rules

• Identify new entity accounts opened between 1 July - 31 December 2014

• If you elect to delay on-boarding ensure the de minimis test is not applied when due diligence is undertaken

• Understand how to complete questionnaires and forms received from other FIs e.g. a deemed compliant FI under Annex II of the Australian IGA should tick the box for a non-reporting model 1 FFI, not the box for registered deemed compliant FFI, and complete Part XII on the W8-BEN-E form. These forms or questionnaires can be complex and parts of the forms may require an understanding of U.S. tax law, as well as FATCA

• Consider having forms reviewed before they are submitted to avoid penalties

• Monitor the ATO guidance to understand the reporting requirements and mechanisms

• Begin due diligence on pre-existing accounts

• Identify and capture data to be reported and to which taxing authority it will be provided

• Build FATCA into business-as-usual policies, processes and procedures such as new entity checklists, documentation for new products.

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<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
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<tbody>
<tr>
<td>1 July 2014</td>
<td>FATCA compliant onboarding of new individual account holders to be operational</td>
</tr>
<tr>
<td>1 January 2015</td>
<td>Reporting FIs to be registered with the IRS</td>
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<tr>
<td>30 June 2015</td>
<td>Due diligence to be completed on high value individual accounts held as at 30 June 2014</td>
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<tr>
<td>31 July 2015</td>
<td>Report to be lodged with the ATO for period ending 31 December 2014 (account and balance information)</td>
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<tr>
<td>30 June 2016</td>
<td>Due diligence to be completed on all other accounts held as at 30 June 2014 and on entity accounts opened between 1 July 2014 - 31 December 2014</td>
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<tr>
<td>31 July 2016</td>
<td>Report to be lodged with the ATO for calendar year ending 31 December 2015 (account and balance information, plus income)</td>
</tr>
<tr>
<td>31 July 2017</td>
<td>Report to be lodged with the ATO for calendar year ending 31 December 2016 (account and balance information, income and gross proceeds)</td>
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The IASB issued the final version of IFRS 9 on 24 June 2014, completing its project to improve accounting for financial instruments and replace IAS 39. Although effective annually from 1 January 2018, entities can apply it earlier.

The standard introduces new business model and cash-flow characteristics’ tests to determine whether the financial asset can be carried at amortised cost. This may well impact the way the assets are measured, as well as recognition of related transaction costs. The standard also provides some one-off opportunities, e.g. to revoke FVTPL classification retrospectively and to apply ‘own credit through OCI’ early in isolation.

In addition to the changed recognition requirements, the impairment requirements of IFRS 9 will also change the presentation of interest income - Stage 3 effective yield recognised on net carrying amount after loan losses are deducted.

The new requirements of the hedge accounting part of IFRS 9 allow for a number of changes in the micro or general hedge accounting rules, with the aim to align more closely to the organisation’s actual risk management strategy and objectives. Macro fair value hedge accounting has been scoped out of IFRS 9 into a separate project. And while there are many positive changes proposed - improved treatment of option time value and hedging of synthetic exposures - the Deloitte survey found that 64% of banks have not yet decided to adopt this part of IFRS 9 as these macro fair value hedge accounting rules are still a work in progress.

Credit & pricing
It is likely that the calculations of expected losses will rely heavily on the models and systems used by credit risk management. However, there will be a number of accounting requirements that may differ from credit risk management and estimating credit losses for regulatory purposes.

Also, it is likely that the need to estimate lifetime losses will increase the level of estimation and entail subjective and complex estimates and judgements. The availability of historical loss/credit rating data and how to overlay future economic expectations may also be significant.

Capital
It will be interesting to see how the accounting loan loss provisions compare to those under Basel II and III. In Australia, any shortfall between accounting and regulatory provisions is reflected as a specific equity reserve, General Reserve for Credit Losses (GRCR). While there is an expectation that IFRS 9 will reduce the gap between regulatory and accounting provisions,
some European banks actually expect that accounting provisions will be higher than the Internal Ratings Based (IRB) regulatory provisions.

Clearly, there will be some region-specific impacts arising from the current recognition practices adopted including the length of emergence period for IBNR (incurred but not reported) losses under IAS 39. Also, it is important to remember that regulatory provisions try to cover for unexpected losses, such as prudent estimates, that are not aligned with the accounting rules.

Lastly, the capital impact of IFRS 9 adoption may depend on when in the economic cycle the entity adopts the new standard. In other words, the difference between incurred and expected losses will be different at the peak of economic expansion compared to the bottom of the cycle.

**Operations, Data & IT**

Clearly, the new standard will require assessment and the possible revision of existing IT systems. Banks should consider whether their legacy systems are capable of catering to the new requirements or whether there is an investment required either to upgrade or build completely new infrastructure.

Some entities may consider a long-term strategic build in parallel with shorter term tactical solutions to minimise the implementation risk. Various models of internal development, as well as a combination of external providers and co-sourced arrangements, are emerging.

**Immediate steps to take**

It is time to raise awareness of the changes and their potential impact to all relevant stakeholders and decision makers within the entity. This should incorporate an initial assessment of benefits and related costs of early adoption, as well as the design of the implementation road map to the initial application period. Given the footprint of IFRS 9 across the bank and three years to implement, it is time to act.
Key Regulatory Timeline

ASX - Corporate Governance Principle 7
Recognise and manage risk (third edition update), effective from March 2014

ASIC - FoFA
Corporations amendments for streamlining FoFA regulation 2014 on 1 July 2014

FATCA
Compliant onboarding of new individual account holders to be operational 1 July 2014

UK Client Money
Rules and arrangements for client money in new unbreakable term deposits, and options for multiple client one pools 1 July 2014

ASIC - FoFA corporations amendments for streamlining FoFA regulation 2014 on 1 July 2014

FATCA
Compliant onboarding of new individual account holders to be operational 1 July 2014

UK Client Money
Rules and arrangements for client money in new unbreakable term deposits, and options for multiple client one pools 1 July 2014

ASIC - CP 221 OTC derivatives reform
Proposed amendments to the ASIC Derivative Transaction Rules (Reporting) 2013. Final derivative transaction rules due to be released late 2014

Dodd Frank
Full compliance required for Swap Dealers and Major Swap Participants 1 September 2014

Basel III
Liquidity Coverage Ratio - APS 210 1 January 2015

FATCA
Reporting Fs to be registered with the IRS (see FATCA article) 1 January 2015

APRA
CPS 220 Risk Management / CPS 510 Governance 1 January 2015

AML/CTF III Rules
Committed on 1 June 2014

Murray Final Report
November 2014

FATCA
See page 22 30 June & 31 July 2015

UK Client Money
Notification rules and guidance for new client and counterparties re-deposit, custody assets or client money 1 December 2014

AML/CTF III Rules
Transition plan by 1 November 2014

UK Client Money
All of the remaining rules and guidance to be implemented 1 June 2015

Privacy
Privacy Amendment (Enhancing Privacy Protection) Act 2012 commenced 12 March 2014

APRA Level 3 Conglomerate Reforms
(TBC late 2015, subject to APRA finalisation and implementation period – ABA asked for 12mths)

AML/CTF III Rules
Committed on 1 June 2016

FATCA
See page 22 30 June & 31 July 2016
**MiFID II**
Final implementation **expected by end of 2016/ January 2017**

**IFRS 9**
‘Financial Instruments’ (effective for annual reporting periods beginning **on or after 1 January 2018**)

**Basel III**
Net Stable Funding Ratio planned for **1 January 2018**
(Basel Committee still deliberating on details)

**FATCA**
see page 22
30 June & 31 July 2016
31 July 2017
ASX Corporate Governance Principle 7

Good corporate governance is essential for efficient capital markets and investor confidence. The ASX Corporate Governance Council’s Corporate Governance Principles and Recommendations set the benchmark for good corporate governance practices in Australia.

The recommendations on risk (Recommendations 7.1 – 7.4) have been substantially enhanced to reflect the lessons of the Global Financial Crisis and other developments. This encourages all listed entities to review the revised risk recommendations carefully and to consider whether they need to enhance their corporate governance practices.

The original ASX Corporate Governance Council Principles and Recommendations were introduced in 2003 with subsequent revisions in 2007 and 2010. The events around the GFC triggered a number of jurisdictions to adopt new legislation to tighten their corporate governance codes.

The Australia Stock Exchange undertook a comprehensive review and consultation process, and released the third edition of the principles and recommendations on 27 March 2014, which took effect for a listed entity’s first full financial year commencing on or after 1 July 2014.

Key Changes to Principle 7 Recommendations from 2nd Edition to 3rd Edition

Recommendation 7.1 and 7.3 now allow listed entities to adopt and report alternative practices in corporate governance.

This recognises that the individual circumstances of the listed entity may warrant establishing a Board level committee to oversee risk and the internal audit function. A larger number of listed entities can now report that they have complied with these recommendations, rather than report why they did not comply.

Recommendation 7.2 advocates that the Board, or its committee, should review the entity’s risk management framework at least annually to satisfy itself of its effectiveness.

Recommendation 7.3 (CEO/CFO certification of financial statements) from the 2nd edition has been upgraded and moved to recommendation 4.2 in the 3rd edition. The revised recommendation 4.2 now states that before the Board of a listed entity approves the entity’s financial statements for a financial period, it should receive a declaration from the CEO and CFO that the financial records of the entity have been properly maintained, and that the financial statements comply with the appropriate accounting standards. The financial statements should also give a true and fair view of the financial position and performance of the entity and that, in the opinion of the CEO and CFO, the statements have been formed on the basis of a sound system of risk management and effective internal control. Unlike recommendation 7.3 in the second edition, this will apply to financial statements for any reporting period, including half yearly and quarterly, not just year-end financials.

New Recommendation 7.4 increases the focus on economic, environmental and social sustainability risks. This recommendation is in response to the increasing focus by investors, and the broader community, on economic, environmental and social issues, and the risks they pose to a listed entity’s ability to create or preserve value. It is modified from Principle 3 from the second edition – ‘act ethically and responsibly’.

Recommendation 7.4 also enhances the language in Principle 3: Act ethically and responsibly

It includes being, and being seen to be a ‘good corporate citizen’, for example, by respecting human rights of employees, creating a safe workplace, dealing honestly and fairly with customers and suppliers, acting responsibly towards the environment and only dealing with others who have similar ethical and responsible practices. It reinforces the increasing importance of sustainability to listed entities as they operate in a complex world with multiple stakeholders.

Key actions to consider

The purpose of reporting under Principle 7 is to provide meaningful information to investors about the entity’s risk management framework. Stakeholders expect companies to provide evidence of effective management, regarding financial risks as well as other non-financial material business risks.

Consistent with open disclosure and an ‘if not, why not?’ regime, the principles do not prescribe the content, format or style of the public disclosures required under Principle 7. They are not ‘boilerplate’ but are designed to determine a genuine insight into the risk management processes and management of material business risks within the company.

For listed entities in the financial services industry, it is also important to know that APRA and ASIC’s regulatory expectations are being harmonised across the financial service sector.

The cornerstone of Prudential Standards CPS 210 (Risk Management) and CPS 510 (Governance) is that the role and responsibility of the Board and Executive in ensuring a healthy risk management framework and their specific components are embedded in day to day business decision making.

The following 10 questions are a useful guide when putting better practices for a sound risk management framework in place. Deloitte and the Group of 100 have developed a Better Practice Guide with useful local and global concepts and ideas for implementing or reviewing the effectiveness of your risk management framework.

1. **Consideration of risks that can destroy shareholder value**: What are the potential risks that can destroy shareholder value for listed entities?

2. **Emerging internal and external risk sources**: How can the Board of a listed entity identify the main internal and external risk sources that could adversely affect the entity’s prospects in the future?

3. **Deriving value from risk management**: How can good risk management practices help to protect established value, and assist in identifying and capitalising on opportunities to create value?

4. **Establishing and embedding risk appetite**: How can the Board becoming actively involved in setting the risk appetite for the entity and embedding it in the company?

5. **Risk disclosures to investors**: How can an entity provide ‘sufficient information on how it is recognising and managing risk’ to its investors, so it helps them to understand and assess their investment risks?

6. **Committee to oversee risks**: How can a Board determine if it should or should not establish a risk committee to oversee the entity’s risk management framework? What is the role and charter of the risk committees?

7. **Reviewing risk frameworks**: How should Boards review and assess their risk management framework to satisfy themselves that it is sound?

8. **Internal audit structure**: What is the right role and structure for internal audit in recognising and managing risk and how is this linked to risk management?

9. **Sustainability risks – a new requirement**: How can a listed entity assess the material sustainability risk and exposures and determine if the assessment process is captured effectively within the existing risk management framework?

10. **Declarations**: What is appropriate wording for the CEO and CFO declaration? What certification should the CEO / CFO perform before completing this declaration?
APRA Update

ADIs

APRA proposes simplified prudential framework for securitisation
On 29 April 2014, APRA released a discussion on its proposals to simplify the financing technique for ADIs for better transparency and understanding.

APRA’s proposed approach to securitisation includes the following:
- A set of key principles that apply to securitisation, rather than an expanded set of prudential requirements
- A simple two credit class structure, which reduces the likelihood of opaque risk transfer and enhances benefits for system stability
- A simple ‘skin-in-the-game’ requirement to mitigate agency risks
- Explicit recognition of funding-only securitisation, with a simple but robust prudential regime that also allows for revolving securitisations or master trusts
- Simpler requirements for capital relief, matching risk to the amount of regulatory capital held
- Better integration of securitisation with the ADI liquidity regime
- Clarification of the treatment of warehouses and similar structures.

APRA intends to release a second consultation package in 2015, after the completion of the Financial System Inquiry, which would include APRA’s response to submissions, as well as draft prudential standards, a prudential practice guide and associated reporting requirements.

APRA releases draft prudential practice guide on residential mortgage lending
On 26 May 2014, APRA released a draft Prudential Practice Guide on Residential Mortgage Lending, a proposed guideline to ADIs on sound risk management practices for residential mortgage lending.

The draft Prudential Practice Guide 223 Residential Mortgage Lending outlines prudent practice in addressing housing credit risk within an ADI’s risk management framework, in applying sound loan origination criteria and appropriate security valuation methods, in the management of hardship loans and in establishing a robust stress-testing framework.

APRA improve capital-raising options for mutual ADIs
On 15 April 2014, APRA released an amended Prudential Standard APS 111 Capital Adequacy: Measurement of Capital (APS 111), which provides additional capital-rising options for mutually owned ADIs.

In October 2013, APRA proposed to allow mutual ADIs to issue Additional Tier 1 or Tier 2 Capital instruments that could, if the relevant conversion provisions were triggered, convert to ‘mutual equity interests’ in the issuing ADI. On conversion, mutual equity interests would be included as Common Equity Tier 1 (CET1) Capital for capital adequacy purposes. Subsequent feedback from industry was supportive of APRA’s proposals.

Accordingly, APRA has amended APS 111 to effect this change.

APRA welcomes assessment of the Basel Capital framework in Australia
On 18 March 2014, APRA released the report published by the Basel Committee on Banking Supervision (Basel Committee) outlining its findings from its assessment of the implementation of the Basel capital framework in Australia. The Basel Committee found that Australia’s capital framework for ASDIs was ‘compliant’ and in line with the Basel capital framework.

APRA releases harmonised standard and proposed guidance on risk management
On 31 January 2014, APRA released a package that harmonises and enhances its current risk management requirements. The package includes the final cross-industry Prudential Standard CPS 220 Risk Management (CPS 220), a proposed prudential practice guide on risk management, and a response paper that addresses submissions received by APRA on the CPS 220 consultation package released in May 2013. In addition, APRA released an amended Prudential Standard CPS 510 Governance (CPS 510) to ensure that governance requirements related to risk management are aligned with those of CPS 220.
CPS 220 applies to ADIs, general insurers, life insurers and single industry groups (Level 2 groups). The prudential standard will also apply to conglomerate groups (Level 3 groups) that APRA intends to determine by 1 January 2015. The prudential standard ensures the consistent application of APRA’s risk management requirements across its regulated industries and reflects its heightened expectations in this area.

The final CPS 220 consolidates existing risk management standards for insurers and includes some risk management requirements for ADIs that are currently spread across a number of ADI prudential standards. The prudential standard comes into effect from 1 January 2015. CPS 220 will not apply in superannuation; Registerable Superannuation Entity (RSE) licensees must comply with the superannuation-specific risk management standard that came into effect on 1 July 2013.

References

APRA proposes simplified prudential framework for securitisation
(http://www.apra.gov.au/MediaReleases/Pages/14_09.aspx)

APRA releases draft prudential practice guide on residential mortgage lending
(http://www.apra.gov.au/MediaReleases/Pages/14_11.aspx)

APRA improve capital-raising options for mutual ADIs
(http://www.apra.gov.au/MediaReleases/Pages/14_08.aspx)

APRA welcomes assessment of the Basel Capital framework in Australia
(http://www.apra.gov.au/MediaReleases/Pages/14_07.aspx)

APRA releases harmonised standard and proposed guidance on risk management
(http://www.apra.gov.au/MediaReleases/Pages/14_04.aspx)
ASIC Update

Consumer Protection

Statement on wholesale and retail investors and SMSFs
On 8 August 2014, ASIC clarified the application of the wholesale investor test to Self-Managed Superannuation Funds.

The revised approach notes that ASIC will not take action if the person providing the advice determines whether the trustee is a wholesale client based on the general test of whether the trustee has net assets of at least $2.5 million, rather than applying the higher $10 million net asset test to the whole SMSF as outlined in ASIC’s article issued in 2004, ‘QFS150 of the Corporations Act 2001 When financial services are provided to a trustee of a superannuation fund, are they provided to a retail client?’

New regulation of financial advisers providing tax advice
From 1 July 2014, the Tax Practitioners Board (TPB) will regulate financial advisers that provide tax (financial) advice services under the Tax Agent Services Act 2009 (TASA). Until 1 July 2014 financial advisers were exempt from the TASA regime.

Financial advisers will continue to be licensed (or authorised under an Australian financial services licensee) by ASIC and adviser obligations under the Corporations Act 2001 (Corporations Act) remain unchanged.

Until 31 December 2015, AFS licensees and their authorised representatives that provide a tax (financial) service can either:
- notify the TPB to become registered as a tax (financial) adviser
- use a relevant disclaimer when they provide tax (financial) advice services for a fee or other reward.

ASIC statement on Senate Economics Committee report
The final Senate Economics Reference Committee’s report into the performance of ASIC was released on 26 June 2014.

The report recommended the following improvements in ASIC procedures including:
- handling of whistleblowers
- increased transparency of processes
- mechanisms to identify emerging risks
- ensuring enforceable undertakings deliver good results for consumers.

ASIC releases information sheet on super fee and cost disclosure and defers section 29QC
On 17 June 2014, ASIC released an information sheet on fee and cost disclosure requirements for superannuation trustees. The requirements are part of the Government’s Stronger Super reforms which started 1 July 2014, and must be met for both superannuation products and managed investment schemes.

Information Sheet 197 Fee and cost disclosure requirements for superannuation trustees (INFO 197) clarifies ASIC’s expectations on the calculation of indirect costs and how performance and advice fees should be disclosed. As part of the disclosure requirements, the consumer warning that states, ‘Your employer may be able to negotiate to pay lower administration fees’ must be included in superannuation products’ PDSs. Issuers of managed investment products do not need to include the statement in their PDSs.

Further by class order [CO 14/541] ASIC deferred the operation of section 29QC of the Superannuation Industry (Supervision) Act 1993 until 1 July 2015.

Section 29QC states a super trustee must use the same calculation when providing information to a person or on a website as it does when giving the same or equivalent information to APRA under a reporting standard.

ASIC guidance for disclosure on superannuation websites
On 16 June 2014, ASIC released guidance on information in relation to superannuation funds and their trustees, that is required to be disclosed on the fund’s websites.

The requirement is part of the Government’s Stronger Super reforms which started 1 July 2014. Superannuation funds must also actively publish the details of their executives, including remuneration, and fund product disclosure statements, governing rules, actuarial reports and summaries of significant events that have occurred over the past two years.

The law requires this information to be kept up to date at all times.

Regulatory Guide 252 Keeping superannuation websites up to date (RG 252) states that a website will be viewed as being up to date if the information is updated within 20 business days of release. For information on remuneration, a website needs to be updated within four months. These time frames are referred to as a ‘safe harbour’, which means that superannuation companies
will be viewed as complying with the law if they update their websites within them.

ASIC reports on decisions to cut red tape
On 26 May 2014, ASIC released Report 395 Overview of decisions on relief applications (October 2013 to January 2014) (REP 395), which summarised examples of situations for the 565 relief applications received between October 2013 to January 2014, where ASIC exercised, or refused to exercise, its exemption and modification powers under the following Acts:

- Corporations Act 2001 (Corporations Act)
- National Consumer Credit Protection Act 2009 (National Credit Act)

The report also highlights instances where ASIC considered adopting a no-action position regarding specified non-compliance with statutory provisions.

ASIC reviews MySuper product dashboards
On 22 May 2014, ASIC issued further guidance to superannuation trustees about their obligation to produce a product dashboard for MySuper products, following a review of existing MySuper product dashboards.

ASIC reviewed a number of MySuper product dashboards across the superannuation industry to ensure they provide useful and accessible information to members. The reviews were based on the product dashboard requirements and measures set out in ASIC Information Sheet 170 MySuper product dashboard requirements for superannuation trustees (INFO 170).

In particular, ASIC expects trustees to:

- Show the product dashboard in a prominent position and readily accessible location on the trustee’s website. This requirement is not met if several pages have to be navigated through, or a site ‘searched’, to view the product dashboard, or the product dashboard is otherwise difficult to find. The product dashboard should be able to be seen readily by a user of the website that has no prior knowledge of the concept of the product dashboard.

- Not include information within the parameters of the product dashboard that is not required by the product dashboard mandatory provisions. This is distinct from the additional information being outside and proximate to the product dashboard. The inclusion of optional information, such as asset allocation information, within the product dashboard has the potential to compromise the ability of users to compare across multiple (non-uniform) product dashboards. It may also serve to confuse users of the product dashboard.

- Address all of the mandatory elements. Some trustees have omitted the past returns and return target-past return comparison from the product dashboard where there is no predecessor product. In this situation, our preferred approach is for the trustee to include all elements with an accompanying explanation to the effect that no past return information is available because the MySuper product has not been in existence for a full financial year and there was no predecessor product.

- Address each of the mandatory elements separately. For example, past return percentages should not be shown in the return target-past returns comparison graph.

Trustees may include additional information outside the product dashboard to assist users. Additional information may include the use of graphs, asset allocation charts, investment risk measures and a glossary of terms for example. In reviewing MySuper product dashboards, we observed that the additional information provided outside the parameters of the product dashboard, but in close proximity, was in most instances helpful to a user in understanding the mandatory elements of the product dashboard. The overall impression formed from the mandatory elements and the optional disclosure around the product dashboard, should not be confusing, otherwise the trustee may be engaging in misleading or deceptive conduct.

Trustees are reminded that it is an offence for a trustee to fail to publish a product dashboard, or to publish a product dashboard that is out of date, omits required information, or is otherwise misleading or deceptive.
ASIC extends shorter PDS regime

On 10 February, ASIC extended interim class order relief from the shorter Product Disclosure Statement (PDS) regime for multi-funds, superannuation platforms and hedge funds.

Previously ASIC issued guidance to assist issuers of superannuation products and simple managed investment schemes to comply with the shorter PDS regime under Class Order [CO 12/749] that commenced on 22 June 2012.

Class Order [CO 14/23] extends the relief in Class Order [CO 12/749] Relief from the Shorter PDS regime for a further 12 months, to 30 June 2015.

The relief was due to expire on 22 June 2014.

The full PDS requirements under the Corporations Act 2001 apply to products that have been excluded from the shorter PDS regime.

ASIC has extended the relief pending a future Australian Government decision on the application of the shorter PDS regime to superannuation platforms, multi-funds and hedge funds.

Class Order [CO 12/749] excluding:
• Superannuation platforms from the shorter PDS regime. However, superannuation platforms may elect to be included in the shorter PDS regime
• Multi-funds from the shorter PDS regime. However, multi-funds may elect to be included in the shorter PDS regime
• Hedge funds from the shorter PDS regime.

Hot off the press
ASIC announces a review of breach reporting - September 2014
ASIC consults on technical changes to trade reporting obligations for OTC derivatives

On 25 July 2014, ASIC released and sought feedback on Consultation Paper 221 OTC derivatives reform: Proposed amendments to the ASIC Derivative Transaction Rules (Reporting) 2013 (CP 221) which proposed the following changes governing the reporting of OTC derivative transactions to derivative trade repositories:

- Various technical changes to the rules, designed to make the reporting regime more effective and easier to comply with
- Clarifying the rules around delegated reporting to provide a ‘safe harbour’ from liability if certain conditions are met
- Requiring certain larger overseas subsidiaries of Australian financial entities to report transactions.

ASIC facilitates internet securities offers

On 3 March 2014, ASIC updated its guidance on compliance requirements to facilitate and encourage the use of the internet and other interactive media for making offers of securities.

The updated Regulatory Guide 107 Fundraising: Facilitating electronic offers of securities (RG 107) aims to ensure that ASIC’s guidance reflects current market practices and advances in technology.

ASIC recognises that there are many advantages to using the internet and other electronic means to distribute disclosure documents and application forms, which can make information easier to access, read and understand for investors.

The updated guidance includes:

- An explanation of ASIC’s view on the way the internet and other electronic means can be used in making offers of securities
- A ‘good practice guide’ to assist providers, distributors, publishers and other parties involved in distributing offers
- Continuation of relief for the use of personalised or Australian financial services (AFS) licensee created application forms.

As part of the update, ASIC confirms its view that the use of electronic disclosure documents is permitted under the law. Class Order [CO 00/44] Electronic disclosure documents, electronic application forms and dealer personalised applications has accordingly been revoked. ASIC has issued a new class order [CO 14/26] to continue relief for the use of personalised or AFS licensee created application forms.

ASIC proposals to facilitate foreign companies offering securities

On 28 May 2014, ASIC released a consultation paper proposing class order relief and guidance to help foreign companies offer CHESS Depositary Interests (CDIs) over their shares to investors in Australia.

The proposals include:

- Confirming initial offers by foreign companies to investors should be made under a prospectus
- Clarifying in a class order that foreign companies, and not the depositary nominee that provides the CDIs, are responsible for providing disclosure to retail investors for offers of CDIs
- Modifying the Corporations Act so that the fundraising disclosure provisions operate effectively for offers of CDIs over shares in foreign companies
- Guidance to help foreign companies comply with the fundraising disclosure requirements and to provide effective disclosure to retail investors for offers of CDIs.
ASIC provides interim relief on key management personnel equity instrument disclosures

On 1 July 2014, ASIC announced the release of a new Class Order [CO 14/632] Key management personnel equity instrument disclosures, to assist in the preparation of directors’ reports for financial years ending on or before 30 September 2014.

The class order was issued to address drafting anomalies in key management personnel disclosure requirements that were moved from accounting standard AASB 124 Related Party Disclosures (AASB 124) into the Corporations Regulations for financial years starting on or after 1 July 2013. The relevant disclosures relate to:

• Equity instruments held by members of key management personnel or their close family members
• Certain transactions involving equity instruments between the disclosing entity and members of key management personnel or their close family members
• Options or rights over equity instruments held by key management personnel or their close family members.

ASIC’s relief means that disclosures only need to be about equity instruments in the disclosing entity or its subsidiaries rather than every company in which they invest.

Findings from 31 December 2013 financial reports

The results from a review of the 31 December 2013 financial reports of 135 listed and other public interest entities were announced by ASIC on 27 June 2014.

Inquiries made by ASIC in relation to these 135 reports relate to the following matters:

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<th>Matter</th>
<th>Number of inquiries</th>
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<tr>
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<td>7</td>
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<td>Consolidation of other entities</td>
<td>5</td>
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<td>Amortisation of intangibles</td>
<td>4</td>
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<tr>
<td>Operating and financial review</td>
<td>3</td>
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<td>Joint arrangements</td>
<td>3</td>
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<td>Segment reporting</td>
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<td>Expense deferral</td>
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<td>Current classification of assets</td>
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<td>Business combination accounting</td>
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<tr>
<td>Other matters</td>
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<td><strong>Total</strong></td>
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ASIC’s audit inspection findings for 2012-13

On 27 June, ASIC released the results of its risk-based inspections of audit firms for the 18 months to 31 December 2013.

In 20% of the total 454 key audit areas that ASIC reviewed across 107 audit files at firms of different sizes, auditors did not obtain reasonable assurance that the financial report as a whole was free of material misstatement. This compares to 18% for ASIC’s report covering the previous 18-month period ending in June 2012.

ASIC inspections suggest that the following three broad areas continue to require improvement by audit firms:

• The sufficiency and appropriateness of audit evidence obtained by the auditor
• The level of professional scepticism exercised by auditors
• Ensuring appropriate reliance on the work of experts and other auditors.
Foci for 30 June 2014 financial reports
On 30 May 2014, ASIC announced its areas of focus for 30 June 2014 financial reports of listed entities and other entities of public interest with a large number and wide range of stakeholders.

ASIC focus is on key areas of impairment and accounting policy choices.

• **For impairment**, ASIC continues to find impairment calculations that use unrealistic cash flows and assumptions, including cases where entities have made unrealistic forecasts that have not been met over several reporting periods. ASIC also continue to find material mismatches between the cash flows used, and the assets being tested for impairment.

• **When deciding on accounting policy choices**, preparers and auditors should focus on the appropriateness of the accounting policy as it may significantly affect reported results. These include revenue recognition, expensing of costs that should not be included in asset values, and the impact of new requirements for consolidations and joint arrangements.

ASIC publishes seventh market supervision report
Report 386 *ASIC supervision of markets and participants: July to December 2013 (REP 386)*, released on 19 March 2014, highlights the volume of market and participant-related outcomes achieved by ASIC in the second half of 2013.

Key outcomes of REP 386 included:
• 19,255 trading alerts produced
• 102 market inquiries conducted
• 31 matters referred for further investigation
• 16 risk-based assessment visits conducted
• 73 surveillances completed
• 26 instances of pre-emptive supervision action
• Seven enforcement outcomes for insider trading offences
• Seven infringement notices issued by the Markets Disciplinary Panel.

ASIC information sheet on audit quality
Information Sheet 196 *Audit Quality: The Role of Directors and Audit Committees (INFO 196)*, released by ASIC on 17 March 2014, is to help directors and audit committees develop robust standards as part of their commitment to improve audit quality.

INFO 196 explains:
• Why audit quality is important
• The responsibilities of the auditor
• The roles of directors and audit committees
• The responsibilities of directors for auditor independence
• Who should manage the appointment of auditors
• What matters should be considered in setting audit fees
• What directors and audit committees can do to promote audit quality.

INFO 196 suggests directors and audit committees consider:
• Non-executive directors recommending auditor appointments and setting audit fees
• Assessing the commitment of the auditors to audit quality
• Reviewing the resources devoted to the audit, including the amount of partner time and the use of experts
• Accountability within the audit firm for quality
• Support by company management for the audit process
• Two-way communication with the auditor on concerns and risk areas
• Ensuring independence of the auditor
• Reviewing audit firm responses to findings from ASIC audit inspections.
ASIC updates hybrid information for investors

On 4 February 2014, ASIC updated information on its consumer finance website, MoneySmart, to help investors understand the risks and complexities of hybrid securities. ASIC has also developed a quiz for investors to help them comprehend the terms of these offers and encourage them to be fully informed before they invest.

ASIC’s focus on these complex products follows a rise in their popularity – in the 18 months to July last year, around $18 billion was raised through ASX-listed hybrid securities.

The updated information on ASIC’s MoneySmart website is to:

• Help investors comprehend the terms of these offers and encourage them to be fully informed before they invest
• Explain the differences between hybrids issued by banks and hybrids offered by other companies
• Highlight the features and risks of these securities and includes information on the new ‘non-viability’ clauses found in recent bank hybrids
• Compare the typical features of two forms of hybrid security - a capital note issued by a bank and a subordinated note issued by a company - to shares, corporate bonds and bank term deposits, to identify the additional risks investors may be taking on
• Break down the common terms found in hybrid prospectuses, so readers can understand what ‘interest deferral’ or ‘loss absorption’ could really mean for them. Case studies are used to demonstrate how these terms operate in practice.
The G20’s regulatory reform agenda is vitally important to underpinning a resilient global financial market that efficiently allocates capital and risk in the name of economic growth. Where reforms are not appropriately calibrated to achieve this, they should be adjusted. Any uncoordinated domestic reform implementations risk fragmenting the global market\textsuperscript{6} which, in the name of economic growth, also need to be prevented.

Earlier this year, the Chairman of the Financial Stability Board wrote to G20 Finance Ministers and Central Bank Governors about the progress and challenges of implementing the G20’s reform agenda on financial regulation.\textsuperscript{7} In his letter, Chairman Carney set out FSB two recommendations (among others).

1. The FSB recommends that the G20 commit to an approach of post facto impact assessments to refine standards ‘when we get them wrong’\textsuperscript{8}

2. The FSB recommends ‘enhanced co-operation to avoid domestic measures that fragment the global system.’\textsuperscript{9}

This would include “…assessment of whether there are any spillovers of national regulatory policy initiatives that could be harmful to the objective of an open, integrated system’.\textsuperscript{10}

These are laudable recommendations and we suggest they can be enhanced in two ways. Both involve the G20 committing to the use of \textit{ex ante} regulatory impact assessments.

1. The G20 should commit to the FSB and the standard setting bodies (SSBs)\textsuperscript{11} following the type of \textit{ex ante} regulatory impact assessment processes recommended by the OECD for domestic regulatory processes\textsuperscript{12} during the development of any new international standards. This could be expected to increase the quality of the FSB’s and SSBs’ regulatory standards and their public accountability. Such a commitment would build on the FSB’s recommendation for impact assessments of reforms \textit{after} they have been implemented.

2. Each G20 member should commit to using domestic \textit{ex ante} regulatory impact assessments to consider the costs and benefits associated with the application of its domestic financial regulation to non-domestic entities.\textsuperscript{13}

This would aid domestic agencies understand the extra-territorial impact of their proposals, particularly when extra-territorial costs add to the costs imposed by the domestic regulation of other nations. This would give G20 members an additional process to assess and avoid spillovers of national regulation that harm an open, integrated system.

\textit{Ex ante} regulatory impact assessment covers a variety of techniques. As explained below, the OECD has recommended that it involve \textit{ex ante} cost-benefit analysis that is applied to a range of policy options, including the option of doing nothing.\textsuperscript{14} This analysis should be performed as early as possible in the policy making process and made available for comment. Such analysis should allow the policy option that delivers the greatest expected net societal benefit to be adopted.

Both of this note’s suggestions concerning regulatory assessments represent enhancements of current international and domestic practices.

At the international level, the FSB and SSBs have used only limited forms of regulatory impact assessments in developing standards, if at all. But even these limited forms have not been \textit{ex ante} assessments of the type recommended by the OECD. At the domestic level, existing regulatory impact assessments may take into some international factors, such as a proposal’s impact on international trade, but there does not appear to be the consistent consideration of extra-territorial costs and benefits.
This article has four parts.
1. The first explains the elements of the OECD’s recommended regulatory impact assessments
2. The second sets out existing impact assessment practices of the FSB and SSBs
3. The third briefly highlights how domestic impact assessments have incorporated consideration of international factors
4. The fourth explains the two suggestions above and provides some thoughts on how the G20 and its members could incorporate them in its processes.

1. What is regulatory impact assessment?

In 2012, the OECD Council on Regulatory Policy and Governance recommended that OECD members incorporate regulatory impact assessments into the ‘…early stages of the policy process for the formulation of new regulatory proposals’. Key points from the OECD Council’s 4th recommendation help us understand what good regulatory impact assessments would involve. Directed at OECD members, these include:

• Members should ‘…adopt ex ante impact assessment practices that specifically include benefit cost analyses that consider the welfare impacts of regulation taking into account economic, social and environmental impacts including the distributional effects over time, identifying who is likely to benefit and who is likely to bear costs’

• The assessments should identify ‘specific policy’ needs and the objective of the regulation

• The assessment should consider alternative ways of meeting the policy objectives. Importantly, ‘(e)x ante assessment should in most cases identify approaches likely to deliver the greatest net benefit to society, including complementary approaches such as through a combination of regulation, education and voluntary standards’

• The assessment of proposals with significant impacts should include quantification of costs, benefits and risk wherever possible. Where quantification is difficult or impossible, the assessments should provide qualitative descriptions of the impacts

• The analysis should ‘as far as possible be made publicly available along with regulatory proposals.’ It should be included as part of the consultation process.

While these recommendations are directed at domestic processes, they are transferable to the policy development processes within the FSB and SSBs.

Recommendation 12 from the OECD builds on the above points by highlighting the importance of international standards in domestic regulatory impact assessments. It states that OECD members should ‘…give consideration to all relevant international standards and frameworks for cooperation in the same field and, where appropriate, their likely effects on parties outside the jurisdiction.’ Importantly, the OECD recommends that members ‘…take into account relevant international regulatory settings when formulating regulatory proposals to foster global coherence’ and ‘…avoid the duplication of efforts in regulatory activity in cases where recognition of existing regulations and standards would achieve the same public interest objective at lower costs.’ This last point highlights the role regulatory impact assessments can play in considering the interplay between domestic regulatory proposals and existing non-domestic regulation.

2. Ex ante regulatory assessment practices at the international level

Strengthening financial regulation in the aftermath of the crisis has been one of the G20’s primary foci. At its November 2008 meeting in Washington, the G20 Leaders agreed to ‘…implement reforms that will strengthen financial markets and regulatory regimes so as to avoid future crises.’ Since then, the G20 through the FSB and the SSBs has pursued an agenda of reforming the regulation of the world’s financial markets. This agenda has resulted in a significant compendium of regulatory standards for G20, FSB and SSB members to implement within their domestic frameworks.

The FSB and SSBs have used a range of measures in the development of these standards to help understand the possible impact of their implementation. These measures are explained below. None, however, fully aligns with the OECD’s recommendations for domestic regulatory impact assessments.

Before setting out these measures, it is important to recognise that the development of all FSB and SSB standards has benefited from the views of the official sector experts that contribute to the FSB and SSB. Indeed, the primary method that has been used to develop effective regulatory standards has been to draw
on the experience and judgment of the individuals of FSB and SSB member institutions.

The assessment measures below, and our recommendations for additional regulatory impact assessment processes, are intended to enhance the impact of this experience and judgment by providing additional evidence for consideration.

**Consultation**

The most commonly used assessment measure has been the public exposure of proposed standards through consultation processes. This allows stakeholders to comment on the possible impact of the standards and provides for some public accountability of the SSBs and FSB.

Where this is the sole form of pre-adoption assessment, it does mean that the relevant standards are not subject to any form of systematic quantitative or qualitative assessment of a proposal’s costs and benefits in the way recommended by the OECD.

This is particularly disconcerting where the standards either purport to apply without the need for domestic implementation or where domestic authorities have little discretion in their implementation.

For example, in July 2013, IOSCO released the *Principles for Financial Benchmarks (Benchmark Principles)*.22 Developed in response to the LIBOR scandal, the Benchmark Principles are intended to address conflicts of interest, transparency and openness in the administration of all financial market benchmarks.23 They have been endorsed by the G20 and the FSB.24

The Benchmark Principles were developed with the aid of a two-part consultation process. Despite commentators identifying the need for cost-benefit analysis, no such analysis was made conducted prior to their adoption.25 Released as ‘recommended practice’, IOSCO has stated that administrators of all benchmarks should publish the extent of their compliance with the Benchmark Principles by July 2014.26 This means that benchmark administrators are expected to comply with the standards without the standards being implemented through domestic regulation.

This by-passing of domestic processes, which would likely include regulatory impact assessments, means the G20 has endorsed the application of regulation that has not been developed with the benefit of any quantitative or qualitative assessment beyond the judgment of SSB members. This highlights the need for rigorous ex ante regulatory impact assessments at the FSB and SSB levels.

**Quantitative impact studies**

In some cases, the consultation process has included or been followed by a quantitative impact study (QIS). These studies have typically sought to assess the likely financial impact on the regulated entities that will bear the burden of the implemented standards. An example of this is the QIS that was conducted on the margin requirements for uncleared OTC derivatives released by the BCBS and IOSCO in mid-2013.27 The requirements were developed using a two-stage consultation process. The second consultation sought comment on the results of a QIS that sought to understand how much additional margin affected institutions would need to hold if the requirements were implemented.28

When conducted without further analysis, the QIS process falls short of the OECD’s best practice for regulatory impact assessments and cost-benefit analysis.29 It simply attempts to quantify the expected compliance costs of the proposed standards. It does not attempt to determine whether the proposed standards’ likely net economic benefit is optimal (such a method may be defensible, however, where the expected benefit of all possible policy options is identical and the only variable is the costs).

**Net economic impacts**

The examples of impact assessments that are closest to that recommended by the OECD were conducted by the FSB and SSBs on the expected net economic impact of the Basel III banking and OTC derivative reforms.

In August 2010, the FSB and the BCBS released a report on the long run economic effect of the then-proposed Basel III banking capital and liquidity reforms.30 The report attempted to quantify the economic output costs and benefits of the proposals.

It did not, however, accompany the original Basel III proposals when they were released for comment in December 2009. Rather, it was released only months before the final Basel III standards were adopted by the BCBS and endorsed by the G20. This raises questions about how effective the study was in informing the policy design process. Further, the study does not seem to have benefited from a process of public criticism. It was released a completed work. Similar criticisms can be made of the macroeconomic impact assessment that was released in August 2013 on parts of the OTC derivatives reforms.31 Again, this was released after the (missed) end-2012 deadline imposed by the G20 for the implementation of the OTC derivatives reforms and at a point when many
3. Domestic assessments and extra-territorial impacts

With limited exceptions, FSB and SSB standards do not take effect without national implementation. At the national level, standards will typically flow through the filter of some form of regulatory impact assessment before being applied via domestic regulation to the regulated population. Currently, national processes for assessing the impact of domestic regulation incorporate international issues typically include the following questions:

- What is the impact of a regulatory proposal on international trade?
- Whether existing international standards apply in the area of proposed regulatory action.

The guides typically do not explicitly ask assessors to consider the costs and benefits of proposed domestic regulation in light of potentially duplicative, conflicting or inconsistent requirements applying to entities from the interplay between the proposed domestic and existing non-domestic regulation. While this type of question would not preclude domestic regulation applying to entities that are subject to non-domestic regulation already, it would require national authorities to consider this type of effect with a view to reducing the costs of any interplay between the domestic and non-domestic regulation.

4. How could regulatory impact assessments better improve G20 outcomes?

These points highlight the opportunity for G20 members to potentially improve the outcomes of its regulatory reforms by incorporating ex ante regulatory impact assessments that are consistent with the OECD recommendations set out above. As indicated, there are two ways that such assessments could be incorporated into the regulatory reform process to improve regulatory outcomes.

At the FSB and SSB level

First, the G20 could require that all FSB and SSB standards and guidance presented for its endorsement or adoption to have been subject to a regulatory impact assessment process that is consistent with the OECD recommendations set out above. These recommendations would need to be adapted for international policy processes but, at a minimum, the G20 should require the FSB and SSB to perform a regulatory impact assessment that would involve them:

- Defining the policy problem that any proposed standards seek to solve
- Identifying a range of policy options to solve this problem (including the option of doing nothing)
- Attempting to quantitatively assess the potential costs and benefits of those options
- Where such quantification of any costs and benefits is not feasible, setting them out qualitatively
- Publishing these workings contemporaneously with any consultation on the proposed standards and invite comment on them.

Any standards presented to the G20 would ideally be the policy option that is expected to deliver the greatest net societal benefit. If followed, this process could be expected to improve the quality of FSB and SSB standards. Asserting this does not intend to gloss over the difficulties of assessing the quantitative costs and benefits of proposed financial regulation.

Such assessments face hurdles in accurately predicting the benefit of proposed standards (typically couched in terms of avoided financial system crises or improved market functioning) and their costs (including compliance costs and any impact on the intermediation of money and risk).

At the FSB and SSB level, the assessments would also need to address the issue of how the standards would ultimately be implemented by the institution’s members. Where standards are detailed and carry a firm expectation of implementation, then the standards could be assessed as written. Some standards, however, are high-level and leave members substantial discretion in how they would be implemented. It would be admittedly be more difficult to quantitatively assess these standards.
However, following the steps above for all proposed standards could be expected to improve the FSB and SSB’s processes by:

- Requiring the clear expression of the policy problem
- Requiring the individuals working on the problem institutions to consider a range of policy solutions, rather than those that seem most obvious
- Building a stronger evidence base that is based on quantification where possible to aid the expert judgment of those individuals
- Exposing the result of this process to criticism to both refine it and to enhance the accountability of the G20, FSB and SSBs.

Being able to follow this process effectively would require the G20 to give the FSB and the SSBs discretion in how to solve policy problems. As such, the G20 would need to ensure that when it sets out its expectations for work it focuses more on the concerns it may have with an area rather than the manner in which those concerns should be addressed. Pre-empting policy outcomes in communiqués would undermine the process above by making it politically difficult to consider a range of policy options and selecting one on its merits.

**Domestic consideration of extra-territorial costs**

Second, each G20 member should commit to using domestic ex ante regulatory impact assessments to consider the costs and benefits associated with the interplay between its domestic financial regulation and any applicable non-domestic regulation. This commitment would help domestic agencies understand the cross-border impact of their proposals, particularly when the extra-territorial costs add to costs imposed by the domestic regulation of other nations.

Applied consistently, this could assist in reducing any adverse extra-territorial effects of the implementation of domestic regulation and, thereby, contribute to avoiding the fragmentation of global markets.

The G20 should also mandate the FSB’s Standing Committee on Standards Implementation to follow up with national authorities on whether their domestic regulatory impact assessment processes provide for and result in the consideration of extra-territorial costs and benefits when implementing FSB and SSB standards.

**Conclusion**

While the quality of the FSB and SSB standards prepared and implemented under the G20’s direction has been generally high, there remain opportunities for improvement with respect to any further standards.

Adopting systematic regulatory impact assessments as set out here would provide better evidence for the policy making process. Having the best evidence available is critical if the G20 is to be confident that international standards are well-adapted to meet the challenges it identifies. Further, regulatory impact assessments could play an important role in ensuring that the implementation of the agreed standards does not lead to any undue fragmentation of global markets.

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Footnotes

6. The main arena in which this fragmentation is occurring currently is within the OTC derivative markets. The OTC Derivatives Regulators Group (ODRG) is currently working at resolving issues arising from the interplay between national implementation of the OTC derivative reforms. At their St Petersburg Summit, the G20 Leaders called on the ODRG to resolve these issues; see paragraph 71 of the G20 Leaders’ Declaration (September 2013). A progress report of the ODRG was delivered to the G20 in March 2014. Beyond the immediate OTC derivative market issues, the International Organisation of Securities Commissions (IOSCO) is also working at resolving issues with the interplay of national regulations. It has established a Task Force on Cross Border Regulation that will seek to publish a tool kit of cross border regulation tools. This was announced in July 2013 IOSCO Board focuses on behavioral economics and social media IOSCO/ MR/24/2013 (1 July 2013), page 5.


8. Ibid, 4.


10. Ibid, 4.

11. These bodies include IOSCO, the Basel Committee on Banking Supervision (BCBS), the International Association of Insurance Supervisors (IAIS) and the Committee on Payment and Settlement Systems (CPSS).


13. This type of argument has been forwarded by Alemanno in the context of promoting regulatory harmonization for the purposes of international trade law. See Alberto Alemanno ‘Is There a Role for Cost-Benefit Analysis Beyond the Nation-State’ in Michael Livermore and Richard Revesz The Globalization of Cost-Benefit Analysis in Environmental Policy (Oxford University Press, 2013).

14. OECD, above n 8, recommendation 4.

15. Most G20 nation states are involved with the OECD. Argentina, Brazil, China, India, Indonesia, Russia, Saudi Arabia and South Africa are the G20 nation states that are not currently members of the OECD. In 2007, Russia was invited to open discussions for OECD membership. The OECD has also offered ‘enhanced engagement’ to Brazil, China, India, Indonesia and South Africa.


17. Ibid.


19. Ibid.


21. The commitment by FSB members to implement agreed international standards is found in Article 6(1)(c) of the Charter of the Financial Stability Board (June 2012).


23. IOSCO, above n 15, 3.


25. See IOSCO, above n 15, 42.


27. BCBS and IOSCO Margin Requirements for Non-centrally Cleared Derivatives (September 2013).

28. BCBS and IOSCO Second Consultative Document - Margin requirements for non-centrally cleared derivatives (February 2012).

29. The margin requirements for non-cleared OTC derivative transactions were included in the macroeconomic study on OTC derivative reforms noted below. An example of standards that have benefitted from a QIS only (at least so far) would be the FSB’s Strengthening Oversight and Regulation of Shadow Banking Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos (August 2013).

30. BCBS An Assessment of the Long-term Economic Impact of Stronger Capital and Liquidity Requirements (August 2010). In December 2010, a Macroeconomic Assessment Group established by the Financial Stability Board and the Basel Committee on Banking Supervision released a report on the the transitional costs (but not benefits) of
the reforms; Final Report Assessing the Macroeconomic Impact of the Transition to Stronger Capital and Liquidity Requirements (December 2010). A quantitative impact study was also released on the Basel III proposals: BCBS Results of the Comprehensive Quantitative Impact Study (December 2010). Again, this simply estimated the compliance impact of the proposals on implementing banks.


32. For example, in its largely contemporaneous progress report on the OTC derivative market reforms, the FSB noted that ‘…over half of FSB member jurisdictions have legislative frameworks in place to enable all reform commitments to be implemented’. FSB OTC Derivatives Market Reforms Sixth Progress Report on Implementation’ (2 September 2013).

33. See, for example, Council of Australian Governments Best Practice Regulation (October 2007) stating ‘regulatory measures or standards should be compatible with relevant international or internationally accepted standards or practices in order to minimise the impediments to trade’. A similar point is made in the more recent Commonwealth of Australia The Australian Government Guide to Regulation (2014) 29 where it states ‘[i]f any of the options involve establishing or amending standards in areas where international standards already apply, you should document whether (and why) the standards being proposed differ from the international standard.’ See, also, European Commission Impact Assessment Guidelines (15 January 2009), 42 indicating that impact assessments should consider international trade impacts.

34. European Commission, above n 29, 42 indicating that impact assessments ‘should examine whether the policy options concern an area in which international standards exist’.

35. An example of this type of consideration is found in the United States Securities and Exchange Commission’s (SEC) discussion of the cross-border application of their rules on security-based swap dealers; Securities and Exchange Commission Application of “Security-Based Swap Dealer” and “Major Security-Based Swap Participant” Definitions to Cross-Border Security-Based Swap Activities Release No. 34-72472 17 CFR Parts 240, 241, and 250. See, in particular, the discussion commencing on pages 164 and 282. The SEC recognises that the application of their Title VII parts of the Dodd-Frank Act to non-US entities could lead to market fragmentation and that, in turn, the availability of substituted compliance could reduce costs.

36. This requirement should extend to any assessment methodologies developed to aid the implementation assessment of the standards where the methodologies add to or alter the obligations imposed by the original standard.

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