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The Changing Face of Compliance and Why You Should Be Concerned

What caused compliance and risk management to become the foremost concern of all financial services providers?


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This article was written by Eva Diaz, co-founder and Managing Director of Profile Booster.

It used to be one of the nondescript back office functions in most financial services companies. Today, compliance and risk management is at the core of every company in the financial markets.

In fact, compliance and risk management has become so critical to the operations of all financial services providers that the demand for experts has skyrocketed over the past few years.

What brought about the changes that pushed compliance and risk management from the humdrum of the back office to the front and centre of every financial services provider including CFD and FX brokers?

According to Doug MacKinnon, an independent anti-money laundering (AML) and counter-terrorism financing (CTF) consultant in Sydney, the 2001 September 11 attacks in the US brought about massive changes in the compliance and risk management environment.

He describes the current compliance and regulatory landscape as far more sophisticated and global in outlook since the 9/11 attacks which destroyed several landmark buildings and have been estimated to have cost at least $3 trillion in damages in the US.

"The compliance and risk environment has become more complex and complicated because of the growing role of security and counter-terrorism measures," MacKinnon said.

Though the security and counter-terrorism measures have always been part of global risk management, MacKinnon said the events surrounding the 9/11 attacks put AML and CTF at the forefront of the global compliance and risk management landscape.

The growing role of technology

Another key factor in the changing role of compliance and risk management is the rapid advancement in information technology. Many leading compliance experts agree that technology has brought and continues to bring innovation and changes.

Long Nguyen, another independent compliance and AML expert, said: "Technology has been the key driver in this change. Technology has increased the speed and variety of ways we now communicate, transact, and work."

He said the current environment now uses data-driven compliance programs to help identify issues before they become systemic.

Xiaoshu Liu, director at Xenia Compliance Consulting, agrees with Nguyen about the prominent role of technology in the compliance environment.

She said: "Technology is playing an increasingly important role in the risk and compliance space. "RegTech" is the new kid on the block, where start-ups aim to provide technology to help automate part of the compliance and risk management process and to increase overall efficiency in the sector."

According to MacKinnon, the fact that new technology has ushered in new tools and methodologies is now allowing financial services providers – including FX and CFD brokers – to monitor vast amounts of data and information. And this has a tremendous impact on the compliance and monitoring environment.

But as new technology and security concerns continue to transform compliance and regulatory functions, the people who are trying to navigate this complex environment are also facing new challenges.

Nguyen, who served as compliance manager in a number of CFD and FX brokers in Sydney before setting up his consultancy, said there are many challenges when working in such a dynamic and complex environment of risk and compliance.

Nguyen said: “The major difference I can see now is that Compliance/Risk Managers are now a major voice and input in business strategies and plans.”

This is a big contrast to how things were maybe 10 years ago when risk and compliance was more of an afterthought.

From a business perspective, this means a massive shift of focus from the board level down to the customer facing functions.

“I have seen a shift in the Compliance/Risk Management role, moving from a reactive approach to a much more proactive role. From the board of directors to Compliance/Risk Managers, there is now a focus on setting up risk frameworks and controls,” Nguyen said.

MacKinnon, who has served in various in-house compliance and risk management roles before doing consultancy work, said from an AML perspective, the current regulatory framework is putting greater scrutiny and due diligence on companies and individuals across the board.

For financial services companies, this could mean more rigid and stringent processes for bill payments and client onboarding.

According to MacKinnon, there was a time that AML was completely and totally separate from CTF. This is because AML used to be limited to surveillance and tracking of illicit funds suspected to be used in drug dealing and other illegal means.

On the other hand, CTF used to be specifically devoted to tracking the movement of money to terrorist groups.

But with the onset of terrorist groups that have been tapping into the existing system, it is now possible that legal sources of money and legal means of transfer may be used for illegal means (i.e. terrorism activities).

"And this is where AML and CTF have come together to be at the core of any Compliance and Risk Management system now," McKinnon said.

As compliance and risk managers, AML and CTF experts try to keep their heads above water in the complex regulatory environment. What do they need to focus on? What are the challenges they face each day to ensure that they're on top of this complex web?

According to Nguyen, the top 3 priorities he sees are:

1. Governance structures – such as segregation of duties, and overall strengthening control frameworks.
2. Culture within an organisation – a critical factor as the culture of a company can be set and influenced by the board of directors, managers, and leaders. And this culture can last a long time after those people have left their positions.
3. Managing regulatory risk – which involves keeping up and staying on top of regulatory requirements, because if an organisation is unable to plan or keep up with developments within the regulatory environment it could lead to actions by the regulators.

From where she sits as consultant, Liu identified the top 3 concerns and challenges for compliance and risk managers as:

1. **Client suitability**
   CFDs and margin FX products are not for everyone. They are high risk in nature due to their considerable levels of leverage involved. For this very reason, ASIC introduced a series of disclosure benchmarks in RG227 a few years ago.

2. **Payment Methods**
   An increased number of payment methods makes compliance monitoring more challenging. Licensees in the space are offering more and more payment methods to make it easier for clients to fund their trading accounts and to withdraw funds, such as Skrill and Neteller.

   These payment methods all offer anonymity to a certain degree, and the bank account or credit card linked to these payment systems may not necessarily belong to the clients themselves. This may expose a licensee to the potential facilitation of third party transactions, leading to even higher risks in terms of money laundering and/or terrorism financing activities.

3. Client complaints
   Complaints, especially those that involve external dispute resolution schemes such as FOS, can become very expensive very quickly. Client complaints may stem from the fact that a client assumes that a particular trading platform operates a certain way without going through a provider's disclosure documents which set out the key terms and conditions that govern the provider's operations.

   A lot of complaints could have been avoided should assumptions not be made in the first place. Sometimes a provider may offer to pay a client to settle a complaint, not because it has done anything wrong, but because the costs involved in the dispute resolution process could be much higher.

Teo Seng Huat, an AML consultant based in Singapore, identified the three key areas of most concern to compliance and risk managers as:

1. AML measures – regulators are becoming stricter in the AML area. He said the Monetary Authority of Singapore (MAS) has recently canceled one bank license (the second this year) and fined another two banks more than a million dollars each for negligence and lack of AML controls.
2. Understanding the risks involved in leveraging and margin requirements in fluctuating markets.
3. Cyber security and the impact on online trading in FX and CFD and the exchanges.

The future of compliance and risk management

Given the continuing evolution of the financial services sector and the compliance and risk management landscape, what does the future look like and what can traders and financial services providers expect to deal with in the coming years?

MacKinnon said he can see a "continuing vigilance and focus on AML and CTF. It can only get stronger as the focus on security becomes a significant part of the mix."

"It is not going to go away as more governments and corporations give emphasis to Compliance, AML, and CTF."

And while some sectors would say that the emphasis on AML, CTF, and compliance, in general, has meant more expense and additional burden in terms of compliance, MacKinnon said: "For companies that adhere to strict compliance and risk management, it could mean a healthier and more thriving business because the processes provide a natural way to qualify clients,"

"Most companies would actually be doing more business and could avoid any aggravation if they stick to the strict AML and CTF procedures. At the end of the day who would want to deal with a client who would give you grief later?" MacKinnon said.

On the other hand, Nguyen said: "In the next few years, I see there will be a lot of consolidation as companies implement changes that the regulators have set in place. The areas I see the most growth and challenges are in technologies such as Robo Advice and Automated Trading. These will present great opportunities for companies, as well as new risks."

On a similar vein, Liu said: "The regulatory environment in Australia is likely to tighten in the future, this is from both the licensing perspective and the AML and CTF perspective."

Su-King Hii, principal at InnoInvest, a premier advisor in the Australian Financial Services sector, said: "ASIC will continue to apply a close scrutiny on the CFD and FX industry in the foreseeable future."

At the same time, he said there are pending laws and regulations that may also bring more changes to the industry including:

- Pending legislation or new laws to further tighten client money rules
- New laws that will give ASIC more enhanced powers to approve a change in ownership of licensees, and the power to intervene in product designs.

According to Mr. Hii, "We are about to see potentially more changes in the regulatory environment. It is not inconceivable to think that ASIC may be very proactive in dictating how CFD and FX products are delivered."