Regulatory Spotlight Shines on Suitability & Transparency in Wealth Management

In the aftermath of some high-profile fines for some of the highest-profile bank names, there is intensifying concern amongst regulators and the industry at large about how private banks and wealth management advisories charge their clients and what remuneration structures they adopt. A panel of experts offered their insights at the Hubbis Compliance in Asian Wealth Management Forum 2020 in Singapore.

These were the topics discussed:

- *What have we all learnt from the UBS Fine? What does it mean?*
- *Fee Charging and Transparency - do we act in the clients' interests?*
- *Does the RM incentive model need to change?*
- *The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry in Australia. How did it effect the industry?*
- *Are there other practices / disclosures (e.g. retrocessions, referral fees) within wealth management which should be examined to avoid similar penalties by the MAS?*
- *How do you operationalise complex regulations that impact countries that are not regulated by those regulators?*

PANEL SPEAKERS

- **Adriel Loh,** Managing Director, Global Head of Compliance Bank of Singapore
- **Alison Fidler,** Head, Conduct, Financial Crime and Compliance, Wealth Markets Products and Sales Standard Chartered Bank
- **Natalie Curtis,** Partner, Herbert Smith Freehills
- **Koh Sin Yee,** Director, Compliance & Regulatory Consulting, Duff & Phelps

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THE KEY OBSERVATIONS

Comply with both the letter and spirit of regulation

Some recent headline cases of major fines of big-name banks by regulators around the world, including Asia, have forced the wealth management industry to focus more effort in ensuring they are compliant with the letter and spirit of current and forthcoming regulation on suitability and the appropriateness and transparency of how they charge clients.

Whatever the regulator says...

The regulators hold the cards, and even if they have not specifically defined some of the ways in which banks and wealth management firms might transgress, they can still act, as has been evidenced from the punishments handed out for what have been called "deceptive trades". In short, regulators have latitude for wide provisions and broad interpretations, so compliance professional beware.

Nowhere to hide if dubious practices persist

The regulators are increasingly public in their rhetoric surrounding suitability, dubious selling practices, overcharging, and conflicts of interest. Whether or not these are clearly defined, the banks and wealth firms in general must adapt practices, be conservative, or continue to be at risk.

Robust controls required

For compliance teams at the private banks and at the smaller wealth management firms, there is an ever-greater weight of responsibility on analysing and tracking pre-trade agreements, pricing and post-trade transparency, to ensure that all spreads and charges are fair and also consistent with what had been told to clients.

Robust controls required

Compliance experts need to start advising their firms to build or re-build processes for recording data, recording calls, more detailed logging of transactions and agreements and so forth. And as much of this will be digitally enabled or enhanced, compliance must be part of that digital journey.

Senior management must be on the ball

Overcharging is just one very small element in a larger picture of client fair dealing, which also takes into account investment suitability, transparency, best execution and other key facets. This means that the senior management cannot simply pass decisions on these key elements to sales or other team members internally, as there is widespread accountability.

Remuneration and its links to client fair dealing

Generally, there seems to be an acknowledgment that one of the major reasons for the global financial crisis was a failure of bank culture, and a failure of culture within the financial institutions, especially in relation to remuneration structures, which encouraged asset and debt expansion at the expense of suitability and affordability.

Are you on your best behaviour?

The Royal Commission Report in Australia was cited as a document of record for this whole area of standards of conduct and the expectations around what is good behaviour. These areas must be constantly communicated through training, through the onboarding processes and obviously via the senior management accountability.

The disclosure must be transparent

The manner of the disclosures from providers to clients is also important, as it is not sufficient to simply bury disclosure in vast legalese documents. For disclosure to be fair and appropriate, it must be visible and comprehensible.

Suitability is subjective, but standards and ethics are not

Singapore's Monetary Authority of Singapore does not at this time impose a suitability obligation on wealth managers, but that does not mean the wealth management industry should not take charge of their behaviour proactively and be more cautious in their selection of products and their advice. If not, they risk penalties and reputational damage.

Remuneration might move away from sales performance

As there is an ever-increasing emphasis on suitability and accountability, banks and other firms are advised to shift their remuneration structures away from simply the more sales, more money formula sales and more towards a balanced assessment of the performance, including attributes such as conduct, adherence to firm culture, gaining new skills and so forth. In short, for success to be measured on many different levels.

ADRIEL LOH
Bank of Singapore

AN EXPERT BEGAN BY FOCUSING ON THE NOVEMBER ANNOUNCEMENT THAT THE SINGAPORE REGULATOR, the Monetary Authority of Singapore (MAS) and the Hong Kong's Securities and Futures Commission (SFC) had issued UBS with a multi-million dollar fine, reportedly because the Swiss bank had deceived wealthy clients over prices for bonds and structured products.

"As wealth management professionals," said one expert, "we know that the MAS is coming after private banks, indeed anyone in wealth management who serves a non-retail client, focusing on overcharging, and they are using this very obscure and vague provision about deceptive trades in connection with the sale and purchase of investment products. Actually, it is a very wide provision."

Tightening but not shackling

And this expert said it is consistent with a ratcheting up of rhetoric and actions that the SFC had issued publicly against private banks relating to suitability, dubious selling practices, overcharging, and conflicts of interest.

"The SFC has been very active, and now the MAS has had to take action as well, and they act generally in the past when the issues affect the retail public at large, not so much the wealth segment. In Singapore, it has been left largely up to the FIs to stick to the private bank code of

ALISON FIDLER
Standard Chartered Bank

KOH SIN YEE
Duff & Phelps

conduct, the MAS didn't prescribe, but in this case, we now know that the wealth management community must be aware that there is a new precedent set by the MAS that they will henceforth take action against overcharging, non-disclosures, and maybe suitability analysis will emerge more in the future because we have seen the implications of the UBS situation."

A growing list of priorities

The same expert then looked in more detail at those implications, noting that in the future there will be mandatory reference checks on pricing to avert misleading disclosures or overcharging practices. "For bank compliance teams this will make your to-do lists even larger, and for the EAM sector, do not think that this is just a private bank issue because the criteria for deceptive trades apply to even non-licensed persons. So, all parties have to look at their pre-trade obligations for the fees, and to check whether the spreads and charges are potentially inconsistent with what has been told to clients."

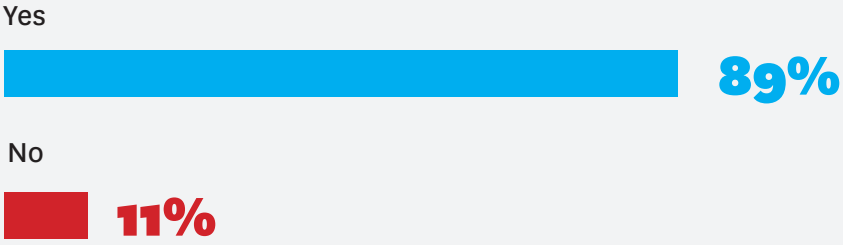
Another expert agreed, adding that the big lesson is the need to have robust controls in place. "We need to start building and re-building processes, recorded calls, perhaps systems where it is mandatory to put the spread into the system and that cannot be altered. We are all going digital, we have got to build robust systems. And compliance must be closely involved as part of the process, to be at the table from the outset, and certainly part of the digital journey. The senior managers also need to be in this from the start and ever-present in the decision and monitoring throughout."

NATALIE CURTIS
Herbert Smith Freehills

Be fair(er)

Another perspective came from a panellist who commented that overcharging is just one very small element in a larger picture of client fair dealing. "In the past, client fair dealing was very much focussed on the retail sector because it was thought that the high net worth could basically take care of themselves," he remarked, "but we

CAN PRICING ENGINES ASSIST IN THE VALUATION (OR PRICING) OF AN OTC PRODUCT?



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now see a far greater emphasis on this whole area of client fair dealing, investment suitability and you also see from MiFID II there is also a very strong emphasis on client fair dealing, best execution and all these areas globally today. And there has been a simultaneous increasing emphasis on senior management accountability, and also on compensation. Generally, there seems to be an acknowledgement that one of the major reasons for the global financial crisis was a failure of bank culture, a failure of culture within the financial institutions."

Connecting the dots

He highlighted the Royal Commission Report in Australia that has also put the spotlight on these areas, aiming to connect the dots between conduct decisions, remuneration, bank culture and appropriate behaviour towards the client. "Of course, we have to push for revenues and growth," he said, "but it has to be a balanced approach, so that means to be prudent in our risk-taking. Right from onboarding a client, the RM has to be thinking not just about what kind of revenue they can bring in, but the risk to the bank from an AML and reputational standpoint."

He added that the Royal Commission Report had highlighted two key areas for improvement. First, the senior management all the way from the board and the senior management must be driving that culture and etiquette message. And remuneration and the compensation framework has to be balanced, not just in terms of their financials but also in terms of values, ethics and in terms of conduct.

There are (more and more) consequences

A fellow panellist added that the Royal Commission had also highlighted how when institutions break the law, they had not always been held to account. "The reality now is we all need the proper checks and balances and controls in place that can perhaps detect and deter these problems," she said. "And there needs to be robust supervision, while the standards of conduct and the expectations around what is good behaviour need to be constantly communicated through training, through your onboarding process and obviously the senior management accountability."

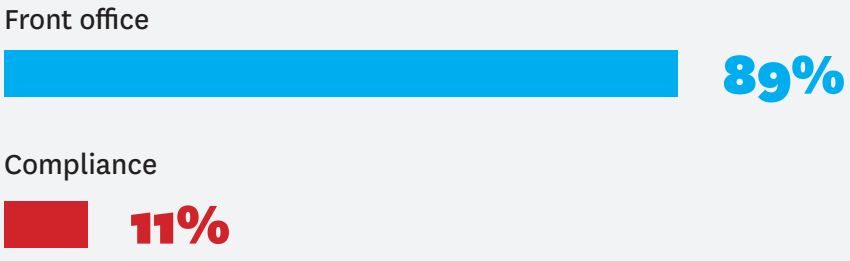
To more formalise pricing and fees, an expert advised that there needs to be a very clear fee schedule and disclosure policy. "WE have seen from some public fines, that banks were charging fees that were on top of the fee schedule, and not properly disclosing those."

This same guest highlighted the issue of price improvement, whereby the price clearly indicated to a client for an OTC transaction might have moved in the client's favour between the time of advising them and the time of execution. He said there is a considerably large grey area as to whether the price improvement should be directly passed through for the client's favour.

Factoring in risk

"If it is the bank taking the warehousing or price risk, then the bank should be able to retain the additional margin if it emerges," he commented. "But generally, that's the investment bank model, not the private bank model, so the PB which is not

SUITABILITY IS OWNED BY WHO?



Source: Compliance in Asian Wealth Management Forum 2020

warehousing assets or taking the market price risk should relay both price deteriorations and improvements to the clients."

"From a compliance perspective," agreed another expert, "that is absolutely right. We need to understand and be on top of these sorts of technicalities."

A panellist also agreed, adding that to be consistent, the bank must advise the clients what their policies are. "We see the regulators in Europe moving towards bringing into place these types of rules, and I think it will come this way to Asia, it just has to be the right thing to do."

Don't let words lead you astray

But a fellow guest said that must also be tempered. "You have to balance this, I think, as disclosure can arguably allow you contractually to do whatever is agreed, whereas the regulator may actually have a different view of that disclosure and that sort of action."

And the manner of the disclosure is also important, another panellist said. "I think if you are disclosing it for example buried in some vast document, that's really not a disclosure. Disclosure means going to the client on the transaction. But a simpler way is to simply agree on the spread with the client, so the spread is simply on whatever is the market price on trade, so that is clear and objective. However, that requires removing the level of cloudiness that has prevailed, so it is a change of behaviour that is required."

Another expert noted that as more PBs move to discretionary mandates, it is increasingly vital that the client is left in no ambiguity as to how he is going to be charged.

A firm-wide commitment

The issue of suitability was then raised, with a guest stating that this is also very much a compliance concern. "Compliance sets the standards, but they are not selling the products, so the front-line sales teams need to understand, buy into the bank's suitability standards, and then comply with them."

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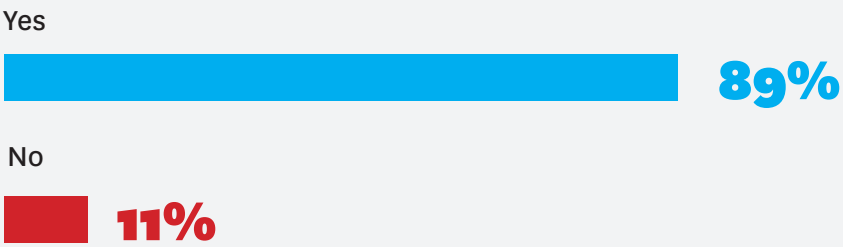
"Suitability ownership lies with everyone in a bank or firm," said another expert. "It's the tone from the top, the expectations that are delivered and communicated to the staff, it's about having sort of appropriate incentive structures, it's about making sure that there is training around how to even carry out the actual suitability assessment and it's then obviously the front line staff that are actually doing it, it's compliance taking ownership about how it is structured, and it is set out in the policies and procedures. It is all part of a major shift towards individual accountability and everybody taking responsibility. We all need to take a more holistic approach."

Another expert commented that as of now the MAS does not impose a suitability obligation on wealth managers because the clients are non-retail, but it does want the wealth management industry to take charge of their behaviour proactively.

DOES THE WAY RMS GET PAID AND GIVEN INCENTIVES NEED TO CHANGE?



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Whereas in Hong Kong, the private banks and the EAMs have to do a suitability analysis for a high net worth individual. "I think in Singapore, which is relatively benign currently, it will likely be much more painful than it is today, there will likely be mandated requirements for suitability, for conflicts, for best interest. So we all need to nip these matters in the bud today."

"Yes," said another expert, "and actually I do think PBs in Singapore already have extensive suitability frameworks for product due diligence to product mismatching to investor risk profiling, all these areas. They are in the code of conduct. While the MAS does not have any hard regulation in place, there is evidence from the UBS case that they are not restricted by lack of formal regulations if they want to take action."

Careful what you offer

Due diligence of products and assets classes, even of exchanges will be increasingly prevalent. "Then there will be questions on clients buying anything that is not on the bank's list of products, or on the platform, then if a client wants to make such an investment, there is a question as to whether we have an obligation to advise them on the risks. Or do we continue to say, well they can go ahead, as we have the legal disclaimers in place? It is not that easy to answer actually."

"To answer that, came a reply, "in Europe now there is an obligation of appropriateness, so even when clients want to do execution-only trades in more complex products, you as an organisation have to consider whether it's appropriate for the client. And some of these products and assets don't necessarily sit in the regulated sphere, for example tokenised and digital assets. But perhaps it's only a matter of time before those types of products can only be sold to regulated persons." Another guest closed the discussion by agreeing, noting that the MAS is working on guidelines relating to suitability."

The final portion of the discussion saw panellists focus on remuneration, with a guest noting that the MAS has conducted a whole series of inspections and has come up with guidelines in terms of the incentive structure. "It is clear that there must be a focus on the conduct, on the values, all these areas need to feature strongly within the incentive structure," he remarked. "If we pay based on the financials that they bring to the bank then that's clearly going to motivate their behaviour, but if we overlay that with conduct where we can cut their variable bonus because of misconduct, or if they exhibit poor culture not in accordance with the bank's core values, then we can be more balanced. The compensation structure will then drive the culture throughout."

"It is clear that there must be a focus on the conduct, on the values, all these areas need to feature strongly within the incentive structure"

A panellist added that all organisations are looking to move towards the concept of a balanced scorecard, with the amount that the actual sales side contributes to that scorecard reducing each year and other elements rising in importance. "As we know," she observed, "things like conduct, culture, how do you measure those and then how you include those in a balanced scorecard are more important. Mandatory training, potential disciplinary actions against staff, or client complaints, all are being factored in increasingly, success will be measured on many different levels." ■