Special Report

A REVIEW OF THE AUSTRALIAN FINANCIAL REGULATORY ENVIRONMENT
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MARKET CONDUCT AND RISK CULTURE: REBUILDING TRUST

Roberto Fitzgerald, Partner, Financial Services Risk, EY

ELEVATED ON THE REGULATORY AGENDA

The continued conduct and culture scrutiny on banks has stepped up another notch. The banks have been hit with a series of high-profile conduct matters. These have included alleged bank bill swap rate manipulation, industry-wide reviews into life insurance claims practices and ongoing financial advice service delivery and charging, and fines and remediation for responsible lending and credit card limit increase practices. The compensation of customers for poor financial advice in wealth management businesses continues.

The Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC) will continue to push banks to develop customer- and risk-centric cultures to create a long-term solution to conduct issues in the sector. To this end, APRA is expected to release an information paper in the coming months following initial industry engagement.

In April, the federal government released a A$127.2 million reform package designed to strengthen ASIC and announced the introduction of an industry-funding “user pays” model starting in 2017. This announcement substantially bolsters ASIC’s authority, resources and surveillance and enforcement capabilities. ASIC will also have an additional commissioner with experience in the prosecution of financial crimes. The package will further focus the industry on its commitment to rebuild trust and confidence in banks.

If elected this year, the Federal Opposition has promised a Royal Commission. The proposal has drawn a mixed response, with concerns it may undermine Australia’s global reputation as a strong and well-regulated financial system, duplicate the work of the Financial System Inquiry, and delay or not result in customer compensation.

The Australian Bankers’ Association released its six point plan to strengthen community trust, including an independent review of product sales commissions and product-based payments. Other actions go to improving customer complaints handling and better supporting whistleblowers.

RENEWED EMPHASIS ON NON-FINANCIAL RISKS

This spotlight on conduct and questions of trust highlights the need for the banks to focus on developing a truly customer-centered culture. This was borne out in Rethinking risk management: Banks focus on non-financial risks and accountability, the most recent issue of EY’s annual risk management survey of major financial institutions where a consistent theme was the degree to which institutions are rethinking their approach to managing non-financial risks and risk accountability.

Recently uncovered conduct and compliance failures have resulted in huge financial and reputational costs to the industry, and nearly two-thirds of survey participants agreed that lapses in internal oversight and controls were the main reasons for these losses.

It has become increasingly apparent that having a strong firm-wide risk culture is one of the key components of successful risk management, and both regulators and boards are demanding significant enhancements to governance, structure and controls in an effort to improve risk behavior.

As a result, there has been an intensified effort across the industry over the past several years to review and assess current processes and procedures and implement changes to proactively and effectively manage the culture. Based on our survey, 77% of respondents reported an increase in senior management attention to risk culture in the past 12 months, a considerable increase from the previous two years. Consequently, 75% indicated that they are in the process of changing their culture. A key driver behind the evolution is the effort to achieve alignment and integration of all the elements that ultimately affect behavior, including risk appetite, accountability, performance management, compensation, hiring and training.

STRENGTHENING THE RISK CULTURE CONTINUES TO BE TOP OF MIND

Given the number of conduct failures across the industry and the intensified pressure from regulators, there has been a major industry-wide effort over the past few years to alter risk culture. Banks are approaching this from at least three directions:

• Further strengthening risk governance and, in particular, shifting accountability for risk into the front office and ensuring that front-office controls are in place and effective
• Clarifying the range and magnitude of acceptable risk using an embedded risk appetite statement and various forms of messaging and training
• More closely aligning incentives with risk objectives and establishing how breaches in rules will be viewed and handled

However, much of this is still work in progress. Executives agree that the key ingredients for creating a strong risk culture must include direction and “relentless” communication from the top of the organization; a strong risk appetite that is embedded into business strategy and planning; clearly defined roles, responsibilities and accountability; and strong consequences for misbehavior through performance management, compensation and disciplinary actions. For many institutions, making risk everyone’s business, from the top ranks down to the front-line staff, represents a significant shift in mind-set, policies, systems and processes and requires an ongoing, long-term commitment and investment.

The views reflected in this article are the views of the author and do not necessarily reflect the views of the global EY organization or its member firms.
EMBEDDING RISK CULTURE AND CONDUCT
Rethinking risk management

Conduct is at the top of the agenda for banking boards and CROs, but banks must move beyond protect-and-survive if they are to deliver sustainable returns.

Compliance risk remains top of the agenda for 61% of boards and 57% of CROs.

Behaviors need to change
Culture is at the root of misconduct and banks agree the key to transformation is striking a balance between a sales-driven front office and the new risk management paradigm. Progress is underway.

89% of banks report an increased focus on non-financial risks.

67% consider conduct risk a major non-financial risk.

Banks recognize conduct risks run deep across the firm
What is the highest conduct risk going forward?

- Product mis-selling: 70%
- Money laundering: 52%
- Market abuse: 36%
- Unauthorized trading: 32%
- Financial advice: 32%
- Sanctions: 30%

Firms in the process of changing their culture: 75%
Report cultural change is a work in progress: 81%
View consistency between organizational culture, risk culture, employee behavior and risk appetite as the key driver of change: 83%
Five ways to increase front-office responsibility

77% of banks list increasing front-office accountability as their top risk-culture initiative

1. Clear, streamlined governance structures, enabled by effective processes and policies, to make the front office truly accountable

2. Increased capacity for the front office to better assess and manage risk

3. More effective communication around values, compensation and training

4. Emphasis on the range and magnitude of acceptable risk using a fully embedded risk appetite framework

5. Alignment of incentives with risk objectives and enforceable disciplinary action for breaches in rules and misbehavior

But de-risking only goes so far

Regulatory expectations, culture weaknesses and public perception are driving fundamental business-model shifts

- Reducing complexity of products: 63%
- Exiting some types of products: 54%
- Exiting some types of transactions: 44%
- Reducing activities with some customers: 44%
- Exiting countries: 24%

Many banks are taking proactive steps to serve clients and deliver returns...

- Enhancing risk assessments: 67%
- Focusing on new products: 62%
- Increasing business-line accountability: 60%
- Strengthening second line of defense: 56%
- Enhancing measurement: 49%

... with specific initiatives underway to measure and monitor conduct risk

- New risk-and-control self-assessments by businesses: 54%
- Improving forward risk assessment: 54%
- New risk-and-control assessments by risk management and compliance: 39%
- Improving data collection on past events: 37%
- Creating scorecards for parts of conduct risk: 34%

Banks are changing their approach to risk management, creating proactive methods to manage non-financial risks and making front-office staff more accountable.

Rethinking risk management: Banks focus on non-financial risks and accountability, EY’s 2015 risk management survey of major financial institutions, is the sixth annual study of risk management practices conducted in cooperation with the Institute of International Finance (IIF). A total of 51 firms across 29 countries participated in this year’s study. Look for our 2016 risk management survey coming in November.
REGULATOR MONITORING SOCIAL MEDIA FOR SIGNS OF CULTURAL PROBLEMS, WARNS CHIEF

Nathan Lynch, Head Regulatory Analyst, Australia & New Zealand, Thomson Reuters

Organizations that show signs of cultural problems or have high levels of customer complaints, including through social media channels, will trigger regulatory “deep dives” from the Australian Securities and Investments Commission (ASIC). The warning from ASIC comes as the agency begins a major litigation with the ANZ and Westpac over alleged benchmark rigging. ASIC also faces political pressure from Canberra over its failure to detect extensive claims-handling breaches at the country’s major life insurers, as revealed in recent media reports.

Greg Medcraft, ASIC chairman, has said that the agency’s surveillance teams will be monitoring various channels to look for evidence of cultural problems. This monitoring will include complaints to ombudsman schemes in traditional media, social media complaints and evidence gleaned through targeted or “risk-based” surveillance work. Organizations that are linked to high levels of complaints can expect to face a grilling from a regulator that is still reeling from the fallout from pervasive breaches in relation to financial advice, benchmarks and life insurance claims.

If ASIC identifies a potential “culture problem” during its ongoing surveillance work, it will treat this as a red flag and undertake a “deep dive” into the organization concerned. During deep dives, the supervisors will look for evidence of specific misconduct, as well as broader, more pervasive conduct problems.

“We want to uncover these problems early and to disrupt and address them,” Medcraft said.

ASIC is also concerned that the rapid pace of technological change in the financial services sector could trigger a “culture shock” at many organizations that are not adequately prepared for change.

Medcraft said that the scale, breadth and potential of technological change in the FinTech space will present unprecedented challenges and opportunities for regulated entities. He argued that organizations that have an established history of good conduct and corporate culture would fare best as the challenges and opportunities of software emerge.

Medcraft also said that innovative business models in the financial services sector are opening up new opportunities in the areas of marketplace lending, crowd funding, robo-advice, payments and distributed ledger (blockchain) technology. At the same time, new threats are emerging around cyber risk and the challenges that digital disruption and global financial markets are posing for regulators and law enforcement agencies.

GETTING ON THE FRONT FOOT

In this rapidly changing financial services landscape, regulators need to get on the front foot, and corporate culture will prove to be more crucial than ever before. Medcraft said that consumers have an unprecedented opportunity to voice complaints via social media, and ASIC will be watching these channels for evidence of systemic misconduct.

“Culture matters to ASIC because culture is a key driver of conduct,” Medcraft said. “Good culture is also good for the bottom line, and it is critical for businesses that want to be around for the long term. A good culture enhances brand loyalty and bolsters reputation, which has a very real financial impact.”
Conflicts can arise or be exacerbated where incentives reward high-risk, short-term business strategies. We encourage all firms to assess their approach to conflicts management.”

GREG MEDCRAFT, ASIC CHAIRMAN

Technology and social media have opened up new channels for customers to express delight or disdain about their experience as financial consumers, Medcraft said. He described this as an era of “customer regulation,” where customers can communicate directly with firms, regulators and the public at large.

“If a business does not have the right culture, it will see the effect of this as customers vote with their feet or make their views known — sometimes very loudly — through social media,” Medcraft added.

The ASIC chairman believes that individuals now have unprecedented access to information and, as a result, companies will be “held responsible by the crowd.”

“If they are not behaving in the right way, the crowd will let them know – if not the headlines,” Medcraft said.

LITANY OF BREACHES

The recent scandals involving financial advice, the alleged rigging of the Bank Bill Swap Rate (BBSW) and claims handling among life insurers have been particularly challenging for the industry and regulators.

“Inevitably, it is the stories of poor culture and poor conduct in the financial industry which are splashed across the front page of the newspaper, which pop up in our newsfeeds, and which are the subjects of heated discussion on social media sites,” Medcraft said.

He also called on financial services firms to take responsibility when they are found to have engaged in misconduct or face high levels of customer complaints. Medcraft has been particularly scathing recently in his assessment of ANZ’s handling of the alleged rigging of the bank bill swap (BBSW) benchmark rate, for example, which is now the subject of major litigation from ASIC. He will say it is unacceptable for firms to repeatedly blame “bad apples” and not accept full responsibility for misconduct within their organization.

“Time and time again, we have seen firms blaming it on a few bad apples driving bad outcomes for consumers, rather than taking responsibility by looking more closely at their organization and implementing the necessary changes to address the root cause of the problem,” Medcraft said.

To encourage firms to take culture more seriously, ASIC will incorporate an assessment of “culture” into its continuing risk-based surveillance reviews. Throughout 2016, ASIC will be looking at the way that remuneration and incentives are structured at organizations during its supervisory work.

“Conflicts can arise or be exacerbated where incentives reward high-risk, short-term business strategies,” Medcraft said. “We encourage all firms to assess their approach to conflicts management.”

REGULATORY RED FLAGS

Medcraft has said repeatedly, including during Senate appearances, that culture is not something that can be regulated with blackletter law. As such, ASIC will not set out to dictate culture to regulated entities but will view it as a barometer of good conduct.

“Culture is at the heart of how an organization and its staff think and behave. It is an issue that companies themselves must address,” Medcraft explained. “It is not enough to talk the talk. Firms must truly embed this in their business.”

The good news for organizations that can demonstrate a robust corporate culture is that they are likely to attract less supervisory attention from the regulator in the future.

“It is the responsibility of each organization to look at what steps they can take to improve their culture and sustain a ‘customer first’ culture over the long term. At the end of the day, you need to have a culture that your customers can believe in,” Medcraft said.

This is an edited version of an article that was originally published on the Thomson Reuters Regulatory Intelligence platform.
COMPULSORY INFORMATION REQUESTS IN SPOTLIGHT AS ASIC RAMPS UP INVESTIGATIONS

Nathan Lynch, Head Regulatory Analyst, Australia & New Zealand, Thomson Reuters

There has been a surge in the number of notices issued under the Australian Securities and Investments Commission’s (ASIC) compulsory information-gathering powers in recent years, according to legal and regulatory figures.

The spike in notices, which have sometimes been criticized as “deep sea trawling” expeditions, has highlighted the need for organizations to have an effective framework in place for managing such requests. Sources said the handling, or mis-handling, of a compulsory information notice could set the course for any subsequent surveillance or investigative work that ASIC undertakes.

Moira Saville, partner at King & Wood Mallesons, said the data in ASIC’s latest annual report supported the perception that there had been an increase in information requests.

“There has been an uptick in the number of investigations that ASIC has commenced in the last year, and I suspect that has led to an increase in the number of compulsory notices that have been issued,” Saville said.

The increase in surveillance activity and investigations meant that financial services licensees needed to be particularly careful about how they respond to compulsory requests. Saville urged compliance teams to contact the relevant ASIC staff member and open the lines of communication and cooperation from the outset.

Natalie Dürr, senior executive in enforcement at ASIC, said the regulator also appreciated the opportunity to begin a dialogue with any firms subject to an information request.

“What we encourage people to do is to pick up the phone and have a conversation with the relevant staff member on the notice. Sometimes it is very difficult for us to anticipate the breadth of documents that will be caught by a notice. We might describe a class of documents thinking that there is only one such kind. … It’s not in ASIC’s interest to receive too many documents either,” Dürr said.

If ASIC receives too many documents, then it will incur unnecessary processing and storage costs, as well as archiving fees and higher costs to retrieve any relevant
data. As such, all parties to a compulsory information request have an interest in ensuring that it is tightly framed.

**UNWIELDY ORDERS**

In Project Mint, ASIC’s investigation into “rumourtrage,” the regulator was widely criticized for requesting too much information from brokers. The post-financial crisis investigation was unprecedented in its scope. It ran more than 18 months, and 71 Australian brokers were forced to hand over trading records and communications. In total, ASIC secured 700,000 emails and 220 hours of broker telephone recordings.

The regulator later described the project as a “mammoth task” and conceded it represented a huge burden on the securities industry for a modest outcome. ASIC has since tightened its information collection processes.

Saville said that if regulators go beyond their powers when issuing compulsory collection notices, they may run into problems with the use of that data.

“ASIC does have an obligation to issue notices that fall within its powers,” she said.

The regulator also has an obligation to issue a notice that requires production in a time frame that is reasonable in all of the circumstances. Saville said this was often a source of concern for people who receive these notices, as the regulator and licensee can have differing views on the volume of documents and length of time that is needed to comply with a production order.

“I would always advocate that you pick up the phone and seek to negotiate [timing]. Sometimes we’ve also negotiated search terms, so the use of keyword searching,” Saville said.

**“TRANCHED PRODUCTION”**

ASIC has also seen an increase in the number of firms that are requesting a “tranchéd production schedule.” This means they can issue the most important tranches of information first and then follow up with less critical material.

Dürr said this could help firms to comply with an initial information request more quickly. In some instances, ASIC sends a notice and then follows up with a discussion around production timing and tranching. In other cases, it may call first to ensure that the production notice is drafted appropriately.

“Sometimes it facilitates the process to get the notice done and out there and then have a conversation. But there are also instances where it makes more sense to have the discussion before the notice is issued,” Dürr said.

She added that supplying documents in tranches can work in certain cases where ASIC is able to begin its investigation by receiving the vital documents first. “That gives us the time for less important documents to be produced later,” she said.

Tranche discovery can have disadvantages for firms, however, as it can end up far more time consuming if it is not handled properly from the outset. Saville said many firms were unaware that producing documents in tranches can add time and cost to a document production project.

“If you are doing a rolling production, then every tranche involves a certain amount of work and sign-off from clients and lawyers,” she said. In some cases, she said it may make more sense to ask for an extension and then deliver all the relevant documents in a single tranche.

Dürr said it was unusual for ASIC to deny these types of requests unless there was a need to get to court quickly — for example, where there is a risk of continuing consumer harm. The failure to deliver documents can also hold up other investigation work, including the examination of other witnesses.

**LEGAL PROFESSIONAL PRIVILEGE**

Legal professional privilege (LPP) is also a thorny area when it comes to compulsory production orders. Some organizations have been known to use privilege to resist orders from ASIC if there is an internal investigation underway. This is understood to have been the case with ANZ Banking Group’s resistance to ASIC’s request for documents and phone records in relation to its benchmark rigging investigations. ANZ’s lack of cooperation ultimately led to litigation, which ASIC launched in March.

Greg Medcraft, ASIC chairman, had warned the bank that “we can do this the easy way or we can do this the hard way,” after growing frustrated with its lack of cooperation.

Melissa Smith, senior manager for financial services enforcement at ASIC, said organizations could waive privilege if they wanted to cooperate with ASIC on information production orders.

“There can be what I would describe as a public benefit in sharing documents that are claimed to be privileged, as it can assist in the effective and efficient conclusion of ASIC’s investigation,” Smith said.

In numerous cases, organizations have waived privilege and shared information with ASIC, and the regulator has decided that “no further action” is warranted.

If a party is resisting production on an LPP basis, then it must provide ASIC with a schedule containing basic information about those documents and the grounds for privilege. Based on that schedule, ASIC will decide whether to take the matter further, challenge the claim of privilege or seek similar evidence from another witness.

If an investigation has taken place, Saville said it was a sign of good cooperation if a licensee shared this report with the regulator.

“There’s such a benefit potentially to ASIC in receiving the internal investigation report from an entity, or the advice that an entity says it relied upon,” she said.

Information Sheet 165 sets out the situations in which ASIC will accept, on a confidential basis, any privileged information from regulated entities. ASIC has a standard agreement, the “Voluntary confidential LPP disclosure agreement,” that sets out the terms on which ASIC will accept such information.

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STATUTORY REVIEW: GOVERNMENT REPORT PROPOSES SWEEPING AML/CTF REFORMS

Nathan Lynch, Head Regulatory Analyst, Australia & New Zealand, Thomson Reuters

Australia is likely to extend its anti-money laundering regime to cover so-called “tranche two” entities, including lawyers, conveyancers, accountants, jewelers, real estate agents and trust and company service providers. The recommendation was contained in a landmark report tabled in parliament on the statutory review of the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (AML/CTF Act) in April. In his response to the report, Michael Keenan, the minister for justice, identified the “tranche two” laws as a matter for action and has committed to conducting a cost-benefit analysis of the reforms.

The Attorney-General’s Department (AGD) has been working on the review of the AML regime for more than two years. It had been aiming to present the report to the minister for justice before the end of last year, but the deadline was extended into late April 2016.

The AGD’s report included 84 recommendations to modernize the AML/CTF regime and position Australia to address current and future financial crime and terrorism challenges. The review found that the AML/CTF Act is too complex and needs to be simplified to enable reporting entities to better understand and comply with their obligations.

Some of the over-arching recommendations include that the AML/CTF Rules should be “simplified, rationalised and presented in a user-friendly format to improve accessibility and understanding of obligations.” The review also said that the AML/CTF Act and Rules should adopt the “technology neutrality” principle.

The report has suggested that a government working group should be established to consider international developments in combating terrorism financing and consider the appropriateness of these measures for Australia.

GOVERNMENT RESPONSE

Keenan said the reforms would take place in two stages to “prevent regulatory fatigue.” The first package of reforms would take place in the short term, and a second package comprising longer-term reforms would be introduced at a later date.

“Industry will be consulted on both the timing and the content of these stages,” Keenan said. “The government will carefully consider all the recommendations in this report to ensure Australia’s legislative framework continues to match the government’s commitment to prevent, disrupt and investigate criminality, corruption and terrorist activity.”

The Australian Transaction Reports and Analysis Centre (AUSTRAC), Australia’s anti-money laundering agency, has endorsed all of the 84 recommendations contained in the report on the statutory review.

“The platform of reforms offers us an unparalleled opportunity to position ourselves at the forefront of international efforts to crack down on terrorism financing, financial crime, tax evasion and to help us stop criminals from exploiting weaknesses in the existing framework,” said Paul Jevtovic, chief executive of AUSTRAC.

“As the conduit between the financial sector and Australian government agencies, improving our collective ability to gather and analyze financial intelligence is critical,” he said. “Importantly, the report provides the opportunity to seriously consider the risks arising from recent terrorist atrocities and whether additional preventative reforms are needed to further safeguard the Australian community.”

“MUTUAL EVALUATION

The statutory review follows a mutual evaluation report on the effectiveness of Australia’s AML/CTF regime from the Financial Action Task Force (FATF), which was released in April 2015. The report found that significant gaps exist in Australia’s AML framework, particularly in relation to enforcement and the regulation of gatekeeper professions, which are not covered by the existing “first tranche” of the AML/CTF Act.

Lawyers, accountants, real estate agents, jewelers and other potential reporting entities have been watching the statutory review process closely. The review recommended that the AGD and AUSTRAC, in consultation with industry, should “develop options for regulating lawyers, conveyancers, accountants, high-value dealers, real estate...”

“As the conduit between the financial sector and Australian government agencies, improving our collective ability to gather and analyze financial intelligence is critical.”

PAUL JEVTOVIC, CHIEF EXECUTIVE OF AUSTRAC
agents and trust and company service providers under the AML/CTF Act.”

The Law Council of Australia has opposed the inclusion of lawyers in the “tranche two” reforms. It is considering the report and has welcomed the announcement that there will be a cost-benefit analysis on any proposed reforms.

Paddy Oliver, a lawyer and managing director of AML Experts in Melbourne, said the review would create an opportunity for professional associations to engage with the government to ensure they have input into the design of the new simplified and expanded regime. Oliver, who advised law firms in the UK when the regime was introduced there, said the legal sector was expected to be particularly vocal about its proposed inclusion in the AML regime.

Oliver said that rather than reject AML regulation outright, the Designated Non-Financial Businesses and Professions (DNFBPs) should aim for a regime that is beneficial and proportionate.

“With the review stating the current obligations are too complex, there is scope for the professionals to agree to ‘AML light’ instead of the full rigors of the current regime. After all, certain services of professionals are described as posing a ‘high ML/TF risk.’ Further, there may actually be some broader business benefits of understanding risks,” Oliver said.

Crispin Yuen, compliance specialist at AML Sanctions, said the inclusion of gatekeepers such as lawyers, accountants, conveyancers, real estate agents, jewelers and trust and company service providers would “complete the circle” and bring about a whole-of-country approach to combating financial crime.

“The terrorist attacks in the last few years have sparked a renewal of global initiatives to strengthen regimes to manage terrorism financing risks and to close off funding to terrorists. Employing counter-terrorism financing measures and complying with targeted financial sanctions is something that financial institutions and DNFBPs can do to disrupt the financial and commercial networks of terrorists, drug traffickers, proliferators of weapons of mass destruction and criminals engaged in activities that threaten Australia. This is a multifaceted fight,” Yuen said.

He also said the extension of the regime to include new payment types and systems, such as Bitcoin and other digital currencies, would be a welcome development.

“The environment needs to be hardened in order to deter financial crime whilst supporting competition and innovation,” Yuen said.

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REGULATORY INTELLIGENCE

NAVIGATE THE GLOBAL REGULATORY ENVIRONMENT WITH CONFIDENCE

Thomson Reuters Regulatory Intelligence delivers a focused view of the global regulatory environment, empowering compliance professionals to make well-informed decisions to manage regulatory risk using the most comprehensive and trusted intelligence available. This solution cuts through the complexity and sheer volume of content within the regulatory environment by providing clarity on what is most important for your organization, in a cost-effective way.

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There was a time in the dim and distant past when banks strove to “achieve” compliance; those dreams have since faded. Investment in compliance is part of our foreseeable future, and in Asia-Pacific (APAC), we have the added complexity and cost for pan-regional financial institutions that have to contend with diverse cross-border regulations.

The good news is that this complexity is providing a fertile breeding ground for new ideas and applications of technology. Incumbent banks are looking to be more efficient and deal with a compliance overhead that has traditionally not provided market differentiation (or perhaps only negative differentiation when noncompliance has been exposed), while RegTech (regulation technology) companies are seeing the opportunity to use technology to reduce costs and provide better ways to serve the compliance needs of financial institutions. It is indeed an exciting prospect.

The penalties for noncompliance have never been greater, and the traditional response has been simply to add more money and resources, evident by a steady increase in the proportion of spend on compliance in all financial institutions. At the same time, the clamor from the business, and from consumers themselves, is for increased focus on digital services, product development and customer insight. Faced with thinning margins and subdued economic outlook, there is a pressing need to enhance performance, simplify operating models and re-engineer legacy technologies, while still ensuring cost management and regulatory compliance. Thus, a blank-check approach to cover soaring regulatory and compliance expenses is no longer sustainable. Banks need to seek more cost-efficient technology-enabled regulatory and compliance solutions.

Step forward the RegTechs — entrepreneurs specializing in financial services and focused on solving the regulatory conundrum. These new firms offer the promise of innovative technologies to automate routine compliance obligations, deliver near real-time risk information, enhance efficiencies and help reduce the cost of regulatory processes, while meeting regulatory commitments.

REGTECH: SHAPING FINANCIAL REGULATION OF THE FUTURE

Anita Kimber, Partner, APAC Financial Services Performance Improvement Leader, EY
Gary Mellody, Partner, APAC Financial Services Risk Leader, EY

PLACING INNOVATION AT THE HEART OF REGULATORY COMPLIANCE

There have been numerous significant regulatory compliance failures over the past few years as banks struggle to keep pace with regulatory expectations.
CENTERING INNOVATION INTO REGULATIONS

Hallmarks of RegTech

While applying technology to the regulatory process is not new, this is about next-generation technologies that can be used to increase efficacies, agility and transparency of financial regulations in a data-rich and analytical manner. While standard compliance offerings are typically designed to address very specific regulatory mandates and require additional technical expertise to modify or enhance, RegTech solutions pride themselves at being agile. These enable the extraction, intelligent analysis and presentation of reports from standardized data to meet financial regulation in near-real time.

RegTech applications are usually delivered through cloud-based technologies, allowing for cost savings and greater utilization flexibility, as well as remote maintenance and management. Timely updates to the latest regulatory releases and changing legislation can also be released via the cloud to clients. RegTech solutions delivered remotely also allow banks to manage the complexity and momentum of regulatory transitions without involving massive compliance resources (though there are security implications – and in some countries, regulatory limitations – with a cloud environment, and banks do need to ascertain that RegTech does not add to compliance complexity).

SERVICES FOR FINANCIAL INSTITUTIONS

Instances of practical use cases are RegTech vendors offering solutions to automate the capital assessment, tracking, monitoring and reporting work. These include the new Basel III (or equivalent rules in APAC) and its associated stress-testing, model developments, minimum capital requirements, and liquidity coverage ratio (LCR) rules; adherence to financial reporting for IFRS 9; expected credit loss (ECL) models; BCBS 239 (on management of data in risk analysis), and Common Reporting Standard (CRS) to promote global automatic exchange of information and cross-border tax compliance. Such technologies not only simplify the compliance process, but can be delivered remotely as Regulation-as-a-Service platforms, offering continuous compliance to multiple regulatory requirements.

Meanwhile, as mandates become increasingly demanding and amounts of data captured in multiple repositories inevitably increase, pressure is mounting for banks to properly manage, store and present information to regulators in a timely and efficient manner. An application here would be to improve know-your-customer (KYC) identity verification and compliance. The provision of timely and accurate KYC reports by financial institutions to regulators is extremely daunting as they are expected to track and retain in excess of 300 data attributes about their clients, so any solution to simplify KYC compliance is most welcomed.

The application of big data paradigms is also paving the way for financial institutions to look beyond the adoption of RegTech for regulatory reporting. For instance, the need for closer trade surveillance has resulted in a massive rise in budgets for compliance staff. This is where RegTech solutions applying cognitive computing on big data for trade surveillance and to monitor suspicious transactions, or to limit incidences of money laundering and terrorist financing, can help protect banks against fraud incidences and penalties for noncompliance. Innovative regulatory
solutions that empower fraud management with network analytics and automated machine-learning techniques will definitely garner increased interest.

We further observe RegTech vendors exploring the use of blockchain and its underlying distributed ledger technology (DLT) for transaction recordings and smart contracts. DLT is a next-generation ledger for the recording of transactions across a decentralized database that eliminates the need for a centralized authority to register and validate transactions. It has massive potential to reduce the administrative cost for trades, given that smart contracts (or scripted ledger transaction entries) can seamlessly self-execute and self-settle trades.

It is thus not surprising that several large financial institutions are experimenting with DLT to varying degrees, while regulators are supportive as smart contracts not only automate clearing, settlement, dispute resolution and collateral management, but also reduce counterparty and systemic risks. Consequently, a rich and diverse spectrum of DLT players is emerging. These include financial product trading vendors that offer purpose-built solutions to assist in the clearing and settlement of financial products, technology vendors offering DLT and service developers.

FOSTERING INDUSTRY ADOPTION: STILL EARLY DAYS, BUT WATCH THIS SPACE

Roadblocks to a RegTech Agenda

While it is clear that digitalization of regulatory compliance can potentially bring huge benefits to the financial services community, adoption has not been particularly aggressive. The primary barrier appears to be largely regulatory based. In many parts of the region, regulators have opposing views about data accessibility and privacy, and have yet to actively collaborate with financial institutions and RegTech providers on mutually agreed-upon standards to drive the agenda forward. This lack of clear regulatory endorsement around common approaches and solutions for RegTech has thus dampened confidence in the sector. And with limited standardization of industry solutions stemming from multiple new regulations, rising complexity, and banks operating across jurisdictions having to adhere to multiple guidelines, it becomes difficult for RegTech vendors to keep their offerings tailored yet continually updated.

Furthermore, conflicting deadlines for compliance with various regulations already has financial institutions struggling to keep pace, and this leaves them with limited bandwidth to actively explore regulatory innovation. Instead, compliance functions remain heavily focused on remediation rather than strategic implementations, and even when they do keep pace, there are often cultural impediments to adopting technology-based solutions among compliance professionals. Consequently, banks end up throwing in more money and bodies to address new regulations individually rather than seeking more efficient and holistic regulatory technology solutions (although this is precisely what they should be doing).

REGULATORY FACILITATION

While regulators are expressing enthusiasm for RegTech solutions that improve information flow with the financial institutions and help monitor global systemic risks, they also recognize the need to raise their technology savviness in order to fully assess these next-generation approaches and their applications for regulation. We see more progressive authorities holding regular industry dialogues with market participants (financial institutions, RegTechs, training academies and universities) to understand technology innovation and assess whether existing rules, policies and guidance are restricting innovation and the adoption of RegTech solutions.

The UK provides a good example of the government (Office for Science) and regulator (Financial Conduct Authority or FCA) working together to support industry adoption. The FCA recently launched a dedicated working group to discuss the development and adoption of new technologies that facilitate regulatory adherence. With authorities actively engaging the FinTech community to automate regulation and compliance, the UK has emerged as the global RegTech leader, hosting a range of start-ups. These organizations offer solutions ranging from fund data utilities, to risk analytics to detect disruptive events in global financial markets, to technology risk solutions for continuous compliance.

In APAC, the Australian government established a FinTech Advisory Group to complement the Innovation Collaboration Committee and promote its FinTech industry. As the advisory group identifies areas of potential future reform and ensures that specific FinTech priorities are considered in the implementation of government policies, it is paying special attention to RegTech.

Meanwhile, to encourage RegTech development in Singapore, the Monetary Authority of Singapore (MAS) announced plans to make its data available through an open-source Application Programming Interface (API) architecture to increase efficiencies in submitting data on applications and transactions for financial stability assessments. MAS is also collaborating with the Association of Banks in Singapore (ABS) to host their inaugural Singapore FinTech Festival in November 2016 with a specific forum focusing on RegTech developments, use cases and compliance areas with the greatest need for transformative solutions.

This new generation of regulatory technology could well be the new face for financial regulation. For the financial institutions, these solutions offer the potential to redesign, simplify and automate data-driven compliance to alleviate regulatory pains and divert more resources back to achieving business objectives. For the regulators, RegTech-inspired reforms provide automated reporting and advanced analytics to modernize their own internal systems, update regulatory regimes to keep pace with market participants and better manage systemic risks. As for the consumers, they stand to benefit as compliance increases and banks focus additional attention on what is important for them — safer products that meet their needs and support their financial security.

Growth drivers are falling into place for RegTech to shape financial regulations of the future. Watch this space!

The views reflected in this article are the views of the authors and do not necessarily reflect the views of the global EY organization or its member firms.
AUSTRAC FINALIZING RULE CHANGE TO ALLOW RELIANCE ON THIRD-PARTY CDD DATABASES

Nathan Lynch, Head Regulatory Analyst, Australia & New Zealand, Thomson Reuters

The Australian anti-money laundering regulator is finalizing its proposed changes to the customer due diligence (CDD) rules to allow reporting entities to rely solely on third-party information databases. The Australian Transaction Reports and Analysis Centre (AUSTRAC) is working on a regulatory impact statement to accompany its proposed rule change, a spokeswoman for the regulator said.

The proposed amendments to Chapter 4 of the AML/CTF Rules were the subject of a consultation that closed on July 8, 2015. The Australian anti-money laundering regulator had proposed changing the AML/CTF Rules to strengthen the CDD requirements in response to industry feedback from an initial consultation in 2014.

The changes to Chapter 4 of the AML/CTF Rules would broaden the collection of identification information from sources other than the customer, which is consistent with the Financial Action Task Force’s (FATF) recommendations.

FATF Recommendation 10 on Customer Due Diligence states that financial institutions must undertake measures “identifying the customer and verifying that customer’s identity using reliable, independent source documents, data or information.” FATF does not require that the “reliable, independent source documents, data or information” be sourced only from the customer.

Chapter 4 of the AML/CTF Rules currently requires that information be sourced from the customer. Under the new proposals, reporting entities would be able to obtain that information from a variety of sources, including third-party databases.

“During the CDD consultation, industry submitted that there are regulatory advantages and savings if their ability to collect information from sources other than the customer was broadened,” AUSTRAC said.

The regulator’s rule change has been designed to address any concerns around customer privacy associated with the move to third-party EDD. In December, the regulator published a draft Privacy Impact Assessment. The final version is expected to be published on the regulator’s website in coming weeks. The PIA was the result of a request from the Australian Privacy Commissioner, who recommended that an assessment be undertaken to address concerns that the proposed amendments would have a privacy impact on individuals.

AUSTRAC said the existing requirements in Chapter 4 to verify information with the use of “reliable and independent documentation or reliable and independent electronic data or both” effectively narrows the collection of information to reputable sources. “This will continue with the proposed amendments as the sources must be reliable and independent,” AUSTRAC said.

The regulator has said it expects that “substantial regulatory savings will result from the proposed amendments.”

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ANZ’S FALLOUT FROM AMBANK SCANDAL SOUNDS WARNING FOR REGIONAL BANK EXPANSION PLANS

Nathan Lynch, Head Regulatory Analyst, Australia & New Zealand, Thomson Reuters

The reputational fallout from ANZ Banking Group’s investment in AmBank has acted as a warning to other banks that are considering an expansion across the Asia-Pacific region, counter-money laundering experts have said. ANZ faces pressure at home and in Malaysia over its ill-fated decision to buy a 24 percent stake in AmBank, the listed financial institution at the center of the 1MDB scandal.

Nigel Morris-Cotterill, a Malaysia-based anti-money laundering (AML) specialist, said it was unrealistic to suggest that ANZ’s significant minority stake in AmBank should have given it the power to override the listed bank’s compliance controls. It would have posed challenges from a regulatory and reputational risk perspective if ANZ discovered shortcomings in the Malaysian bank’s compliance controls, he said.

“ANZ has relatively little direct control over the actions of AmBank, and it does not directly manage AmBank’s financial crime controls,” Morris-Cotterill said. “There is always a risk in stepping outside one’s own borders and one’s own culture.”

Sophie Gerber, director of legal and compliance at Sophie Grace Legal in Sydney, said financial services firms were often attracted by the commercial possibilities of regional expansion. The lure of a lighter-touch regulatory environment was a contributing factor.

“When you move into new jurisdictions or markets like Malaysia, you have to manage the risks that this could pose to your more heavily regulated businesses that are under the same branding or the same ownership. This sort of expansion can present opportunities, but it can also be to the organization’s detriment. Once problems emerge in a less regulated market, the regulators in other more heavily regulated countries will inevitably start paying more attention as well,” Gerber said.

The ABC’s *Four Corners* current affairs program reported that a MYR53.7 million (USD13.7 million) ringgit fine that AmBank paid in November last year to Bank Negara Malaysia was for AML breaches relating to politically exposed person (PEP) accounts. At the time, AmBank said in a filing with Bursa Malaysia that the penalty related to compliance and governance failures.

“This review has led to the strengthening of our governance structure and is ongoing,” AmBank said at the time. “AmBank Group takes its compliance responsibility very seriously and has agreed with Bank Negara’s four-year program of work towards achieving market best practices.”

Paddy Oliver, managing director of AML Experts in Melbourne, said it was likely that ANZ was concerned about its exposure to AmBank well before Bank Negara fined it.

Oliver said it was possible that AmBank had reported suspicions to the Malaysian central bank, but these may not have been acted upon at a policing or political level. This would have placed the Australian bank in an unenviable position if there was political pressure to keep the accounts open, he said.

“As would happen in Australia, if a bank meets its legal obligation to report a suspicious transaction to that country’s financial intelligence unit (FIU) it can do no more. It is only if there has been an internal compliance breach — for example, not having adequate or any controls around suspicious matter reporting or PEPs —
that would cause the board and senior management to be concerned,” Oliver said.

REPORTING RED FLAGS

The ABC’s Four Corners team obtained records that show that Malaysian Prime Minister Najib Razak’s accounts had triggered red flags at AmBank, and these suspicions were reported to the FIU at Bank Negara Malaysia.

“Four Corners has established that Dr. Zeti Aziz, the governor of Bank Negara Malaysia, Malaysia’s central bank, was repeatedly warned about the Prime Minister’s unexplained wealth by senior officials at AmBank,” the program said.

The ABC reported that, at one meeting with the bank in 2012, a senior central bank official handed back a compliance report on Najib’s unexplained wealth that was marked as “highly sensitive.” The official allegedly said that Bank Negara did not want to have a copy of the report on its premises.

Morris-Cotterill said many banks with pan-Asian growth ambitions paid insufficient attention to the risks associated with doing business in the region. He said that while Transparency International’s Corruption Perceptions Index was just an “indicative guide,” banks should be wary about buying stakes in financial institutions in foreign countries. This could prove problematic if the bank failed to secure majority control.

Bill Majcher, a Hong Kong-based financial crime consultant and former investment banker, said ANZ should have become concerned about its investment in AmBank by 2012 at the latest. The deterioration in Malaysia’s political environment was apparent to anyone watching the country closely, he said, and bribery and corruption risks had soared for financial institutions.

“Things have changed in Malaysia. It has gone from a high-functioning economy and democracy to essentially a failed state. It has got that bad. Realistically, 10 years ago this might have been a good investment for ANZ,” Majcher said.

“Where I think ANZ starts having a problem is probably around 2011 or 2012, when it should have identified that the prime minister had opened an account with AmBank. That should have gone straight to the board — the audit committee, the governance committee. So you’ve got people from ANZ on those boards for governance reasons to protect their investment and their reputation,” he said.

“TRIGGER EVENTS”

The question still remains to be answered, however, as to whether ANZ Bank should have known about the extent of the problems at AmBank. Morris-Cotterill said it was reasonable to suggest that a significant shareholder with a reputation and its own staff to protect would require that there be certain compliance “trigger events,” particularly in relation to PEPs.

Sources also said the problems for AmBank could have been compounded by Malaysia’s strong bank secrecy laws. It is uncertain whether the passing of information to an overseas shareholder, or to another financial institution, would be permitted under the Banking and Financial Institutions Act of 1989.

ANZ said there was a range of legislative challenges and other obligations under the Listing Rules that hampered its ability to oversee AmBank’s day-to-day management of suspicious matter reporting and other compliance controls.

“ANZ is a minority shareholder of AmBank with 24 percent ownership. As a minority shareholder, ANZ is not involved — and not permitted to be involved — in the day-to-day operations of AmBank, which is a listed company on the Malaysian Stock Exchange,” an ANZ spokesman said.

Majcher said even despite these corporate governance challenges, there were sufficient red flags regarding the volume of money passing through Najib’s accounts to warrant enhanced due diligence on those transfers.

“The question ANZ also has to ask is where were AmBank’s financial controls in the treasury function? With treasury management, you’re looking at capital flows every single day. Those types of transactions involving $70 million into a personal account, that’s not a common occurrence. Even if you didn’t know it was the prime minister’s account, this should still have raised questions on either the governance side or the risk management side,” Majcher said.

“To me, ANZ demonstrated a huge failure in the sense that it wasn’t outcomes-based. It might have been rules-based or risk-based but it wasn’t focusing on outcomes. From what I can see, ANZ is saying that it had a limited influence over AmBank, but to me those are just excuses,” he said.

EFFECTIVE PEP SCREENING

Morris-Cotterill said the case highlighted the importance of having an effective PEP screening program in place when doing business across the Asia-Pacific region, as ANZ and AmBank have found to their detriment.

“All Malaysian banks hold accounts for senior politicians, their families and associates. There is nothing unusual in that. It happens all over the world. However, as a politician’s account, the account in question should have been subject to enhanced monitoring,” Morris-Cotterill said.

“One would have thought, that good corporate governance from ANZ’s head office would have required that at least their representative in the company was aware of sizeable and unusual activity in such an account,” he said.

Morris-Cotterill said Malaysia’s counter-money laundering regime was strong and it was “almost inconceivable” the bank would not have filed reports with the FIU.

“Politics is a powerful thing. The pressure, internally and externally and self-imposed, upon financial institutions is immense, and when it’s a prime minister even more so,” Morris-Cotterill said.

He stressed that this was not a problem that was exclusive to Malaysia — or indeed to developing countries in general.

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AUSTRALIA THE PERFECT LAUNCHING PAD FOR BLOCKCHAIN-BASED TRADING, SAYS MASTERS

Nathan Lynch, Head Regulatory Analyst, Australia & New Zealand, Thomson Reuters

Blythe Masters, the banker widely credited with inventing the credit default swap, has set her sights on a new target for innovation and disruption: Australia’s securities trading infrastructure. Masters said Australia was the perfect launching pad for a new securities settlement platform based on so-called “distributed ledger technology,” or blockchain. Masters’ company Digital Asset Holdings (DAH) is working with the Australian Securities Exchange (ASX) on a blockchain-based technology that aims to slash settlement times and streamline risk management, market supervision and back-office compliance for market participants.

“Australia is the perfect environment for this type of project,” Masters said. “The project the ASX is running has the potential to be one of the first successful projects of this type in the world.”

The ASX has invested A$15 million to buy a stake in DAH as it develops a potential replacement for its legacy CHESS settlement infrastructure. The age of the system and the computer code upon which it is built means that it will need to be replaced within the next few years.

Peter Hiom, deputy chief executive at the ASX, has taken a deep personal interest in the blockchain project. He said the exchange was taking a calculated risk with its investment in distributed ledger technology. The exchange is not certain that the investment in DAH will lead to a workable replacement for CHESS, but it is a risk that the ASX deemed worthwhile, given the promise of distributed ledger technology to reduce settlement times to T+0 and slash market participants’ capital requirements.

“We’re at the beginning of a journey. We don’t know where that journey will end, but we know where it begins — and it’s right here in Sydney,” Hiom said. “Everything you’ve ever read about blockchain and how it works you need to forget as it relates to a regulated market. No one’s cracking codes or mining coins. It is a different cryptography that is used, but it’s the underlying technology of the blockchain that allows us to think about operating financial markets in a different way.”

Masters reaffirmed that message, saying the platform that DAH and the ASX are building will be based on trusted nodes, not anonymous miners, and this will lead to a huge simplification of the computational power that is required to make Bitcoin work. That simplification will lead to a reduction in processing times and a major increase in the number of transactions that can be processed on the ledger each day.
Masters said it was better to think of the DAH model as a revolutionary database technology that allows multiple versions of a single, indisputable record of transactions to sit on a ledger that exists simultaneously in several different locations. She said the exchange, market participants and regulators would be some of the "trusted parties" that would have access to this ledger.

The fact that the ledger can only be appended, not amended, and transactions cannot be reversed once they have been recorded, meant that it was perfectly suited to trade settlement, Masters said.

"Imagine a database architecture where there are numerous renditions of the same information and that is kept in a network that has multiple nodes. Those nodes each keep a complete, full replica of the relevant database content that is synchronized and replicated so that at any point in time, there is one version of the truth that is accessible in multiple places," she explained.

The data in the ledger would be fully encrypted, which Blythe said would increase security and allow the system to support complex levels of permissioning for the various parties in the securities trading chain.

She said this type of model could improve the security of trading infrastructure and reduce the cost of running settlement infrastructure by an order of 50 to 70 percent.

**REDUCING SETTLEMENT TIMES**

The ASX’s goal with its investment in DAH is to move to a model where the ledger has enough flexibility to allow each trade to operate on a different settlement time frame. Domestic investors, for instance, could move to intra-day settlement, while major funds or overseas investors may choose to stick with T+2 or move to T+1.

Trades under a distributed ledger technology would be irreversible, and changes in ownership, including settlement, could take place in a matter of minutes, the ASX said. In cases where trades need to be reversed — for instance, error trades or “fat finger trades” — the market operator would need to append a new transaction to the ledger.

The exchange and DAH hope that moving to a “single source of truth” model, based on a private blockchain, will achieve significant savings in back-office and reconciliation processes, as well as simplifying the analytics and the recording of many regulatory requirements.

Masters said the lack of fragmentation in Australian markets, with centralized clearing and settlement, made it an ideal location to test these ideas over the next 12 months. She also said the support from regulators such as ASIC made Australia “very attractive” to innovators and start-ups such as DAH.

**REGULATORY BENEFITS**

From a regulatory perspective, the blockchain-based settlement model holds great promise. Under the model that DAH and the ASX are developing, the market regulator would be able to view all trading activity, including the identity details of each trader and market participant.

Masters said investigations into suspected market misconduct would be much faster, simpler and cheaper, as ASIC would have access to an indisputable, centralized record of all transactions. In the early stages of an investigation, market supervision teams would no longer have to pursue each individual broker for information, as they would already have a record of all the relevant trading data that is “computationally unfeasible to fake,” she said.

Masters said this would also allow regulators to take action much more quickly in cases where market misconduct had taken place.

Greg Medcraft, ASIC chairman, said he was personally very excited about the possibilities that blockchain poses for regulators, exchanges and market participants alike.

“I must say I’m fascinated by the potential of the technology. It does take me back to the excitement of my old days in securitization and the start of that new technology,” Medcraft said, referring to his previous role as a structured products specialist with Société Générale. “We think digital disruption will bring great opportunities, and for Australia it’s about harvesting those opportunities.”

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**“We’re at the beginning of a journey. We don’t know where that journey will end, but we know where it begins — and it’s right here in Sydney.”**

PETER HIOM, DEPUTY CHIEF EXECUTIVE AT THE ASX

**CRITICAL SUPPORT**

Hiom said support from regulators was critical in getting this type of disruptive project from an idea to the development stage.

“We have worked with our regulators, with governments and with our market participants to determine exactly how this technology could be applied,” Hiom said.

The ASX deputy chief said regulators were attracted to the idea that each stakeholder could have different levels of insight into the blockchain. This could significantly reduce the costs and complexity of ASIC’s regulatory oversight role, he said.

“For every equity transaction, there are many parties to the transaction. There is the end investor who wishes to sell the shares, the end investor who wishes to buy the shares, there are the executing brokers, there are the clearing participants, the settlement participants, the nominee, the custodian, the exchange itself,” Hiom said. “For participants in that ledger, any one actor would only see what they’re permitted to see, which for most of us means only the information that relates to ourselves.”
ASIC’s market supervision team, on the other hand, would be able to see all of the information that is held on the ledger with updates coming through from all participants in real time. “The regulator would be able to connect every end investor with every asset they own — and the record of that asset, who owned in the past and what the carrying value of that asset is,” Hiom said.

KNOWING YOUR CUSTOMERS AND AML/CTF COMPLIANCE

The ASX and Blythe are also optimistic about the potential to use the blockchain technology to minimize obligations to other regulators, including by simplifying anti-money laundering compliance and satisfying Foreign Account Tax Compliance Act (FATCA) obligations. The ASX and DAH are still exploring the potential of the “trusted digital identity” aspects of blockchains.

Blythe said the ASX and ASIC would have the opportunity, for example, to have a direct window into the beneficial owner behind each market transaction. “What do regulators care about? They care about transparency,” she said.

It is possible, for example, that the customer’s identity could be verified by a trusted third party and recorded on the ledger as “KYC checked” with a unique identifier assigned. That digital identity could then be “ported” as the customer moves between different brokers. The encrypted ID entry on the ledger could include information such as the customer’s nationality, to assist with FATCA, sanctions or AML compliance.

“Once you’ve got that customer information, a whole bunch of things are possible that relate to monitoring for anti-money laundering, FATCA obligations for brokers, even ‘know your customer’ obligations,” Hiom said. “The brokers might not have to undertake a KYC check for each client or an AML check. That’s contained within the ledger and may only need to be refreshed, centrally, on a semi-regular basis.”

The ASX is building its blockchain solution in parallel to the existing CHESS infrastructure. The exchange hopes to have a fully operational system up and running by the end of 2017, at which point it would initiate the transfer across from CHESS.

Hiom said that the initial proposal would be to run the two in parallel with CHESS as a backup system until the market had full confidence in the distributed ledger technology.

BROADER ADOPTION

The fledgling Sydney Stock Exchange (SSX) is also working on a market to be powered by blockchain technology. The exchange is understood to be working with local developers on the new platform, which would underpin its secondary market for private capital.

David Lawrence, SSX chief operating officer, said he believed the secondary market would be a better avenue to test the nascent distributed ledger technology.

“We believe the start-up sector, especially disruptors, will be more receptive to the adoption of new blockchain technologies for this platform than the existing listed company market,” Lawrence said.

If the technology behind the secondary market is a success, the SSX will look to roll the platform out across the primary market at a later date. At present, the SSX has only five listings but is looking to expand this with a recent re-branding exercise and a move away from its focus on listing Chinese companies.

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