Cross Border Compliance Report 2019

Sponsored by:

www.asianprivatebanker.com

This survey was conducted independently by Asian Private Banker, but was made possible through the sponsorship of BRP and Indigita.
# Table of Contents

**PART I: WHY THIS SURVEY**

1. Private banking in Asia ................................................................. 10
2. Scope of the survey ........................................................................ 11
3. Cross-border activity ..................................................................... 13
4. Research Methodology ................................................................. 17

**PART II: RESULTS OF THE SURVEY**

5. Landscape of Cross-border Compliance ........................................ 20
6. Awareness of Cross-border Risks .................................................. 24
7. Internal Cross-border Regulation (country manuals) and Organisation .................................................. 28
8. Travels and internal validation ...................................................... 36
9. Tax Suitability .............................................................................. 38
10. Training ..................................................................................... 40
11. Business Relationships with Finders, Business Introducers, and IAM .................................................. 44
12. Controls on Cross-border Activity and Sanctions .......................... 46
13. IT Developments ........................................................................ 48
14. Conclusion ................................................................................. 53
15. Bibliography .............................................................................. 55
List of Charts

1. Institution Type ........................................................................................................................................... 17
2. What is the size of your institution’s AUM in Hong Kong and Singapore? ........................................... 18
3. How many RMs does your firm employ in Hong Kong and Singapore? ..................................................... 18
4. What percentage of your firm’s AUM in Hong Kong and Singapore is generated from offshore flows? ................................................................................................................................. 21
5. Aside from Hong Kong and Singapore, in how many countries do your clients reside? .................. 21
6. How would you rate your knowledge of cross-border regulations? .............................................................. 22
7. What percentage of your firm’s AUM in Hong Kong and Singapore is generated from offshore flows? ................................................................................................................................. 23
8. How do you usually interact with your clients that reside outside Hong Kong and Singapore? ........ 23
9. How would you rate the following risks related to the cross-border activities of your firm? ...... 25
10. How would you rate the following risks related to the cross-border activities of your firm? ...... 25
11. Have you ever been subject to inspection, audit or a recommendation from a supervisory authority with regards to cross-border risk mitigation? .............................................................. 26
12. Have you ever quantified your civil liability exposure linked to cross-border product placement? ........................................................................................................................................... 27
13. What are your firm’s sources of information for cross-border compliance issues? .......................... 29
14. What are your firm’s sources of information on cross-border compliance issues? .......................... 29
15. Which of the following country manuals for cross-border financial issues do you have at your disposal? ........................................................................................................................................... 30
16. Has your firm defined default rules applicable to business relationships with customers residing in countries for which the bank does not have country manuals? .................................................. 30
17. How do you update your cross-border country manuals? .................................................. 31

18. How often do you update your cross-border country manuals? ........................................ 31

19. Which topics do your country manuals or your ongoing analysis cover? ......................... 32

20. Which topics do your country manuals or your ongoing cover? [Comparative] .................... 32

21. Do your firm’s internal guidelines provide solutions for complex situations? ................. 33

22. Do your firm’s internal guidelines define how to determine the relevant cross-border rules for a legal structure? .................................................................................................................. 33

23. Do your firm’s internal guidelines define how to determine the relevant cross-border rules for a legal structure? [Comparative] ........................................................................................................ 34

24. Who in your firm is ultimately in charge of cross-border compliance? .............................. 35

25. How does the person/department in charge of cross-border compliance report on cross-border risk? .................................................................................................................................................. 35

26. What best describes the validation process that your relationship managers need to undergo before they travel to a foreign country on a business trip? ........................................ 36

27. What best describes the validation process that your relationship managers need to undergo before they travel to a foreign country on a business trip? ........................................ 37

28. Does your firm take into consideration cross-border compliance risks when deciding on the duration of overseas business trips for relationship managers? ........................................ 37

29. How does your firm decide on the duration of overseas business trips for relationship managers? .............................................................................................................................................. 38

30. What best describes the importance of tax suitability in your cross-border risk mitigation strategy? .................................................................................................................................................. 38

31. What best describes the importance of tax suitability in your cross-border risk mitigation strategy? [By Institution] .................................................................................................................. 39
32. What kind of training does your firm offer to relationship managers on cross-border regulation? ................................................................. 40

33. What kind of training does your firm offer to relationship managers on cross-border regulation? [By Institution] ........................................................................................................................................... 41

34. What type of tools does your firm use for its cross-border regulation training programs? .......... 41

35. What type of tools does your firm use for its cross-border regulation training programs?
[By Institution] ...................................................................................................................................................... 42

36. Do you require that relationship managers take any tests and/or obtain certification covering cross-border regulation? .................................................................................................................... 42

37. Do you require that relationship managers take any tests and/or obtain certification covering cross-border regulation? [By Institution] ............................................................................................................. 43

38. How would you rate the importance of the following considerations when your firm decides to partner with a business finder? ........................................................................................................ 44

39. Remuneration for business finders is based on? ................................................................................................. 45

40. How often does your firm monitor compliance with internal cross-border rules? ......................... 46

41. What are the consequences for a relationship manager for a violation of internal cross-border rules? ............................................................................................................................................... 46

42. Does your firm perform checks on the cross-border compliance of your business finders? ........ 47

43. What best describes the digitisation process of your cross-border compliance operations? .......... 49

44. Do you agree or disagree with the following statement: “The digitalization of our cross-border rules is a strategic goal for our firm”? ............................................................................................................ 50

45. Which areas does your firm plan to cover with regard to the future digitalisation of its cross-border compliance structures? ........................................................................................................................................ 50
46. Which areas does your firm plan to cover with regard to the future digitization of its cross-border compliance structures? (By Institution) ................................................................. 51

47. How would you rate the contribution of an effective IT solution relating to cross-border compliance risk to the following issues? ................................................................................ 51

48. Within the next 24 months, the needs of your firm to tackles cross-border compliance risk will: ........................................................................................................................................ 52

49. If you foresee an increase or significant increase in your firm’s cross-border compliance needs, what do you believe are the most important driving forces behind this trend? .................. 52

List of Tables

1. Breakdown of research timeline .................................................................................................................. 19

2. To the best of your estimates, what percentage of your firm’s AUM in Hong Kong and Singapore is generated from offshore flows? .................................................................................. 20

3. How would you rate the cross-border risk, that your firm currently faces? .............................................. 24

4. Cross-border compliance capabilities and knowledge .................................................................................. 45
1. Private Banking in Asia

Globally, Asia has become the fastest-growing region in terms of private wealth and assets. In 2017 alone, personal financial wealth in the region grew by 19% to reach an overall level of US$36.6 trillion, with Mainland Chinese residents accounting for 57%¹ of that total. It is fair to say that Asia has enjoyed impressive growth in the past decade, with 2017² seeing the combined assets under management (AUM) of the top-20 private banks in the region (excluding China onshore) surging past US$2 trillion for the first time.

Set to benefit most from this growth are the region’s two main offshore wealth management centres – Hong Kong and Singapore. With US$1.3 trillion in offshore assets, Hong Kong is the second-largest cross-border financial centre in the world after Switzerland, while Singapore comes a close third with US$1 trillion. Moreover, according to a 2018 Asian Private Banker report on Singapore’s role as an offshore wealth management hub, approximately 82.5% of its AUM originate from abroad. A similar scenario can also be discerned in Hong Kong, where Mainland Chinese assets account for the majority of offshore flows into the territory.

Indeed, both Hong Kong and Singapore have been positioning themselves as advantageous locations for cross-border transactions in order to attract offshore wealth, as proximity is a key factor for investors when selecting an offshore financial services location. According to the aforementioned Asian Private Banker report, Southeast Asia is Singapore’s largest source of offshore inflows. While Mainland China is a key source of asset inflows for both jurisdictions, it is Hong Kong that particularly benefits, largely on account of the tightened capital controls regulations now in place on the Mainland. In terms of other inflow sources, Taiwan and Japan both remain important to Hong Kong and, to a lesser extent, to Singapore. Ultimately, both these financial centres attract clients from all over the world, while also functioning as regional hubs for private banking activities.

Due to the growing number of clients coming from third-party countries, Hong Kong and Singapore’s financial services providers have increasingly had to contend with overseas regulatory regimes relating to access to client markets, investor protection, foreign exchange control limitations and a number of other issues. At the same time, they have had to service clients subject to different regulations with regard to the taxation of financial assets and revenues on securities. Inevitably, having to juggle so many different regulatory requirements was always going to be the downside of intensified cross-border activity. For many, attempting to keep in step with the different regulatory regimes of a multi-origin client is all but attempting the impossible, at least without an efficient support system. In line with this, the consensus among regulators is that cross-border exposure has become the most significant risk for the private banking sector. While it’s accepted that a higher level of prudence and vigilance is required when dealing with multiple regulatory requirements across multiple jurisdictions, how are financial institutions to address this issue? And what will need to change?

PART I: WHY THIS SURVEY

2. Scope of the Survey

In a bid to understand the exact nature of the cross-border challenge facing the sector, *Asian Private Banker*, sponsored by Geneva-based BRP Bizzozero & Partners SA (BRP) and its regtech subsidiary, Indigita SA (Indigita), conducted an in-depth study of how private banks are attempting to ensure cross-border compliance. In particular, it sought to analyse the current and future regulatory landscape of the market, while examining the current and emerging trends in Asia’s private banking and wealth management industry, especially with regard to Hong Kong and Singapore.

Beyond the largely accepted need for the expansion of compliance teams, there is a consensus among industry leaders that the wider deployment of IT and technology has a key role to play. Such technology can be utilised in a number of different ways in each division, including providing additional regulatory insights to relationship managers and helping to optimise mundane operational tasks. Given the benefits of scalability and the expertise required for regulatory innovations, it is no surprise that third-party regulatory technology (regtech) firms have become ubiquitous in an industry where their services are continually required.

It is no overstatement to say regtech is expected to bring momentous changes to the private banking sector. Our findings indicate that 75% of private banks have increased their technology budget over the past year, with a third of respondents reporting an increased spend of at least 20%.³ This year-on-year increase may be due to the significant number of new regulations introduced over the last decade, which has created a considerable administrative burden for many private banks. In lieu of further margin compressions, many banks have resorted to information technology as way of improving operational efficiency and meeting regulatory requirements.

Essentially, this digitalised cross-border compliance seeks to extract the maximum value from data, assist in the decision-making process and ease the overall burden on compliance professionals. The use of intelligent tagging, for example, has facilitated the accelerated categorisation of text documents, enabling compliance teams to indicate the relative importance of different legal terms. In the future, however, comprehensive coverage of regulatory issues could be provided by – and be executable via – a rule engine. As this would provide a binary – yes or no – answer to regulatory queries, wealth managers would no longer have to postpone responding to queries due to regulatory uncertainties, while financial entities would be able to rely on the consistent application of appropriate solutions.

In light of this, it is wholly understandable that the use of third-party professionals to implement digital-based management of compliance risks has become increasingly popular in recent years. This access to digital solutions that provide real-time updates on cross-border regulatory developments and tax compliance has proven an essential tool for wealth managers looking to mitigate potential regulatory risks.⁴ Artificial intelligence has also come to play an increasingly important role in helping relieve RMs of stringent regulatory tasks, freeing them to spend more time on relationship development.⁵ Globally, ³ *Asian Private Banker*, “75% of Asia PBs increase tech spending YOY prioritize still painful for KYC”. *Asian Private Banker*, 15 May 2019. Available at https://asianprivatebanker.com/technology/75-of-asia-pbs-increase-tech-spending-yoy-prioritise-still-painful-kyc/


for example, UBS has deployed 700 ‘bots’ [autonomous online programs], including 100 in Asia, to assist RMs in AML (anti-money laundering), onboarding and the provision of advice.\(^6\) It is wholly probable that such technology could also contribute to mitigating cross-border risks.

It is also worth noting that most third-parties offer training to users of their compliance products. While some intermediaries offer AML/CTF (counter-terrorist financing) management software, which provides transaction monitoring screening and management tools, others offer a wholly automated “first line of defense”, based on digitalised country manuals, tax codes and regulatory frameworks.\(^7\)\(^8\)

This reduces the need for calls to specialist compliance staff, while increasing the consistency of regulatory risk assessment and enhancing productivity across the entire organisation. In addition, through a combination of sophisticated algorithms, such solutions allow different sources of data to be combined via a transversal intelligent process. This sees the financial services regulatory requirement crosslinked with tax consideration as well as product placement rules by taking into consideration the context (active vs passive, cross-border vs meetings, etc.) the status of the client (qualified vs retail), the underlying agreement (execution only/advisory/discretionary) and the public data available on financial products (documentation (such as prospectus), categorisation, etc.).

To this end, the report answers the following questions:
1. What impact do cross-border regulations have on a private banks’ activity?
2. How are cross-border risks perceived?
3. How do private banks structure and monitor their cross-border activities?
4. What are the sourcing policies for compliance solutions (in-house/third-party solutions) and what is their relationship to cross-border solution providers?
5. How is training in cross-border compliance organised?
6. To what extent do private banks look towards digitalisation as a mean of augmenting the efficiency and effectiveness of their compliance processes?

\(^6\) ibid.
\(^8\) Bilan, Interview to the CEO of Indigita. https://www.bilan.ch/entreprises1/indigita_digitalise_la_gestion_de_fortune_
3. Cross-border Activity

In order to put this report in due context, it is first necessary to review the concepts underpinning cross-border activity, the risks related to any such activity and the overall stance of the regulatory bodies.

To that end, it may be useful to begin by defining terms. The term cross-border activity, we take to refer to any financial activity related to the export of services abroad. The concept of financial services with regard to private banking, meanwhile, extends across banking services (account opening, issuing of payment cards etc.) and investment services (discretionary portfolio management, advisory, execution only, Lombard credit). In line with international treaties, we can consider such services to have been exported in every instance where a client or prospect resides abroad. From this perspective, cross-border activity occurs even if a client travels to Singapore or Hong Kong to receive the financial service in question. Among the other options for exporting services are the following: the relationship manager travelling to the target country and the relationship manager interacting with a client or prospect who resides abroad via a remote means of communications. Essentially, cross-border activity takes place every time a service provider and a client reside in different jurisdictions, even if these jurisdictions are part of the same state (e.g. Hong Kong, Macao and Mainland China).

Cross-border activity also includes instances when financial products are sold to/placed with an investor who resides in a different jurisdiction to one of the service providers. The concept of financial product here can be taken to be referring to any financial instrument (CIS, structured products etc.) utilised in the private banking sector.

Any activity involving a client resident in a third jurisdiction obliges a financial institution to take into consideration the barriers that can limit its activity or require it to be licensed in the target country. The most important barriers can be summarised as follows:

- Financial regulations concerning access to the local market
- General rules on commercial presence
- Investor and consumer protection rules
- Foreign exchange control rules
- Taxation of the financial institution as a permanent establishment
The problem is that there are no two jurisdictions that have the same rules in place regarding inbound cross-border activity. With regard to the financial regulations relating to market access, each jurisdiction has a specific approach (territorial, personal or both) and different tolerance thresholds, depending on the nature of the promoted services, and has different safe harbours (e.g. status of the client), while not all jurisdictions can recognise reverse solicitation. To make things still more complex, many of the constituent nations of the European Union also have different regulatory requirements.⁹

The complexity of the situation creates many risks for financial institution, with these collectively known as “cross-border risks”. This concept comprises at least five different elements:

- **Regulatory risk**: This relates to any violation of a target country’s market access regulations.
- **Civil risk**: Refers to the possibility that a client may sue the financial institution and invoke the protection of his own domestic legal system.
- **Criminal risk**: Relates to the possibility that a financial institution or a relationship manager might be prosecuted for aiding and abetting a client in the commission of a tax crime by assisting the latter in opening an overseas account.
- **Tax risk for the financial institution**: An area of uncertainty that has become increasingly significant for financial institutions over recent months is the tax risk. This is linked to the possibility that any activity performed in the target country may be linked to a permanent establishment, thus revenues generated from services rendered to clients overseas could also be taxed in the client’s country (e.g. interest rates on credits granted to individuals living in Italy). Last but not least, the commercial risk refers to the inability of a financial institution to fully take into consideration the tax impact on the client of any financial products placed in the execution of a discretionary or advisory mandate.

Cross-border exposure is considered by many regulators to be the biggest risk facing the private banking sector. In 2010, the Hong Kong Securities and Futures Commission¹⁰ and the Swiss FINMA¹¹ were among the first regulators to directly express this concern, while earlier this year, Banco Central del Uruguay also raised concerns about liquidity- and credit-risks relating to cross-border activities.¹²

---

⁹ A. Bizzozero/R. McGrand/B. Bartels, op. cit., p. 10 ss.
¹⁰ Securities and Futures Commission, “Circular clarifying the licensing obligations of corporations and individuals and more particularly those conducting business outside Hong Kong”, April 1, 2019, available at: https://www.sfc.hk/edistributionWeb/gateway/EN/circular/openFile?refNo=H571
Of late, it has become increasingly apparent that the risk posed by cross-border activity is becoming a universal concern. A prime example of a country with a regulatory framework and an ongoing evolution requiring intensive monitoring by overseas financial companies is China. Two examples will demonstrate why this has become such an issue:

- In February this year, the People’s Bank of China (PBOC), China’s central bank, replaced its foreign exchange department with a macro-prudential management bureau in order to strengthen and improve financial regulation and reduce risk. This new bureau is responsible for formulating macro-prudential policies, assessing financial agencies, drafting rules and regulations and monitoring and managing systemic financial risks. With the establishment of this bureau, one of the aims of the Chinese government was to restrict capital flight.

- As of February this year, illegal forex trading has become a criminal offence, with those involved liable to be charged with the illegal operation of a business. According to a joint judicial pronouncement by the Supreme People’s Court and the Supreme People’s Procuratorate, any bankers found to be unofficially trading in large amounts of foreign currency are liable to be charged with operating an illegal business and face more than five years of imprisonment. Previously, offenders were only liable to be fined.

In addition, earlier this year, the State Administration of Foreign Exchange (SAFE), the Chinese state body with oversight of foreign exchange market activities, initiated action against one Mainland entity for soliciting Mainland investors to engage in forex margin trading outside the Mainland on behalf of an online trading platform operated by the entity’s offshore shareholder. On this matter, SAFE advised: “The Mainland authorities have not approved any institution to engage in forex margin business – either directly or on an agency basis – on the Mainland, and it is illegal for any unapproved institution to conduct forex margin trading or for any client, whether an organisation or individual, to entrust an unapproved institution with doing so”.¹³

The upshot of this is that many overseas regulatory authorities have taken note of the measures taken by the Chinese regulator and ensured their domestic market players are fully aware of these mainland requirements. Accordingly, Hong Kong’s Securities and Futures Commission (SFC) has not only informed local operators about this development, but also stated that all locally-licensed corporations (i.e. those entities licensed in Hong Kong) must ensure they fully comply with the licensing and other requirements of all jurisdictions where they operate or provide services, while also implementing adequate compliance controls.¹⁴

For its part, the Australian Securities & Investments Commission (ASIC) has also emphasised its concern regarding AFS licensees with China-based clients that may be conducting unlicensed or illegal activities if they are providing margin foreign exchange products to mainland retail clients. It also indicated that will consider whether breaching overseas law is consistent with obligations under

---


¹⁴ ibid.
existing Australian legislation to provide services ‘efficiently, honestly and fairly’.¹⁵ It also seems that SAFE contacted the European Securities and Markets Authority (ESMA) in order to express concern that some EU brokers may be soliciting Chinese residents with such services.¹⁴

From 2014 onwards, the Automatic Exchange of Information (AEOI) and the Common Reporting Standard (CRS) have been rolled out on a global basis, with 82 jurisdictions now signatories.¹⁶ The fact that assets are now increasingly tax transparent, however, has not necessarily meant that cross-border risk has been reduced. On the contrary, as the client is transparent, he/she is no longer concerned over the possible disclosure of the situation to the relevant authorities. Indeed, should any problems arise, it is now far easier for the client to sue the bank and/or report any possible violation of financial regulation on the part of the bank. At the same time, as the primary goal of maintaining assets abroad is no longer to conceal them, clients are now more interested in receiving an efficient investment service, one that also takes into consideration the tax impact of any securities investment performance.

In terms of operational exposure, cross-border risk needs to be evaluated, mitigated and monitored. While, at present, every bank and EAM manages cross-border risks in a different fashion, some clear trends are apparent. One of the intentions of this report is to identify and evaluate any such trends.

---


4. Research Methodology

This report was commissioned by BRP and Indigita and conducted by Asian Private Banker between February-July 2019. To that end, Asian Private Banker collated and analysed primary and secondary sources and gathered data within a framework that integrated quantitative and qualitative analytical research tools.

In more specific terms, we established a seven-member research team, comprising five members of the Research Department, one member of the Editorial Department and one member of the Relationship Management Department. This team took full advantage of the research opportunities on offer at a number of Asian Private Banker events, while leveraging the company’s existing network and consulting extensively with members of the senior management team. Other team members were appointed on an ad hoc basis.

In terms of data collection, Asian Private Banker’s research team prepared a questionnaire that was circulated to our contacts in private banks, independent asset managers (IAMs) and multi-family offices (MFOs) in Hong Kong and Singapore. The sample was based on 51 completed questionnaires, with 33% of the sampled population sourced from Asia-Pacific-headquartered universal banks, 41% from Euro-headquartered banks, 8% from US-headquartered banks, and 18% from IAMs and MFOs.

In addition to the questionnaires, we conducted 21 face-to-face semi-structured interviews with senior representatives and relationship managers (RMs) of private banks and wealth managers in Hong Kong and Singapore, all of whom had relevant experience in cross-border compliance.

In all, the report captured more than 75% of the market with contributors’ AUM ranging from less than US$1 billion to more than US$100 billion, while extending across 80% of the top 30 banks in AUM terms.
RM headcount across the sample population for private banks differed considerably, with 14% reporting they had less than 10 RMs, 20% with 10-50 RMs, 37% with 50-100 RMs, and 29% with more than 100 RMs.

Chart 2: What is the size of your institution’s AUM in Hong Kong and Singapore?

Chart 3: How many RMs does your firm employ in Hong Kong and Singapore?
Active work on the project began on 1 February 2019. At this point, a four-stage process was implemented:

1. Conducting any preliminary research deemed necessary (including a literature review)
2. Design and execution of research material
3. Data collection and analysis
4. Drafting, editing, digitalisation, and submission of the completed research paper

The precise dates for each stage of the project were as follows:
- Preliminary research: 1 February 2019 - 8 February 2019
- Research design: 8 February 2019 - 15 February 2019
- Data collection: 15 February 2019 - 30 April 2019
- Data analysis: 30 April 2019 - 30 May 2019
- Drafting, editing: 1 June 2019 - 24 June 2019
- Submission: 24 June 2019
- Digitalisation: 1 September 2019 - 30 September 2019
- Publication: 1 October 2019

Table 1: Breakdown of research timeline

<table>
<thead>
<tr>
<th></th>
<th>Feb</th>
<th>Mar</th>
<th>Apr</th>
<th>May</th>
<th>Jun</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preliminary research</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Research design</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Data collection</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Data analysis</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Drafting, editing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Submission</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
5. Landscape of Cross-border Compliance

Offshore flows constitute one of the major driving forces behind the emergence of Hong Kong and Singapore as global financial hubs for the private banking sector. Such flows also currently account for the lion’s share of the AUM by private banks and wealth managers. According to survey respondents, on average, 52% of the AUM by private banks and IAMs in Hong Kong and Singapore has been generated from offshore flows, with four respondents indicating that 100% of their AUM is derived from offshore flows. According to forecasts from the Boston Consulting Group (BCG), the cross-border assets booked in Hong Kong and Singapore are expected to exceed US$3.3 trillion by 2023.¹⁷

These figures, however, do not fully correlate with the general information summarised in Chapter 1, where it was emphasised that approximately 80% of AUM in Singapore and Hong Kong was sourced abroad. The discrepancy between the two figures is down to differing interpretations of the precise concepts. What is clear from both statistical sets, however, is that overseas-derived AUM plays a hugely significant role in the private banking sector.

Table 2: To the best of your estimates, what percentage of your firm’s AUM in Hong Kong and Singapore is generated from offshore flows?

<table>
<thead>
<tr>
<th></th>
<th>Average</th>
<th>Median</th>
</tr>
</thead>
<tbody>
<tr>
<td>To the best of your estimates, what percentage of your firm’s AUM in Hong Kong and Singapore is generated from offshore flows?</td>
<td>52</td>
<td>54</td>
</tr>
</tbody>
</table>

A further breakdown by nature of institution shows that IAMs/MFOs have the highest percentage of AUM derived from offshore flows (58%). US and APAC-headquartered banks follow closely behind with offshore flows accounting for 57% and 51% of their AUM, respectively.

Furthermore, offshore flow sources are concentrated in comparatively few countries, with 47.5% of survey participants indicating that, apart from Hong Kong and Singapore, their client base extends across less than five countries, while two-thirds indicated their clients reside in fewer than 10 countries outside of Hong Kong and Singapore. Interviews with chief compliance officers from private banks and IAMs, revealed that the majority of offshore flows originate in China, Indonesia, Malaysia or Taiwan. Mainland Chinese clients, in the case of Hong Kong banks, accounted for by far the largest proportions of cross-border activities. Overall, only about a third of the firms participating in the survey currently had a client base that extended across 10 or more countries. This last figure highlights the fact that Singapore and Hong Kong are both global financial centres for the private banking sector, attracting clients from across the world. This is likely to be boosted still further by increasing geopolitical tensions, which are leading to increased asset inflows into financial centres with political and regulatory stability and the offer of high-quality services, with Hong Kong and Singapore precisely fitting the bill. Inevitably, many of the financial institutions in these two Asian financial hubs see this as an opportunity to expand their services into additional overseas markets.
Regulatory frameworks - including market access rules, national consumer protection regulations and investor protection rules (including MiFID) - inevitably impact the cross-border banking business model, often obliging banks and IAMs to take strategic decisions with regard to the number of countries they want to focus on. In the future, it will be increasingly important to assess the influence of cross-border risk mitigation tools on the geographical strategy of a bank or IAM. Clearly, the facility to monitor cross-border risk would allow financial institutions to extend the geographical scope of their private banking activity.

Accordingly, it is imperative for RMs to be well-versed in cross-border regulations in order to avoid significant non-compliance risks. Overall, our respondents assessed their knowledge of cross-border regulations as ‘above average’, with the average score being 3.7, on a scale of 1 to 5, with 5 representing the highest level of familiarity and 1 indicating the lowest level of familiarity with cross-border regulation. When broken down by nature of institution, the survey indicated that IAMs/MFOs have the greatest familiarity with cross-border regulations, followed closely behind by Europe and US-headquartered banks, while APAC-headquartered banks ranked the lowest among our sample.

Perhaps unsurprisingly, those firms with a greater reliance on offshore flows had more in-depth knowledge of cross-border regulation. Firms with above average cross-border regulation knowledge (i.e. those firms that ranked their knowledge of cross-border regulation higher than 3) reported that 60% of their AUM in Hong Kong and Singapore was generated from offshore flows, while firms with below average cross-border regulation knowledge relied on offshore flows for only a third of their AUM. Inevitably, financial institutions in major international wealth management centres, such as Hong Kong and Singapore, must leverage on their service quality and proven capability to service cross-border clients in order to continue to secure asset inflows.
As described in chapter I. 3 above, cross-border activity occurs every time a client is domiciled abroad or the transaction takes place abroad. Cross-border business is usually conducted by an RM travelling to his client’s country of residence in order to meet in person and establish a working relationship. As such clients are frequently highly mobile, however, engagement with an RM can also take place at the bank’s head office. Contact may also be made by the RM remotely via email or a long-distance telephone call.

All such channels, to one extent or another, had been utilised by many of our survey respondents. At 76%, phone/email was the most commonly used option, followed by clients meeting RMs at bank premises (73%), with RMs travelling to their clients’ country of residence (71%) coming in third place.
6. Awareness of Cross-border Risks

In chapter I.3 above, we described the risks associated with cross-border activity. We are now going to consider the level of awareness of such risks on an industry-wide basis.

Although compliance investment advice has long been a cornerstone of the financial services sector, over the past decade, US$320 billion in fines have been levied with regard to related transgressions.¹⁸ This saw regulatory costs amounting to US$100 billion in 2017 alone, according to Thomson Reuters, with regulatory alerts being issued at an average rate of 201 per day.¹⁹ Looking ahead, most banks expect the number of regulatory publications, changes, and announcements to only carry on increasing.

Despite the rising legal and reputational risks involved in the provision of cross-border financial services and the many high-profile failures reported over recent years, most respondents were confident of their own regulatory compliance, viewing the risk their firms’ face with regard to cross-border compliance failure as below average (with an average score of 2.8, on a scale of 1 to 5, where 5 represents the highest level of risk).

Table 3: How would you rate the cross-border risk, that your firm currently faces?

<table>
<thead>
<tr>
<th>How would you rate the cross-border risk, that your firm currently faces?</th>
<th>2.8</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average</td>
<td></td>
</tr>
<tr>
<td>Median</td>
<td>3.0</td>
</tr>
</tbody>
</table>

Overall, respondents viewed the risk of losing a client because of a failure to take into account the tax regulation in the client’s country of residence relating to proposed/confirmed investments as the greatest risk associated with their cross-border activities. Their next biggest concern was placing securities banned in the client’s country of residence in his/her portfolio, followed by the risk of being sanctioned by the target country’s regulatory body. These findings were taken as clearly indicating two things: firstly, while financial institutions have a general awareness of cross-border risks, there is no across-the-board understanding as to the exact nature of the biggest risks associated with cross-border activity; secondly, financial institutions own perception of the seriousness of cross-border risk is far lower than the reality of such risk.

¹⁹ Ibid., p. 17
PART II: RESULTS OF THE SURVEY

A further breakdown by nature of institution indicates that APAC-headquartered banks, who are generally less confident of their familiarity with cross-border regulations, take a more serious view of the potential risks associated with cross-border activity.

Chart 9: How would you rate the following risks related to the cross-border activities of your firm?

![Chart 9](chart9.png)

Chart 10: How would you rate the following risks related to the cross-border activities of your firm?

![Chart 10](chart10.png)
On the part of regulators, however, an increasing awareness of the gravity of cross-border risk has led to a greater number of inspections, audits, and recommendations from a supervisory authority – such as the SFC and MAS in Hong Kong and Singapore. Prior to 2015, less than 10% of wealth management firms had been subject to an inspection/audit/recommendation. Since 2015, however, the number of firms subject to such enhanced scrutiny has more than doubled. Indeed, in 2018 alone, 30% of respondents indicated that they had been subject to an inspection/audit/recommendation with regards to cross-border risk mitigation.

Chart 11: Have you ever been subject to inspection, audit or a recommendation from a supervisory authority with regards to cross-border risk mitigation?

Chart 12 indicates that a sizable number of Hong Kong/Singapore financial institutions are yet to properly evaluate their own level of exposure to cross-border risk. Despite the fact that the civil liability for violating the rules governing the placement of products client’s country can be objectively seen as a tremendous risk, only 40% of responding firms had fully or partially quantified their civil liability exposure with regard to cross-border product placement. Overall, more than half the contributing firms had not evaluated the level of civil litigation risk associated with an active recommendation to a client abroad to invest in particular financial products. Due to the complexity of the relevant regulations, awareness of such risks may be particularly important for the cross-border product placement of collective investment schemes (CIS) and/or other sophisticated financial products, such as structured products, CFD, binary options, etc.²⁰

---
The risk is even more evident in instances where certain products are specifically prohibited in individual jurisdictions and have been recommended in a general promotion to all of an institution’s private investors.

Chart 12: Have you ever quantified your civil liability exposure linked to cross-border product placement?

- Yes: 15.8%
- Partially: 23.7%
- No: 60.5%

61% of respondents lack of risk management implementation
7. Internal Cross-border Regulation (country manuals) and Organisation

The challenge financial institutions face when it comes to ensuring global compliance is complicated by the fact that every country has different regulatory requirements. In the Asia-Pacific region, there is no collective body comparable to the European Union that provides a regulatory framework for all the constituent countries to adopt.²¹ The upshot of this is that every jurisdiction makes its own independent policy decisions regarding financial regulation with little or no overlap with other countries. Additionally, the situation is complicated still further as the regulatory requirements of these countries are not available in one common language, such as English.

Currently, governance, risk and compliance functions account for 15-20% of total run-the-bank costs, with 10-15% of the total workforce of an average universal bank engaged in governance, risk and compliance.²² In other words, up to 10% of a bank’s revenue is spent on compliance costs every year. Of more concern still, senior executives at private banks see compliance costs as only likely to increase as their firms’ expansion into additional foreign markets requires allocation of a higher level of resource to cross-border compliance. As a result, financial institutions have to choose between expanding into new business areas or withdrawing from a number of recently-entered markets in order to focus on a few core markets. For firms that choose to continue their expansion abroad, they will need to implement a robust and reliable cross-border framework if they are to master all the market-specific requirements. First and foremost, any such framework must prioritise the acquisition of specific information on the regulatory requirements of all target countries. Any bank/IAM that seeks to mitigate its level of cross-border risk needs to understand the relevant rules on market access and translate these into internal guidelines (country manuals).

In all, 79% of the participating private banks/IAMs indicated that they regularly request legal opinions from local law firms when looking to analyse cross-border issues. In addition, 60% acquire cross-border country manuals from external providers, while more than 60% also rely on in-house personnel. This data clearly shows that cross-border issues are typically tackled through a variety of routes. It is highly likely that the solicited legal opinions are used to address specific questions, while cross-border country manuals are the preferred means of tackling the issues most frequently arising. For their part, in-house personnel, of course, are the logical choice when it comes to processing external legal opinions, customising the content of acquired country manuals to the specific organisation and size of the company and to undertake any specific research projects and in-depth analyses deemed necessary for the business.

²¹ Note: In reality, each country has specific rules concerning cross-border activities, in addition to the general regulatory framework on UE level (A. Bizzozero/R. McGrand/B. Bartles, op. cit., p. 15 ss).
Among the different types of institution, those that identified as an IAM/MFO have the highest number of constituent firms that consult with local law firms with regard to cross-border compliance issues. This is largely on account of the fact that they lack the in-house resources to constantly keep up-to-date with the regulations in multiple jurisdictions.

**Chart 14: What are your firm’s sources of information on cross-border compliance issues?**

- **Legal opinions directly from local law firms**
- **Country manuals for cross-border financial issues from external providers**
- **In-house personnel**
- **No organized solutions for the time being**

---

**Legend**

- Green: Legal opinions directly from local law firms
- Blue: Country manuals for cross-border financial issues from external providers
- Orange: In-house personnel
- Green: No organized solutions for the time being

---

**Chart 13: What are your firm’s sources of information for cross-border compliance issues?**

- Legal opinions directly from local law firms
- Country manuals for cross-border financial issues from external providers
- In-house personnel
- No organized solutions for the time being
About half our respondents provided country manuals for their target countries only, while 26% of participants were taking a broader view and looking to cover both target and non-target countries, and 21% provided country manuals for every country where they had a client.

In addition, 67% of respondents stated they had defined default rules applicable to business relationships with customers residing in countries for which the firm does not have country manuals, while only 9% had not yet defined business protocols for countries that are not covered by their country manuals.

**Chart 15: Which of the following country manuals for cross-border financial issues do you have at your disposal?**

- 60% Only covering target countries
- 40% Covering target countries and non-target countries
- 20% For all countries where client reside

**Chart 16: Has your firm defined default rules applicable to business relationships with customers residing in countries for which the bank does not have country manuals?**

- 60% Yes, for all countries
- 40% Yes, just for target countries
- 20% No
Overall, 94% of the participating firms had implemented an update of their cross-border country manuals. More specifically, 67% of such firms update their cross-border country manuals internally on a case-by-case basis through ad hoc legal opinions or subscriptions to alerts, while just more than a quarter of all respondents have outsourced the updating of their manuals to an external provider.

In terms of the frequency of updating country manuals, 50% of private banks/IAMs choose to do so in response to regulatory changes, while 41% have no formal internal rules regarding update frequency. In fact, updates take place once a year for 35% of the surveyed financial institutions, and every two years for a further 15%. Looking to the future, most respondents expect to update their manuals more regularly in order to keep up with the accelerating pace of regulatory change, as well as in response to the ever-greater awareness of cross-border risk.

Country manuals provided by financial institutions cover a multitude of topics linked to cross-border activity, with almost all such documents addressing issues related to marketing and selling banking and financial services. A further 70% of contributors reported that their manuals also cover regulations relating to the placement of financial products, while 55% cover foreign exchange control regulations.
Although almost all country manuals cover rules on marketing/selling banking and financial services, there is a steep reduction in coverage of additional topics in the manuals utilised by firms with less familiarity with cross-border regulations.

Chart 19: Which topics do your country manuals or your ongoing analysis cover?

Chart 20: Which topics do your country manuals or your ongoing cover? [Comparative]
In all, 65% of respondents indicated that their firm’s internal guidelines provided solutions for handling complex situations. Typically, such guidelines would cover such issues as which cross-border rules apply when the RM is in contact with an individual residing in country A and serving as a power of attorney, while representing an account holder residing in country B.

Additionally, more than half of the participating firms had internal guidelines that define how to determine the relevant cross-border rules for a number of legal structures, such as a trust or a foundation, in which the process distinguishes between transparent and non-transparent structures. Some 38% of respondents, however, reported that their firms’ internal guidelines do not define how to determine the relevant cross-border rules for a legal structure.

**Chart 21: Do your firm’s internal guidelines provide solutions for complex situations?**

- Yes: 60%
- No: 40%

**Chart 22: Do your firm’s internal guidelines define how to determine the relevant cross-border rules for a legal structure?**

- Yes, and the process distinguishes between transparent and non-transparent structures: 40%
- Yes, but the process does not distinguish between transparent and non-transparent structures: 20%
- No: 40%
Tellingly, APAC-headquartered banks – the grouping that ranked lowest in terms of familiarity with cross-border regulations – accounted for a significant proportion (50%) of the firms that had not yet established internal guidelines as to how to determine the relevant cross-border rules for a legal structure. Perhaps more surprisingly, among IAMs – the sector that, on average, has the most in-depth knowledge of cross-border regulations – there was also a significant number of firms that did not have set guidelines for determining the relevant cross-border rules for a legal structure.

Chart 23: Do your firm’s internal guidelines define how to determine the relevant cross-border rules for a legal structure? [Comparative]
In terms of internal division of responsibility, more than 75% of respondents indicated that their compliance team oversees cross-border compliance. Essentially, this means that compliance teams are responsible for formulating cross-border guidelines, creating and updating country manuals and other related tasks. Throughout Asia, over the past four-five years, compliance teams have typically taken on greater responsibility and decision-making capabilities. As a consequence, it is not unusual for regulatory-focused solutions to be trialed in the region before being rolled-out internationally.

More than half of the respondents stated that the officer responsible for determining cross-border risk reports to the executive committee, while 41% of heads of compliance report to their firm’s risk/audit committee and a further 35% report to the board of directors. In some 12% of participating firms reporting to governing bodies was not mandatory, though a significant number of such instances related to IAMs. It is also worth noting that, in some cases, all reports on cross-border risk are presented to the executive committee and to their board (and/or the risk/audit committee). This dual-reporting structure is particularly common in those firms with the highest awareness of cross-border risk.
8. Travels and Internal Validation

Travelling to their country of residence is a common means of building a relationship with a client/prospect. As travelling abroad exposes a bank to enhanced cross-border risk, there is a global move towards making RM travel subject to prior approval and sometimes dependent on passing an internal test. Overall, 47% of the participating firms stated that their RMs were required to pass a test before being authorised to travel to a foreign country to meet clients. Some 45%, however, reported that while no tests were obligatory prior to a business trip, the RMs had to be authorised at a senior level following the submission of a formal request. Among the remaining 8%, it appeared no prior approval process was in place.

Chart 26: What best describes the validation process that your relationship managers need to undergo before they travel to a foreign country on a business trip?

Further analysis indicated that Europe and US-headquartered banks have the most robust approval processes, with 80% and 50% (respectively) of such firms requiring RMs to pass a test before being authorised for travel.
Chart 27: What best describes the validation process that your relationship managers need to undergo before they travel to a foreign country on a business trip?

Across the whole sample, four out of five respondents indicated that their firm takes into consideration cross-border compliance risks when deciding the duration of RM overseas business trips.

Chart 28: Does your firm take into consideration cross-border compliance risks when deciding on the duration of overseas business trips for relationship managers?

Generally, the duration of RMs’ business trips are determined on a case-by-case basis, with the length of stay seldom being the same for every country. This is in line with the fact that, in Asia, each individual jurisdiction makes independent policy decisions regarding financial regulations with little or no overlap with other countries, a situation that makes a lack of consistency almost inevitable.
9. Tax Suitability

According to Asian Private Banker’s 2019 Client Tax Reporting study, wealth managers have experienced a significant increase in requests for client tax reports, with 65% of respondents indicating increased interest from their clients, especially among those whose assets are managed by IAMs and MFOs. Furthermore, 97% of employees at private banks expect the demand for tax reporting to increase in the next three years. Many, however, are concerned not only that such data will be provided to regulators, but also as to just how regulators will use the information they receive.

In total, 52% of participants in the 2019 Client Tax Reporting study stated that they provide tax reporting solutions to their clients via generic tax reports. The sample population for this report reflected a similar breakdown, with 52% indicating that their firm takes tax suitability into consideration when assessing cross-border risk, while a further 16% intend to take tax suitability into account in future as they look to enhance their cross-border offering. It is worth noting that ‘tax suitability’ in this context is deemed to mean the capacity to take into consideration the tax impact of the financial investment the bank/IAM is placing in the managed account or is proposing to a client based on an advisory mandate. As indicated in the introduction, the incapacity to take into consideration tax suitability would represent a significant commercial risk as the client could be prompted/obliged to change service providers. This has been a standard requirement in the EU since 2015.²³

Chart 30: What best describes the importance of tax suitability in your cross-border risk mitigation strategy?

²³ Note: Firms should ensure that staff giving information about investment products, investment services or ancillary services that are available through the firm have the necessary knowledge and competence to [...] understand the key characteristics, risk and features of those investment products available through the firm, including any general tax implications and costs to be incurred by the client in the context of transactions. Particular care should be taken when giving information with respect to products characterised by higher levels of complexity
A breakdown by institution type again shows a stark contrast between APAC-headquartered banks and their counterparts located elsewhere when it comes to integrating tax suitability into their risk mitigation strategy. In total, some 60% of APAC-headquartered banks who participated in the study stated they do not take tax suitability into account as part of their current risk mitigation strategy – almost double the size of the second highest percentage that gave the same response.

Chart 31: What best describes the importance of tax suitability in your cross-border risk mitigation strategy? [By Institution]

It is, however, expected that more institutions will begin to take tax suitability into account in the next 12 months, with 66% of banks planning to increase their investment in additional client tax reporting services in response to client demands.
10. Training

As regulators set out aggressive agendas for the revision of cross-border rules, multi-jurisdictional financial institutions face the challenge of ensuring RMs keep up to date with the regulatory requirements of all target countries.

In light of cross-border risk, it is imperative that financial institutions ensure RMs are well-versed in the regulatory requirements of each jurisdiction where they service clients, with training required to ensure compliance with all current regulations and tax suitability requirements in each location.

Across all respondents, 71% indicated their firm offered continuous general training in cross-border awareness, while 29% and 21% offered continuous training in particular countries and ad-hoc training in particular countries, respectively. Only 6% of participating firms reported they provided no formal training.

Chart 32: What kind of training does your firm offer to relationship managers on cross-border regulation?

In response to the torrent of new guidelines released by various regulatory bodies with a focus on senior management accountability and the creation of a more ethical environment within financial institutions, many APAC-headquartered banks have substantially increased the level of training offered to RMs, consequently giving them the highest percentage among all types of participating institution with regard to the level of continuous general training they offered. They did, however, lag behind many of their counterparts when it came to training geared to specific countries, with only 8% of APAC headquartered-firms indicating that RMs received training in this area. By contrast, 24% of European and 17% of USA-headquartered banks offered training relating to specific targeted countries.
Overall, in-house face-to-face training was the most favoured among our sample population, with 56% of contributing firms having adopted such a practice. At 35%, e-learning developed in-house was the next most popular option, followed by the use of e-learning material acquired from external providers at 29%. Face-to-face training sourced externally was the least popular option, presumably due to related sensitivity/confidentiality issues.

Chart 33: What kind of training does your firm offer to relationship managers on cross-border regulation? [By Institution]
In fact, only those APAC-headquartered banks with the least familiarity with cross-border regulations and IAMs comprised of small teams and lacking the necessary resources, relied on face-to-face training provided by external providers. Among the Europe and US-headquartered banks, however, a significant number have developed in-house e-learning tools, an option seen as not only cost-efficient but also as one that ensures their institutions remain compliant with the most up-to-date regulations across multiple jurisdictions.

Chart 35: What type of tools does your firm use for its cross-border regulation training programs? [By Institution]

Despite the number of new regulations designed to ensure financial institutions are compliant from the top down, 45% of respondents indicated that their RMs are not required to take any tests or obtain any certification related to cross-border regulations, indicating the persistence of something of a ‘box-ticking mentality’ among many financial institutions in Hong Kong and Singapore. More positively, 41% of RMs are actually obliged to continually pass tests in order to ensure they are staying up-to-date with all regulatory changes.

Chart 36: Do you require that relationship managers take any tests and/or obtain certification covering cross-border regulation?
The training programs on offer at various types of institution closely reflects the level of validation RMs are required to have when dealing with cross-border activity. Again, APAC-headquartered banks and IAMs tend to have the least enforcement when it comes to the mandatory testing/certification of RMs with cross-border responsibilities.

Chart 37: Do you require that relationship managers take any tests and/or obtain certification covering cross-border regulation? [By Institution]

For their part, the MAS and SFC have released a substantial number of proposed guidelines in their respective jurisdictions with the aim of increasing the accountability of senior managers, as well as junior staff, who fulfil "material risk functions", such as internal audits and risk management. These newly rolled-out regulatory regimes have led to an increase in personal liability, which, in turn, has put pressure on the management of financial institutions to prioritise compliance issues. In line with this, Ong Chong Tee, MAS's deputy managing director for financial supervision, warned that persistent misconduct and a lack of individual accountability will serve to erode public confidence in financial institutions. Accordingly, the watchdog confirmed its commitment to steering the industry away from “mechanistic compliance,” and emphasised that a top-down approach is necessary if the financial industry's ethical standards are to be raised effectively.

In terms of strengthening senior accountability, the Singapore regulator cited the example of a number of jurisdictions – including the UK, Australia and Hong Kong – that already have in place regulations that clarify the responsibilities of senior managers in banks and other financial institutions.

---

11. Business Relationships with Finders, Business Introducers, and IAM

As banks expand their operations overseas in search of new revenue streams, many opt for a partnership with a finder, a business introducer and/or an IAM as a means of brokering introductions with new clients. IAMs also sign cooperation agreements with finders and business introducers for the same purpose. Among the majority of respondents, geographical coverage was the most important criteria when they looked to appoint external business finders. Overall, the majority of our interviewees were seeking new business opportunities in such emerging HNWI hotbeds such as India, Thailand, and Vietnam, as well as in a number of the more established markets, notably China, Indonesia and Japan.

When assessing cross-border risk, it is worth bearing in mind that financial institutions are deemed liable for any actions taken on their behalf by a contracted business finder. Regulators, therefore, advise all financial institutions to take this into consideration when selecting and managing any finder. According to the findings of our survey, more than two-thirds of the participating financial institutions were aware of the significance of this risk. The geographical area where finders are active is considered as being a major factor in cross-border risk and is generally taken into consideration when appointing such service providers.

Chart 38: How would you rate the importance of the following considerations when your firm decides to partner with a business finder?

More than half of all respondents stated that the remuneration of business finders was purely based on retrocession fees on commissions generated by introduced clients or a mix of AUM of introduced clients and retrocession fees. Only 17% of respondents, however, stated their remuneration model was fixed on a country-by-country basis after taking into consideration the various cross-border constraints. This last figure indicates the beginning of a trend to take a country-by-country approach, which is generally seen as the best way to mitigate the cross-border risk represented by the activities of external finders.
PART II: RESULTS OF THE SURVEY

Chart 39: Remuneration for business finders is based on?

Overall, the cross-border capabilities of business-finders was viewed as highly important, with respondents according it an average score of 4.04 (on a scale of 1 to 5, with 5 denoting the highest degree of importance). Furthermore, the importance accorded cross-border capabilities revealed a slight inverse correlation with familiarity with cross-border regulations, except in the case of IAMs who tend to prefer to outsource compliance-related tasks where possible.

Table 4: Cross-border compliance capabilities and knowledge

<table>
<thead>
<tr>
<th></th>
<th>How would you rate the importance of cross-border compliance capabilities when you onboard a new business-finder?</th>
<th>How would you rate your knowledge of cross-border regulation?</th>
</tr>
</thead>
<tbody>
<tr>
<td>APAC-HQ bank</td>
<td>4.40</td>
<td>3.00</td>
</tr>
<tr>
<td>Europe-Universal</td>
<td>3.50</td>
<td>3.94</td>
</tr>
<tr>
<td>Europe-Pure play</td>
<td>3.30</td>
<td>3.60</td>
</tr>
<tr>
<td>IAM/FO</td>
<td>4.20</td>
<td>4.19</td>
</tr>
<tr>
<td>US-HQ bank</td>
<td>4.00</td>
<td>3.50</td>
</tr>
</tbody>
</table>
12. Controls on Cross-border Activity and Sanctions

More than 80% of contributors stated their firms are constantly looking to ensure compliance with internal cross-border regulations, with country manuals, travel policies and training all deployed for just such a purpose. This indicates that, despite the “box-ticking mentality” of many firms, compliance with the most up-to-date regulations is a priority for the majority of financial institutions.

Further underlining this, three out of four contributors indicated that any of their RMs who violate internal cross-border rules face severe penalties, including a reduction in remuneration and even possible dismissal.
This has been seen as coming in response to the internal governance frameworks advocated by a number of regulators, which typically include consequence management systems and formalised whistleblowing channels designed to ensure adequate protection for those who highlight transgressions. Under the SFC’s MIC regime, all licensed companies are required to name the senior managers in charge of eight core functions, including overall management oversight, key business lines, operational control and review, risk management, finance and accounting, information technology, compliance and anti-money laundering and counter-terrorist financing.²⁵ Under the new rules, the manager in charge may be subject to civil action relating to any misconduct in their area of responsibility should investigations prove they were liable for the transgression.

Chart 42: Does your firm perform checks on the cross-border compliance of your business finders?

13. IT Developments

Banking services and products are becoming increasingly digitally-focused and, inevitably, the compliance arrangements of private bank must factor in the related regulatory developments. As, somewhere in the world, a new finance-related regulation is introduced or an existing one amended every 12 minutes, this has seen the services of regtech firms increasingly in demand, with multiple private banks having collaborated with such service providers in order to enhance their regulatory efficiency and compliance measures.²⁶

Indeed, it has been widely recognised that financial institutions that provide cross-border services face an increasing regulatory burden. Since 2009, financial institutions have been fined more than US$342 billion, a figure expected to rise to more than US$400 billion by 2020.²⁷ This surge in regulatory activity has led to a greatly increased volume of extremely complex, constantly evolving regulations. These vary from one jurisdiction to another and must be understood and complied with both in the country where the financial intermediary is based and the country where the client resides. In addition, the increasing deployment of technology in cross-border business means that financial institutions have to reconcile their capacity to use fintech to sell products and services on a global basis with a regulatory framework which is still predominantly based on national regulations.

Currently, no financial institution operating at an international level can deal with the ever-changing regulatory environment without adopting a comprehensive cross-border policy, with the industry overall requiring a comprehensive and pragmatic solution to such challenges. In line with this, every firm should implement regtech solutions to handle all regulatory data related to every location where they are active. In this field, the challenge is to move from a situation where financial services providers manage their activity based on in-depth knowledge of the regulatory environment of their target market to one where they can easily access detailed information on the regulatory constraints of any market where they are active. Inevitably, failing to do so will have two primary consequences – exposure to undue risks and missing out on potentially lucrative opportunities.

One thing is clear, in the future no auditor will approve any business relationship that has been established or is continuing without the final services institution in question having in place the required information resource, as well as an efficient IT system capable of continuously monitoring changing cross-border constraints.

The financial industry is also facing a major paradigm shift with regard to financial product-related data. In the case of the EU, for instance, MiFID II has made it mandatory for product manufacturers to provide distributors with clear information on target markets. While this is a long-awaited and very positive development, it has nevertheless, raised the issues as to whether financial product distributors can exploit such indicators in an appropriate manner as part of the suitability process.

Inevitably, financial institutions that are unable to manage their cross-border compliance efficiently will face not only potential fines and unnecessarily high operating costs but will also risk missing-out on significant business opportunities.

Only 16% of respondents, however, reported that their firms had implemented the digitalisation their cross-border compliance systems. A further 32%, though, did state their firm were currently undergoing this process.
Among the firms that have not yet digitalised their cross-border compliance operations, 54% of respondents agreed/strongly agreed that this remained one of their firm’s strategic priorities.

**Chart 44:** Do you agree or disagree with the following statement: “The digitalization of our cross-border rules is a strategic goal for our firm”?

- Strongly disagree: 3%
- Disagree: 3%
- Neutral: 40%
- Agree: 37%
- Strongly agree: 17%

In total, 81% of participating firms were prioritising the digitalisation of their investment services, while a further two-thirds planned to implement regtech to help ensure their compliance with financial product placement regulations.

**Chart 45:** Which areas does your firm plan to cover with regard to the future digitalisation of its cross-border compliance structures?
US- and Europe-headquartered banks appear to be most ready to embrace the digital transformation of their cross-border compliance structures, with such institutions placing a particular emphasis on its importance to their investment and banking services.

Chart 46: Which areas does your firm plan to cover with regard to the future digitization of its cross-border compliance structures? [By Institution]

It is also clear that the majority of financial institutions see real value in the use of IT solutions to manage various cross-border compliance risks, including risk reduction, administrative burden reduction and operational cost reduction.

Chart 47: How would you rate the contribution of an effective IT solution relating to cross-border compliance risk to the following issues?
In total, more than 70% of respondents expected the need to address cross-border compliance risks to increase/significantly increase in the next two years, while less than 5% of financial institutions see the necessity of tackling cross-border compliance risk as likely to decrease.

Among those respondents expecting a significant increase in their firm’s cross-border compliance requirements, the most significant driving force was seen as increasing international regulatory requirements, while the increase in national regulatory requirements was a close second.

Chart 48: Within the next 24 months, the needs of your firm to tackles cross-border compliance risk will:

- Significantly increase: 7.4%
- Increase: 22.2%
- Remain the same: 66.7%
- Decrease: 3%

Chart 49: If you foresee an increase or significant increase in your firm’s cross-border compliance needs, what do you believe are the most important driving forces behind this trend?

- International regulatory requirements will increase: 75%
- National regulatory requirements will increase: 25%
- The share of offshore customers in the firm's client book will increase: 50%
- The total number of the firm's customers will increase: 0%
14. Conclusion

Tightening regulations and raised geopolitical tensions have led to increased asset inflows into Hong Kong and Singapore, financial hubs that can offer regulatory stability and high-quality services. As such, offshore flows constitute a major driving force of AUM in both Hong Kong and Singapore. It is estimated that cross-border assets booked in the two mid-shore hubs will exceed US$3.3 trillion by 2023.

Our research shows that, in general, financial institutions in Hong Kong and Singapore are well aware of cross-border risks, although some institutions seem not to have fully evaluated the extent of this risk.

The survey also indicated that almost every financial institution is taking appropriate measures for mitigating cross-border risks.

The first measure taken by many is building up their familiarity with the regulations relating to access to foreign markets and the placement of financial products in such jurisdictions. This knowledge of overseas regulatory requirements is typically acquired by a variety of means, including subscriptions to country manuals and the solicitation of local legal opinions. At present, the majority of banks and IAMs only aim to develop their knowledge with regard to their primary target countries. It is, however, possible to discern a trend for this knowledge being extended across all countries where an institution’s clients reside (at present, 26% of respondents stated that they provide country manuals for both target and non-target countries). The trend is even more apparent among those committed to establishing digitalised cross-border regulatory resources. In general, financial institutions in Hong Kong and Singapore are confident in their ability to comply with cross-border regulations, with respondents according this an average score of 3.7 (on a scale of 1 to 5, with 5 denoting the highest level of familiarity with cross-border regulation). A more in-depth breakdown, however, indicated that APAC-headquartered banks have less familiarity with cross-border regulations than their European-and US-counterparts, while IAMs – who tend to have the most seasoned RMs – have the highest level of knowledge related to cross-border activities. At the same time, this apparent familiarity with regulatory requirements inversely correlates with the perceived level of risk relating to cross-border activities. It is also worth mentioning that the range of knowledge related to foreign regulatory requirements frequently extends to the tax suitability of financial products, with 68% of firms reporting that such suitability is taken into account (or will be over the near term) when assessing cross-border risk.

The second measure concerns the organisational structure of financial institutions with regard to cross-border activities. In all, more than 75% of respondents indicated that it is their compliance teams that have responsibility for cross-border compliance, with more than 50% of firms also requiring the responsible officer to report to the executive committee with regard to cross-border risk.

The increased transparency required by banks has led to a greater number of inspections, audits, and recommendations from a supervisory authority with regards to cross-border mitigation. Between 2015-2018, the percentage of firms subject to inspection/audit/recommendation increased by 200%. In 2018 alone, 30% of the firm participating in our survey had been subject to an inspection, audit, or recommendation with regard to cross-border activity and their internal organizational structure.

The third measure relates to training. Although the majority of financial institutions organise training on cross-border compliance issues, there is a sense that such initiatives remain open improvements.
Given that 71% of banks take a box-ticking approach to this by providing general training in cross-border awareness, the consensus is that these programs could be further enhanced. In the case of RMs, their cross-border expertise needs to evolve from generalist in nature to being focused more on particular geographical areas, with a specialist knowledge of tax and regulatory issues, as well as an understanding of the structures best suited to opening client accounts in individual jurisdictions.

Another priority is for firms to increase the frequency with which RMs are tested on their understanding of cross-border regulatory issues. This is seen as an invaluable means of ensuring key personnel remain up to date with all regulatory changes, as well as a significant move forward from the perfunctory approach to such issues widely seen in the past. Given the frequent nature of such updates and the time constraints on staff, it is thought the e-learning could be the ideal means of ensuring contemporaneous familiarity.

Last but not least, it’s fair to say that many financial institutions see huge potential in digitizing cross-border compliance solutions. Despite a substantial number of firms exhibiting a “mechanistic approach” to compliance, the majority still acknowledge the importance of enhancing such practices. In total, 82% of respondents confirmed that their firms constantly monitor internal cross-border rules compliance, with a number of resources - including country manuals, travel policies, and training – deployed for this specific purpose.

This commitment is further underlined by the fact that 79% of the participating financial institutions impose strict censure on RMs who violate internal cross-border rules, with the available disciplinary options ranging from financial penalties to dismissal.

With banking services and products are becoming increasingly digitally-oriented, many private banks and IAMs have embraced RegTech as a means of maintaining compliance with the increasingly dynamic regulatory environment. In total, 48% of participating firms had already digitalised their cross-border compliance systems or were currently undergoing the process. Among the firms yet to commit to such a process, 54% agreed/strongly agreed that the digitisation of their cross-border regulatory compliance procedures remained a strategic goal. Overall, it was widely acknowledged that digitisation improves efficiency, ensures consistency and reduces costs. It’s clear to see that a global digitised solution, extending across all client-relevant jurisdictions, would be a huge asset to any financial institution, ensuring universal regulatory compliance while keeping the related costs to a minimum.
15. Bibliography

A. Bizzozero/R. McGran/B. Bartels, op. cit., p. 10 ss.


Circular No. 2320 of the BCU. January 17, 2019.


