The Risk That Lies Beneath: Cross-Border Risk within Banking & Capital Markets

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Global firms must be aware and understand the implications of various jurisdictional requirements, highlighted by the impact of structural reform, financial regulations and referendums, to establish effective and efficient cross border controls.

Lack of effective controls when transacting cross borders can lead to significant legal, regulatory and reputational risk & liability. Understanding and mitigating the risk can be overwhelming, given complex cross-border business models and various local jurisdictional requirements; however, with a proven, structured control framework and approach, the challenge can be broken down into smaller, manageable solutions and implementations.

How 'Legal Entity Aware' Are You?

Cross-border risk is inherent to a global business model. Recent industry response to structural and regulatory reform have highlighted significant cross-border risk causing firms to scramble to effectively demonstrate adherence to local jurisdictional requirements. An effective response requires a strategic and considered approach to enable it to holistically address the evolving regulatory environment.

Below are *sample* key assessment questions around understanding how aware you are of legal entity usage across the trade lifecycle and what front office controls may be needed:

1. How are legal entities being used in the lifecycle of transaction (e.g., riskless principle, principle, agency) and how are legal entities being recorded in various downstream systems?
2. Are legal entities appropriately licensed or have an exemption from being licensed in order to engage with clients in different jurisdictions?
3. Are Front Office employees adhering to local requirements when travelling to or 'reaching in' to different jurisdictions?
4. Is it commercially viable to engage with clients in particular jurisdictions with the additional layers of controls that may be needed?

Impact of Structural Reform, Financial Regulations & Referendums

Since the financial crisis there has been, and continues to be significant regulations and reform to the Banking and Capital Markets sector driven by a need to make it more accountable, transparent, resilient and resolvable.

Many firms have assessed ways to streamline processes, enhance efficiencies and reduce costs to improve their bottom line. There has subsequently been a significant impact to the industry in terms of obligations and requirements to meet the various overarching cross border regulatory landscape

Most notably the following have (or will have) significant impact on cross border harmonization:

- BREXIT
- Intermediate Holding Company Structuring and Regulatory Considerations (IHC)
- Dodd Frank Wall Street Reform and Consumer Protection Act (Title VII Swaps Reform, Volcker Rule, Recovery & Resolution Planning, DFAST/CCAR)
- SEC Rule 15a-6
- Foreign Account Tax Compliance Act (FATCA)
- Know Your Customer (KYC) & Anti-Money Laundering (AML)
- Markets in Financial Instruments Directive (MiFID/MiFID II)
- European Market Infrastructure Regulation (EMIR)
- Various Trade Reporting Regulations

Global firms should have large sustainable programs of work looking at these structural and regulatory reforms and their impacts across the various platforms, regions and jurisdictions.

Key Considerations

With this in mind there are a number for key considerations that firms will need to address in order demonstrate adequate & effective controls to regulators and minimize their exposure:

- Defining the impact of client domicile (Country of Incorporation vs. Country of Operation)
- Leveraging existing regulatory client classification (e.g., KYC, MiFID, etc.)
- Identifying salesperson and trader locations, as well as primary business locations and jurisdiction presence
- Assessing revenue, RWA and balance sheet impact
- Understanding and mapping legal entities across the trade lifecycle and within various downstream systems

- Assessing impact of cease trading vs continue trading while remediating vs accepting risk
- Assessing existing new and amended product approval process vs cross border requirements

An example of the industry response to the structural and regulatory reform has seen the development of coordinated client execution strategies to ensure specific booking follows a common, and standard booking strategy while addressing the regulatory and structural reform requirements. In order to do this a foundation needs to be established to document the current state usage of legal entities by product and assess these against legal and regulatory requirements.

Need for Enhanced Supervisory Controls Framework

Firms require a robust supervisory controls framework of preventative and detective controls that are sustainable, repeatable and accountable to mitigate all impacts of risk. It is also important to develop a 'playbook' to enable scalability and quickly address new and changing requirements.

Examples of controls and awareness:

- Enhance global client onboarding policies and procedures accounting for local jurisdiction client classification requirements.
- Update existing policies and procedures that may be impacted by changes to the cross border booking model (e.g., follow the sun, remote booking, etc.)
- Establish global employee travel tracking tool, with attestations, pre-travel approval and MI reporting
- Adjust and amend global booking model (e.g., back-to-back trade execution)
- Pre trade controls to enhance front office regional and jurisdiction regulatory requirements by informing front office employees of potential client and jurisdiction restrictions
- Post trade detective controls to identify breaches with respect to client and jurisdiction restrictions (e.g., implementing a T+1 Trade Control Breach Report)
- Develop risk reports (e.g., open exposure risk and P&L reports by region and jurisdiction)
- Develop training, communication and jurisdiction guidelines/policies for front office staff to enhance awareness around jurisdictions requirements
- Revise new and amended product approval process
- Define Governance and change control structure to improve transparency, standardization and consistency

Change Control Management

A structured approach through various work streams should be undertaken to successfully enhance the risk framework around client footprint, management, execution and on-boarding. Initially there will be a need to leverage progress achieved through existing tactical fixes to build a cohesive and efficient client management framework

How CrossCountry Can Help

CrossCountry Consulting has a proven structured control framework and approach, along with experienced consultants that can manage and implement this change

- Project Due Diligence and Mobilization
- Document Current State (Identify jurisdictions and understand which legal entities are engaged with clients)
- Assess Commercial/Reputational Impact
- Define Cross-border Requirements with Legal & Compliance
- Identify and Assess Current State Gaps Against Cross-border Requirements
- Develop & Implement Solutions
- Document a 'playbook' to enable scalability
- Establish Ongoing Monitoring and Change Control

Contact Information

CrossCountry Consulting is ready to help you analyze your cross-border risk. Please contact us for more information.

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