FROM CRISIS TO CONFIDENCE: A CALL FOR CONSISTENT, HIGH-QUALITY GLOBAL REGULATION

ROUNDTABLE SUMMARY

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International Federation of Accountants®

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香港會計師公會

FROM CRISIS TO CONFIDENCE: A CALL FOR CONSISTENT, HIGH-QUALITY GLOBAL REGULATION

The group called for action from political leaders and governments around the world for a consistent, high quality system of global regulation; further, they suggested key areas where jurisdictions can enhance collaboration and identified ten key principles that all regulators should follow.

FOREWORD

On December 8, 2015, IFAC in partnership with the Hong Kong Institute of Certified Public Accountants convened a groundbreaking discussion on the financial regulatory environment. The Hong Kong roundtable brought together senior representatives from regulatory authorities, financial markets, academia, listed companies, investment funds, and the accounting profession and encouraged them to take a fresh look at the causes, costs, and solutions to the problems arising from a patchwork regulatory environment.

The following highlights the discussion, the consensus reached, crucial items for ongoing debate, and a path forward to promote a global regulatory system that encourages long-term growth.

PATCHWORK REGULATION POSES ISSUES FOR GROWTH AND RISK

In the years since the financial crisis, regulation—and, as a result, the work required to manage global investment, finance, and financial reporting—has increased exponentially. Recent reforms such as Basel III, anti-money laundering regulation, market infrastructure and derivatives reforms, and corporate financial reporting and auditing regulation have often taken a prescriptive approach, focusing on detailed procedures, processes, and compliance rather than outcomes—and uniformly applying sometimes inappropriate solutions to a broad range of companies.

Business and finance have become fully globalized; however, the approach to regulations remains largely national. With hundreds of regulatory systems operating globally, market hubs such as Hong Kong are nexus points where multinational companies need to navigate complex compliance and regulatory issues.

Within companies, people are already finding ways to exploit the global patchwork, creating a culture where regulatory arbitrage is encouraged. Roundtable participants raised concerns that the current environment is creating incentives for risk-adding behaviors, such as structuring transactions to circumvent regulatory barriers, an overly narrow focus on compliance, and increased activity in less regulated areas such as shadow banking.

Roundtable participants from all sectors voiced concerns that this complex, patchwork structure is limiting innovation within companies and stymying growth. As one participant put it, "The costs involved with an idea have become so complex, it's no longer worth the effort." The escalating cost and complexity of compliance is creating oligopolies among the few organizations that can keep up and impediments to growth for small- and medium-sized entities (SMEs) and the small accounting firms that support them.

Long-term Impact on financial and business governance

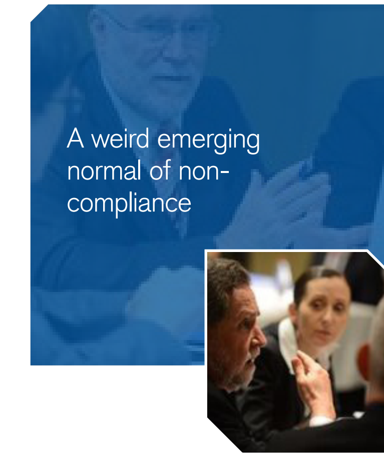
Individuals with the competence and ethics required to govern and inform corporations and gatekeepers are seen as more critical than ever to an effective and safe financial system. However, longer-term impacts on the capacity to attract the best talent into the roles where it is needed are perceived as real concerns in the regulatory environment.

This environment is also having an impact on the pipeline for finance, governance, and accounting professionals. Young people and high-potential talent are beginning to see the role as compliance-oriented rather than a strategic business function. The regulatory focus could be limiting the pipeline of qualified personnel in governance and regulatory roles; the participants pointed out that senior financial and accounting professionals who could bring deep experience to regulatory jobs instead resign in frustration.

Desire to move beyond reactive regulation

The current regulatory environment grew out of a reaction to the recent global financial crisis. Participants noted that many individual regulations stem from the symptoms of the financial meltdown, rather than the crisis' actual cause: regulations were based on the assumption that people were acting ethically and, in many cases, they were not.

The group called for regulators to view regulation through the filter: Are we enabling markets? In addition, they noted that strong, effective regulation represents a compact among government, business, the political sphere, and the community at large.



It stems from clear understanding and agreement on how best to serve the public interest. For complex issues in the financial and accounting realms, experts and practitioners need to play an active role in the conversation. Only with this input will regulators and legislators understand the full costs, benefits, and implications of their proposed rules.

The escalating cost of compliance is creating oligopolies and an environment where only a few firms can afford to keep up with the costs and complexity of compliance. For smaller organizations, this creates an impediment to growth. Participants also pointed out that in many arenas, a massive gap is emerging between regulations on the books and the ones that are enforced. The danger of this is "a weird emerging normal of non-compliance," where organizations choose which regulations they enforce. These issues create new—and invisible—risks within the system.

The group agreed on a series of principles for financial regulation that foster growth, derived from a broad review of existing pronouncements on regulation that have been made by international organizations. They called for all national regulatory bodies to adopt a process that includes:

1

Clear Objectives in the Public Interest

Regulations should be based on a clearly articulated goal that all participants agree is in the public interest.

2

Proportionate and Balanced Approach

Although regulations are often designed to handle the outliers, good regulations are applicable to organizations of all types, and are structured to scale for different sizes of organizations.

3

Evidence-Based Assessments

New regulations should be subject to an impact evaluation that evaluates effectiveness as well as both financial and time costs. The OECD's Regulatory Impact Assessment (RIA) provides a potential model.

6

Consistent and Coherent

While many individual jurisdictions still have room for improvement to create consistent regulatory systems, the biggest gap exists on a global scale. Organizations that operate beyond a single jurisdiction called out vast differences and inherent contradictions between systems.

7

Transparent and Open Consultation

Stemming from the idea that regulation is a compact among multiple actors, participants called for broad transparency and consultation during the development process that allows all impacted parties to be involved and share insights about potential implications.

4

Appropriate Resourcing

Too often, regulators do not have the resources needed to address the complexity and scale of the corporations and markets they are expected to regulate. The biggest gap identified was funding and support for cross-border collaboration. Individual jurisdictions have minimal interest in funding global oversight, despite the benefits to economic growth.

5

Collaborative Action

A lack of robust incentives for collaboration creates country-based regulatory ecosystems. New incentives such as education, advocacy support, and increased global forums could trigger deeper cooperation.

8

Active Oversight

The need for more active and independent oversight of regulators was raised as a significant gap. As one participant noted, "The assumption that everything a regulator says or does is in the public interest" has caused damage to the effectiveness of regulation and the strength of the compact between stakeholders. Purely political oversight was not seen as necessarily helpful, as it is vulnerable to vested interests.

9

Systematic Review

Once a regulation is enacted, changing it becomes challenging—even if it doesn't meet objectives. These lingering regulations contribute to the complexity of the regulatory environment. Participants broadly supported systematic reviews of how new regulations are performing, including sunset clauses and other mechanisms.

10

Deliberate Enforcement

Fair and visible enforcement was seen as an important factor in ensuring confidence in regulation, and the environment for finance and business.

A call for consistent, global systems of regulation

Over the past several years, the G-20's agenda has progressed and the Financial Stability Board has evolved into a permanent entity, but sufficient global influence to create a meaningfully harmonized system is still lacking.

The need for consistent, high-quality global regulation has reached a point of urgency. The upside of harmonized regulations are similar to those of global trade agreements—yet international regulations are rarely negotiated or managed with the same attention to global growth and societal good as these trade agreements.

Within the European Union, recent financial sector legislation was originally designed to create a single model across Europe, but the result has created a more complex—and arguably less thorough—regulatory system than the one it replaced. For example, recently adopted EU audit firm rotation rules vary substantially from state to state, creating confusion about how multinational organizations can possibly comply. The differences among member states in how capital is defined have implications that permeate new bank capital regulations. Similar issues have surfaced with respect to the extraterritorial impacts of secrecy laws, bank capital, market infrastructure, and a broad range of other regulations.

Global oversight remains the largest gap

Active, independent, global oversight of the regulatory environment would allow collaborative discussion and better analysis of cost-benefit tradeoffs. It would also create a regulatory structure free from political constraints, allowing regulatory architects to focus on public benefits such as how regulations can enable increased global commerce while helping catch system-wide vulnerabilities that could lead to a global crisis.

To make a consistent, global regulation system work, a step change in the will and resources available for international regulatory cooperation is required. The existing infrastructure including G20, FSB, and other international organizations must adopt unified, consistent regulations as a central objective. This requires abandoning approaches that tackle issues in silos and creating accountability for consistent implementation within individual nations.

Our challenge: Measuring the lost growth

As these conversations continue, the biggest challenge is how to measure what is lost under the current regulatory system. We know that the cost of compliance has increased dramatically, but it's much more difficult to define the missed opportunities. How much is innovation being suppressed? What risks are we unable to see? What growth and investment has been sacrificed because international compliance has become too onerous? To create incentives for a more unified global system, advocates will need to quantify the impact of inaction.

PARTICIPANTS

Representatives from the organizations listed below participated in the roundtable discussion and contributed to the call to action:

Barclays	Hong Kong Investment Funds Association
BDO Hong Kong	Hong Kong Polytechnic University
Chartered Financial Analyst Institute	International Federation of Accountants
Daobridge Capital	KPMG
Deloitte	PwC
EY	RSM Nelson Wheeler
Grant Thornton	Securities & Futures Commission of Hong Kong
Hong Kong Exchanges and Clearing Limited	Shinewing Hong Kong
Hong Kong Financial Reporting Council	Singapore Accounting and Corporate Regulatory Authority,
Hong Kong Institute of Certified Public Accountants	University of Hong Kong

The roundtable discussion was moderated by Professor Richard Petty, Macquarie Graduate School of Management (MGSM).

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