



Establishing an effective compliance function for financial institutions in Hong Kong

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Introduction

In Hong Kong, with growing regulatory scrutiny and expectations from the Hong Kong regulators such as the Hong Kong Monetary Authority (“HKMA”) and the Securities and Futures Commission (“SFC”), and given the devastating financial and reputational impacts resulted from non-compliance of rules and regulations, more financial institutions are devoting substantial resources into strengthening their compliance function.

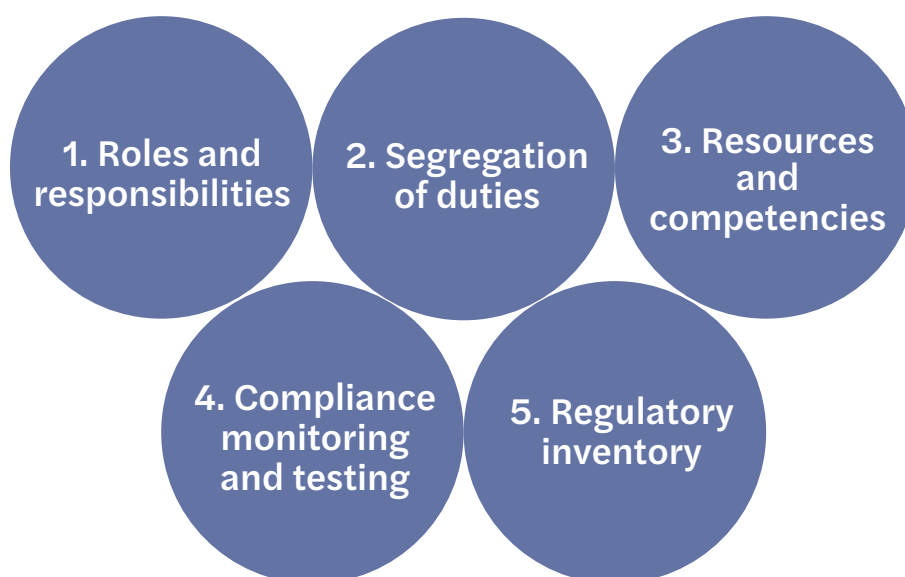
Under the second line of defence role within the corporate governance structure of a financial institution, the compliance function should be able to ensure that it operates with integrity and adhere to applicable laws, regulations and internal policies. A strong and independent compliance function is able to mitigate risks related to misconduct, money laundering and other forms of non-compliance.


This publication outlines the key elements for establishing an effective compliance framework within a financial institution and how our service financial advisory offerings assist you in achieving this important goal.

Compliance framework – key focus areas

The structure of a compliance function in a financial institution ranges from a pure advisory function with only a few headcounts and primary responsible for advising the institution on regulatory matters, to having a fleet of compliance personnel to perform regular and in-depth compliance checks on key regulatory focus areas. As the regulatory requirements become more and more stringent nowadays, there is a tendency for compliance functions to shift more towards the latter end of the aforementioned structure.

In order to keep pace with today's ever-changing regulatory environment, the following elements should be considered when building an effective compliance framework:





Compliance framework – key focus areas

1. Roles and responsibilities

Compliance is one of the core functions identified by the Hong Kong regulators, and is responsible for ensuring an institution's compliance with its own internal policies and procedures, and applicable legal and regulatory obligations.

Besides, in order to manage money laundering risks effectively, a Compliance Officer at the senior management level should be appointed to hold the overall responsibility for the establishment and maintenance of the AML/CFT Systems. Senior management should also appoint a senior staff member as the Money Laundering Reporting Officer to act as the central contact point for suspicious transaction reporting.

The following are the key roles and responsibilities of an effective compliance function:

I. Compliance policies and standards

Setting the policies and procedures for adherence to legal and regulatory requirements, which should cover the following topics where applicable:

- registration / licensing and financial resources requirements;
- record keeping (for management and regulatory reporting, audit and investigations);
- business practices (e.g. code of conduct, investment suitability);
- prevention of money laundering;
- internal control matters; and
- compliance with the relevant client, proprietary and staff dealing requirements.

II. Advisory oversight

Advising the business lines on regulatory changes and developments.

III. Investigations and complaints management

Establishing complaint investigation and handling mechanism.

IV. Non-compliance escalation and regulatory relations

- Monitoring, handling and reporting material non-compliant behaviours to senior management and, where appropriate, to regulators; and
- Liaising with regulators on regulatory enquiries and communication on regulatory matters.

V. Provision of compliance training

Providing staff training on regulatory requirements.

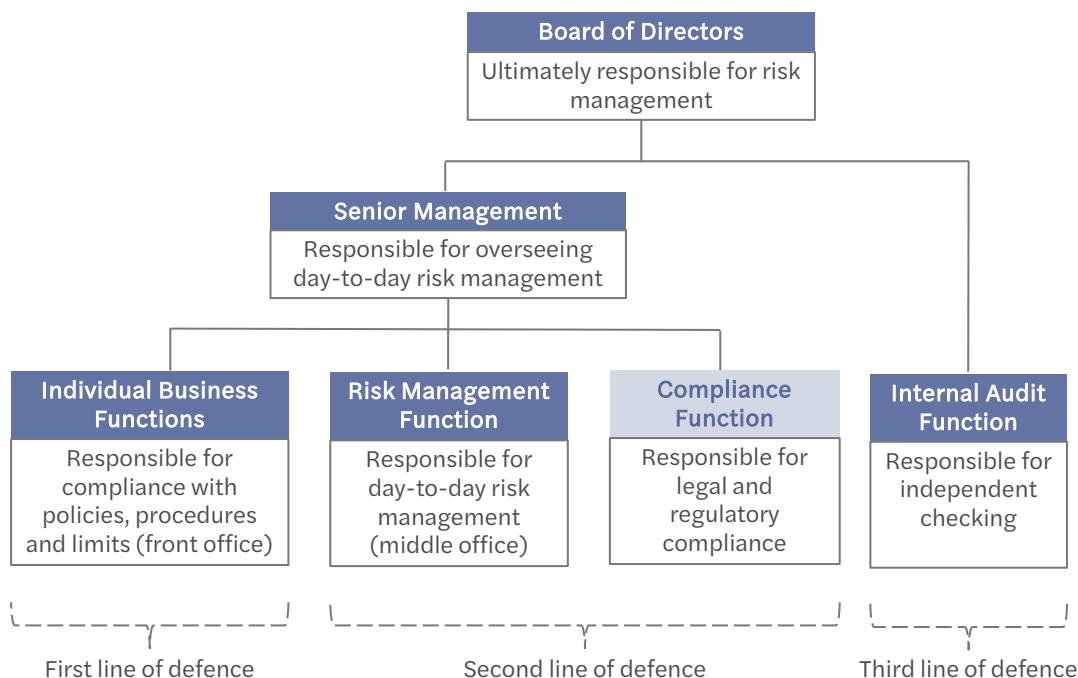
Compliance framework – key focus areas (Cont'd)

2. Segregation of duties

During the past decade, one function that has seen tremendous growth in most financial institutions is Compliance - its role has transformed from that of an advisor on regulatory matters to one that stand-alone and takes accountability on an institution's compliance to rules and regulations.

It acts as part of an institution's a second line of defence and has been given more responsibility to ensure an institution has rigorous risk management, controls and monitoring. In practice, it means to be independent of all operations and business units and directly reports to senior management (i.e. CEO, COO, the board of directors).

To ensure proper segregation of duties, compliance and audit functions should be separated from each other, and segregated from business units that carry out regulated activities. This can be illustrated in the diagram below:



3. Resources and competencies

Compliance functions need to have adequate resources to make them more efficient. Staff members working in the compliance function are required to have sufficient knowledge, skills and experience to perform their tasks.

Compliance framework – key focus areas (Cont'd)

4. Compliance monitoring and testing

Management should ensure the compliance function covers all relevant aspects of an institution's operations. The core activities of a compliance function generally include the following:

Compliance Monitoring and testing

Conducting compliance testing, which includes the following processes:

- determine the key areas for compliance testing
- determine the nature, extent and frequency of compliance testing
- design the compliance testing programme
- perform the testing
- assess and evaluate results of the testing
- report of findings to senior management

5. Regulatory Inventory

From simply keeping an eye out for the constantly changing regulatory developments, institutions have progressed to keeping a detailed record of regulatory requirements. The practice often includes four steps:

I. Identification

As the first step, identify all applicable rules and regulations to the institution and understand its regulated business activities, operations and products.

II. Mapping

Next, map the policies and procedures as documented in the compliance manual to each of the identified regulatory obligations in step I.

III. Gap analysis

Based upon the mapping result, evaluate and determine where any gaps might exist between the internal controls and the relevant obligations.

IV. Inventory preparation

Last, create a regulatory inventory that summarises the relevant rules and regulations and the corresponding control processes established by the institution. Also, any gaps identified in step III should be highlighted and addressed accordingly.

How can Mazars help?

At Mazars, we have extensive experience working with the diversity of financial services players. We assist major financial institutions including brokerage houses, asset managers, investment and corporate banks, retail and private banks, central banks, insurance companies and regulators in dealing with business and regulatory issues with impacts, domestic and international.

Mazars is here to assist you in complying with the regulatory standards and requirements in establishing an effective compliance function. Depending on the scope, coverage and specifics of your needs, our services would typically involve one or more of the following:

A. Regulatory reviews and advice

- I. Review your firm's current practices with regard to compliance function, including
 - policies and procedures,
 - compliance function structure,
 - governance and supervision, and/or
 - resources and competencies.
- II. Provide observations and recommendations to assist you in developing or enhancing your compliance function.
- III. Review related documentation and records to ensure compliance.

B. Design and implementation of policies and procedures

- I. Design / review the scope, quality and structure of the compliance function and provide advice which commensurate with the institution's specific business and risk profile.
- II. Design / assess compliance systems and practices against industry leading practice and develop compliance measuring, monitoring and reporting tools.

C. Design of regulatory inventory

- I. Design / review of regulatory inventory/ compliance obligations register which captures business conduct, operational and regulatory reporting obligations relevant to the business activities and license status of the institution.

D. Training and insights

- I. Provide training and education for staff, the board, senior management and risk management / compliance team on the compliance framework.
- II. Provide ongoing insights into how peer firms are dealing with the regulatory requirements and any common challenges encountered along the way.

We also take on special projects and ad-hoc mandates. We are flexible in our approach and offerings. Please feel free to contact us with any enquiries.

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