VIDEO ROUNDTABLE DISCUSSION

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REGULATORY RISK MANAGEMENT

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In the years since the global financial crisis, legislators, government officials and bureaucrats have piled on new rules and regulations. Enforcement and supervisory regimes have been significantly bolstered. However, complexity, uncertainty and lack of clarity all mark the current state of financial regulations in the U.S. and abroad.

A group of experts assessed how compliance officers, risk managers and others in finance must cope with this unsettled state during a recent roundtable panel, "Regulatory Risk Management." The Deal and Intralinks co-produced the video roundtable.

Panelists included **Barbara Novick**, vice chairman of **BlackRock Inc.**; **Satish Kini**, partner at **Debevoise & Plimpton LLP** and chair of the firm's banking group; and **Douglas Gordon**, senior vice president of strategy and product marketing for **Intralinks**. **Rhonda Schaffler**, anchor at **The Deal**, served as moderator.

Kini summed up the confusion. "Many firms would really like to say, 'Okay, if these are the rules, we'll comply with them,' " he said. "But they feel like they don't know exactly what all of the courses of conduct are."

Panelists cited the mammoth financial reform law known as Dodd-Frank as a prime example. The law itself runs to nearly 1,000 pages, but according to Novick, Dodd-Frank has spawned hundreds of studies and rules by various agencies. "Not all of these have even been completed, and with about two-thirds done, we're at 22,000 pages of new rules," she said.

Kini described the law, enacted in 2010, as a mold "in which regulatory implementation … could be poured into that mold, and we could see what the structure would look like. So, amazingly, that is still an ongoing process."

What's more, Novick added, it's quite possible the law itself could be changed. "It's hard not to imagine that, at a very minimum, you need some sort of technical corrections bill or some lack to say, 'Did we really get all of this right, or are there some things that maybe we're a little off?' "

In the aftermath of the financial crisis, the U.S. government created new agencies, which add to the complexity. Kini named three: the Consumer Financial Protection Bureau; the Financial Stability Oversight Council, or FSOC; and the Federal Insurance Office. Kini holds out little hope for that kind of governmental oversight being streamlined. "It's hard to see us really coming down to one financial regulator, and more likely than not we will continue to have a multiplicity of regulators," he said.

Added to all that is what Novick termed as "a whole new wave outside of Dodd-Frank." The Labor Department, for example, has just introduced the Fiduciary Rule related to retirement advice.

Entire categories of financial instruments are being scrutinized. The SEC is expected to finalize by year's end four separate proposals related to money markets: two on reporting, one on liquidity risk management and one on derivatives. "That would be, again, another whole set of compliance and reporting and testing things," Novick said.

What that means, Novick continued, is "a huge sea change going on," both in terms of participants and products related to money markets. "Going forward you're going to have retail funds [which] have different features than institutional funds. You're going to have government funds that have more leeway than some of the prime funds," she said.

Pile on top of everything coming out of the U.S. a dizzying amount of regulations in Europe, the panelists detailed. "It's become a very highly complex, interwoven scheme of regulations, not just in the United States, but also internationally," Kini said. Many institutions are "faced with having to try and work their way through these two sets, or multiple sets of regulatory requirements."

For private funds, as an example, there are different reporting requirements for each country in Europe. For mutual funds, "you need to do every share class in every language for every fund," Novick said. "With a very large fund range, you start talking about […] producing hundreds, maybe even thousands of these [key information documents] for investor disclosure."

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All that makes implementation not only difficult but a kind of moving target. "When you have more regulators, you naturally will have a greater diversity of viewpoints as to what rules mean, a greater diversity of rules, a greater diversity of information collection requirements," Kini said.

There are also very real consequences, with not only firms, but individuals within firms, being threatened with liability. Firms in the financial industry, the panelists agreed, are struggling with a balance between accountability, compliance and core business strategies, between costs and benefits.

Of course, some regulatory issues resonate louder than others. Kini cited anti-money laundering as one particular focus. "There's a lot of regulatory and enforcement risk there, so there's a great deal of effort going into that area," he said, noting that new customer due diligence rules have been issued with a year's lead up time.

Another is what Gordon termed "third-party oversight." Banks, Gordon explained, may have done everything possible and

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necessary to insure proper customer data protection. However, information is becoming extremely mobile and cloud-computing fundamental. Financial institutions work with a variety of third-party providers. The institutions are asking themselves whether they are "doing the right things to protect that data as it moves out," Gordon said.

"The banking regulators have been very clear and have developed very robust third-party information technology oversight guidelines and expectations," Kini added. "They are being very adamant that institutions do oversee all of their service providers, offshore and onshore."

To tackle all this requires substantial investments in IT, the panelists agreed. "Technology is a core backbone of whether people can meet the compliance requirements that they have," Gordon said.

However, because of regulatory uncertainty, how to structure that technology fix is anything but certain. Some firms, Gordon said, ask for an immediate work-over with longer-term solutions held off for later. Others, he said, have a "view of where risk is moving over the next five to 10 years" and look for a much longer-term solution that can fit that construct.

In meeting the challenges of those complex regulatory demands, openness is key. "Everything we're doing is about driving transparency around information sharing, Gordon said. "You are replacing very ad hoc models."

That kind of visibility about what is transpiring and the standardization of what information is available is absolutely essential, Gordon added. "If you're going to ask compliance officers to actually do their job, they have to be clear [on] what is actually happening, provide them that information, and do it in ways that are sufficiently standardized so people can make intelligent decisions."

And, he said, that transparency and information sharing sits well with authorities. "The way to get in front of the regulators is to be very transparent and to prove you are taking this seriously," Gordon said. "We see these financial intelligence units being created that [put] big resources into detecting issues ahead of time and sharing versus saying, 'Let us know when something bad happens and we promise we'll go do an investigation.' "

Of course, all this requires substantial investment. And there's some pushback on costs. Federal courts are beginning to question costs and cost-benefits, Kini said. He cited the decision in April by a U.S. district court judge who threw out FSOC oversight of MetLife Inc. Among other findings, Judge Rosemary Collyer ruled the agency failed to make a sufficient cost benefit analysis. (The government said it would appeal the case.)

However, panelists agreed that firms must focus on risk management, outside the question of regulatory oversight. One key is a kind of checks and balances within corporate governance. "In asset management, having a separate risk management function from the portfolio function, having the price of securities, again, separate from the person who manages the portfolio," Novick described.

"It's in everybody's best interest to harmonize, so there can be more focus on the real problems and less about repeating the same thing over and over again," Gordon said.

Will that happen? Panelists are skeptical. "I don't think you'll end up with one uber-type regulator internationally," Novick said.

If anything, the regulatory hodgepodge could worsen, panelists warned. "I think we're going to see an era going forward where politics are going to rebound into our regulatory structure to a far greater degree than have been the case in the past," Kini said. ■