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Are You Ready for Your Next Cross-Border Regulatory Inquiry?

Financial institutions that serve clients in multiple jurisdictions must be vigilant, adapting their legal and compliance teams' practices, procedures, and internal communications in every market and across regional management silos to ensure all matters are properly evaluated.

BY DAVID WISHENGRAD, HELENA S. FRANCESCHI

The nature of global financial regulatory enforcement has evolved dramatically. A decade ago, it consisted of disparate local issues confined by national borders. A faraway compliance matter could be handled ably by local counsel without global consequence or significant financial risk.

No longer.

Today, the regulatory world is a global marketplace, in which authorities often share insight and information across borders. And they are frequently willing to levy fines for matters already addressed by one or more of their peers.

Consequently, when a regulatory matter arises—even in a secondary or tertiary market—engaging local regulators without first considering the global ramifications may ignite the attention of additional regulatory bodies, which in turn can spark sweeping class action lawsuits. Together, the result can be hundreds of millions of dollars in potential liability.

To avoid this outcome, financial institutions that serve clients in multiple jurisdictions must be vigilant, adapting their legal and compliance teams' practices, procedures, and internal communications in every market and across regional management silos to ensure all matters are properly evaluated. Once identified, high-risk matters must be coordinated and addressed with the understanding that any action taken in the local market or beyond—any statement, settlement, or admission—could have global repercussions.

How did we arrive at this point?

For decades, financial regulators focused on activity within their own borders. If an issue arose in South Korea, for example, the company assigned local counsel to address the matter with Korea's Financial Supervisory Service. A settlement might be reached, and the matter would be considered resolved.

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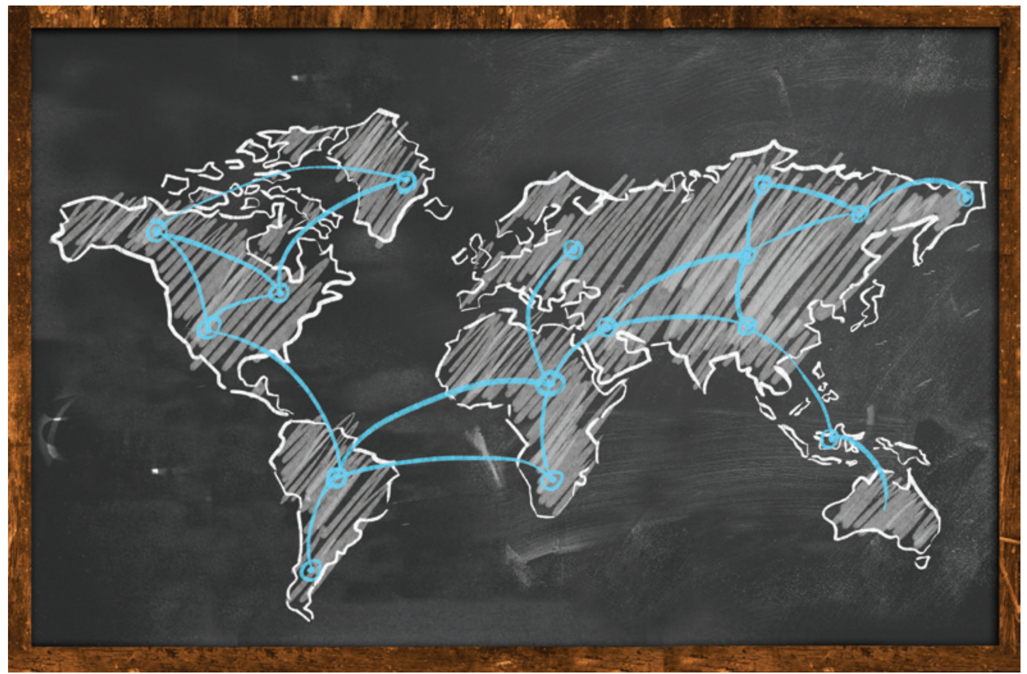
But several trends have brought an end to that model. For two decades, electronic trading and communications have flourished, encircling the globe. Today, financial transactions take place between market participants without regard for national boundaries. And in the wake of the 2007-2008 financial crisis, leading global financial institutions have grown even larger, reaching new customers, expanding into new markets, and building a wider operational footprint to service them.

At the same time, financial regulators have evolved. They have increased their own cross-border information sharing and cooperation—both regionally and globally. This cooperation spans both

securities regulators and their counterparts who enforce competition laws. Further, the globalization of financial marketplaces has incentivized these authorities to reevaluate the limits of their jurisdiction and test the reach of their authority. No longer focused only on activity originating in their home markets, regulators increasingly define their jurisdiction to include extraterritorial conduct that impacts their home markets. This paradigm shift has allowed regulators to act on a host of new matters. And, it has dramatically increased the likelihood that any one allegation will attract the attention of multiple government bodies—each with the power to levy fines based on its own unique regulations and with the benefit of its home-jurisdiction legal processes.

As a result, troublesome trading activity in Australia is still most likely to attract the Australian Securities and Investments Commission. But if the Monetary Authority of Singapore learns of the activity through APAC regulatory cooperation and believes that the activity impacted Singapore's citizens, it is increasingly likely to investigate, too. As additional regulators open inquiries, media attention grows and class action lawsuits almost certainly follow. What might have been a quiet settlement of a few million Australian dollars can quickly balloon into liability measured in the hundreds of millions of U.S. dollars.

For example, the LIBOR crisis began in the United States nearly 10 years ago with an investigation into a single benchmark rate, denominated in dollars. The matter grew to



encompass numerous interest-rate benchmark rates from the UK to Singapore resulting in approximately $9 billion in fines levied against more than a dozen banks from nearly as many regulators. Class action suits quickly followed. Many of the banks have settled those class actions and paid $100-$250 million apiece, while others continue to fight.

The investigation into the foreign exchange market followed a similar, multi-year, multi-regulator course and involved cross-border cooperation among leading authorities in the United States and UK, among others. Eventually, 16 banks would stand accused in U.S. class actions of rigging the foreign exchange market. Over the course of the litigation, many, also facing regulatory enforcement actions, pleaded guilty to criminal antitrust violations. In the aggregate, banks paid more than a dozen regulators over $13 billion in fines. Ultimately, 15 of the banks settled with U.S. plaintiffs, collectively paying $2.3 billion but failing to contain the damage as copycat lawsuits spread to the UK and Canada. According to plaintiffs, the FX U.S. settlements represent the third largest antitrust class action settlement in history.

These are staggering sums. And the financial industry should expect regulators to follow a similar road map as they open future investigations.

Yet, cross-border cases like these can turn on questions that many U.S.-based litigators were not prepared to answer just a few years ago. How does a financial institution contain such inquiries or settle such matters, without prejudicing other regions? For example, the EU does not offer the "neither admit nor deny" approach to a legal settlement, as the U.S. Securities and Exchange Commission does. Instead, an EU settlement is an admission of guilt and can cause regulators from around the world to line up for their own penalties.

Or consider Korea again: How does a firm safely communicate about a

regulatory matter in a legal system that does not provide U.S.-style attorney-client privilege? Communications in South Korea that would be protected in other jurisdictions can become public, fueling other regulatory inquiries. Understanding and planning for these local intricacies can be the difference between a local matter and a global conflagration.

Or imagine an enforcement action in which a local counsel settles with the national regulator on what appear to be favorable terms. Then a second regulator, claiming jurisdiction based on local market effects, reviews the settlement. Perhaps the second regulator finds the settlement fails to confine the conduct or its effects to that first jurisdiction. Or the newly-attentive authorities discover a set of facts that cite the globalization of the marketplace and thereby may implicitly or explicitly implicate their jurisdiction. Or perhaps the second team of authorities applies a rule that simply does not exist in the original, national jurisdiction. As a result of any one of these actions, local counsel may be opening the financial institution to significant liability, albeit unwittingly.

These are the nightmares of in-house legal counsel.

With such risks in mind, financial institutions with cross-border operations should consider the following:

- Ensure local regulatory matters are reported immediately by local staff, up to regional or global management in some cases. Financial institutions should have in place strict requirements for reporting, clear channels of communication, and regularly-scheduled opportunities for information sharing. Regional heads responsible for these matters must also communicate regularly.
- Once reported, financial institutions must examine such matters for the potential to become a global issue, no matter the country of origin. Any enforcement action has the potential to have a global impact if the conduct at issue touches customers or markets beyond local borders. Of course, not every matter will meet this global standard (for example, a dispute regarding local regulatory reporting requirements).
- Do not approach these regulatory risk assessments haphazardly, but make them a key component of the institutional process. Every global financial institution needs a team specifically charged with assessing local regulatory matters for global risk. Designed correctly, this singular team will be able to see across regional silos to understand global risks and fact patterns. Then, the team will also be positioned to flag similar matters that have been detected elsewhere—an essential step to successful global engagement and consistent messaging.
- When that team determines that a local matter carries global risk, the financial institution must provide local counsel proper outside support. Local counsel is essential to successfully engaging local authorities, but often they have little appreciation for what their local processes or admissions to regulators may mean for the institution on a global scale. Local counsel should be paired with legal partners who can keep local counsel apprised of the firm's position in other jurisdictions and also guide the matter with an eye toward reducing or eliminating global risks.
- Develop global, uniform messaging for financial products or processes. Today, most global financial institutions have three or four major regions, each functioning as its own silo. Although this is an operational necessity for such large institutions, it is imperative that the firm speak with one voice and move forward with one strategy, so actions or statements made in one jurisdiction or region do not create or increase risk elsewhere. This uniform strategy is also a key component of reducing collateral ramifications related to civil litigation.

Regulators are already taking a more globalized approach to enforcement: breaking down silos, communicating cross-border, and collectively identifying areas of concern and risk. Expect these trends to continue. Financial institutions must take similar steps within their organizations to meet the demands of this evolving environment. The above recommendations can help financial institutions meet these challenges.

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