

# Practical Reflections on the Roles of the Legal and Compliance functions in a Global Financial Institution

**Presentation to the joint FSI, BSI and OECD Regional Seminar  
on Corporate Governance for Banks in Asia**

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**Deutsche Bank** 

# Overview

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- The Basel Committee on the Compliance function in Banks
- Deutsche Bank's structure and control environment in Asia Pacific
- The role of the Compliance department
- The role of the Legal department
- Key Control Issues
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- When things go wrong – The incident management policy
- Conclusion

# Introduction

- Corporate governance is a relatively modern concept and although its use emanates from the USA (probably first used there in 1962), it is now a truly international concept.
- However, broad use of the concept has not contributed to clarity of what it is but rather to ambiguity. As one commentor has put it:-

“In its narrower, and most usual sense, it refers to control of corporations and to systems of accountability by those in control. It refers to the companies legislation but it also transcends the law because we are looking not only at legal control but also de facto control of corporations. We are also looking at accountability, not only in terms

of legal restraints but also in terms of systems of self regulation and the norms of so called “best practice...” Added to this we have business ethics.”

- This presentation offers a practical overview of the Legal and Compliance functions at a geographically diverse financial services institution that operates in local, regional and global markets, and how they contribute to a broader corporate governance framework.

# A Global Structure

Deutsche Bank comprises three Group Divisions

**Corporate  
and  
Investment Bank  
(CIB)**

**Private Clients  
and  
Asset Management  
(PCAM)**

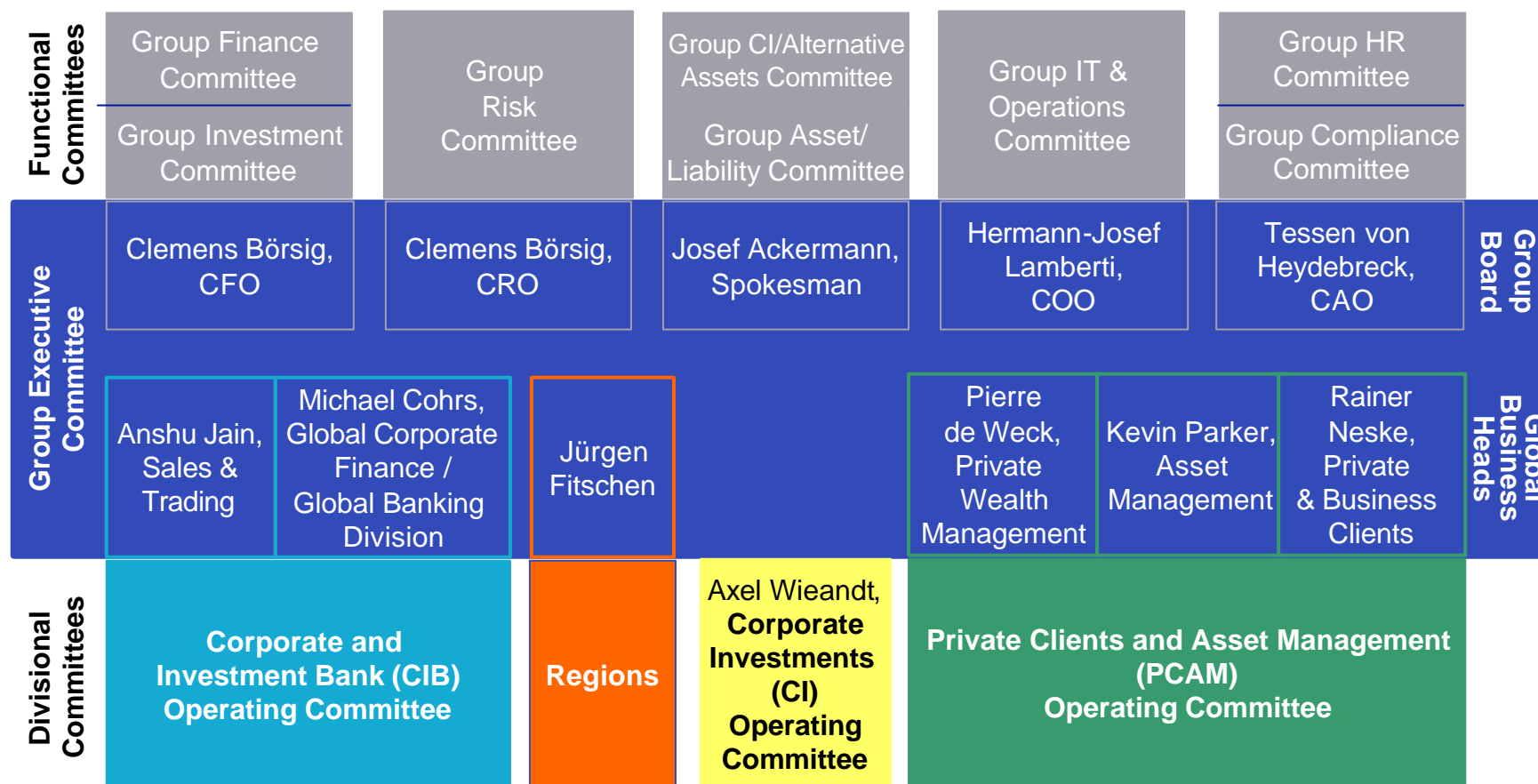
**Corporate  
Investments  
(CI)**

## Corporate Center

The Corporate Center supports the Board of Managing Directors with planning, steering, control, risk management and regulatory compliance.



# DB Global Management Structure

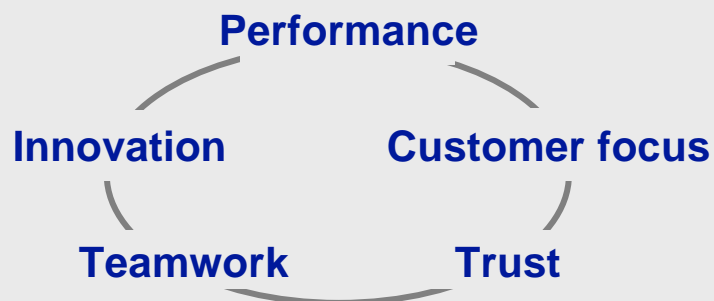


# Our mission statement, our values and our strategic targets

## Our mission statement

**“We compete to be the leading global provider of financial solutions for demanding clients creating exceptional value for our shareholders and people.”**

## Our values



## Strategic targets

- **Become global leading financial institution by market capitalization**
- **Achieve accelerated PCAM growth / balanced earnings mix**
- **Maintain leading position in Europe / increase US origination and distribution / grow in Asia**



# Deutsche Bank's Business Divisions

## Corporate and Investment Bank (CIB)

### Global Markets

- Government Bond Sales and Trading / Investment Grade and High Yield Sales and Trading / Bond Origination and Syndication / Risk Management Solutions / Interest Rate Derivatives / Credit Derivatives / Foreign Exchange / Money Market Products / Securitized Products / Credit Research/ Structured Investment Products / Cash Equity / Equity Derivatives / Equity Prime Services / Structured Equity Solutions / Equity Research/ Convertibles

### Global Banking

- Advisory / Asset & Finance Leasing/Coverage
- Equity Capital Markets / Debt Capital Markets / High Yield & Loan Capital Markets / Commercial Real Estate

### Global Transaction Banking

- Global Cash Management / Global Trade Finance / Trust and Securities Services

## Private Clients and Asset Management (PCAM)

### Asset Management

- Deutsche Asset Management
- Scudder Investments
- DWS
- Alternative Investments: DB Absolute Return Strategies / DB Real Estate / Private Equity Fund Group

### Private Wealth Management

- Active Advisory / Portfolio Management / Alternative Investments / Mutual Funds / Art Advisory / Real Estate Services / Financial Planning / Fiduciary Services

### Private & Business Clients

- Basic Banking Products / Investment Products / Pension and Retirement Products / Consumer Credit / Real Estate and Small Business Financing
- Investment and Financial Centers / Mobile Financial Advisors / Online Banking





# Asia Pacific (ex Japan) Network



The Asia Pacific region has always played an important role in Deutsche Bank's international strategy. Our roots in Asia go back to 1872 when our first branches were opened in Shanghai and Yokohama.

Today we employ 5,333 staff in 16 countries in the Asia Pacific (ex Japan) region.

## Essential features of the Compliance Function (Basel Committee on Banking Supervision, April 2005)

- “Tone at the top”: compliance, and the establishment of a corporate culture valuing honesty and integrity, starts at the top
- “Compliance risk” defined as: the risk of legal or regulatory sanctions, material financial loss, or loss to reputation a bank may suffer as a result of its failure to comply with laws, regulations, rules, related self-regulatory organisation standards, and codes of conduct applicable to its banking activities

## Essential features of the Compliance Function (Basel Committee on Banking Supervision, April 2005)

- Compliance risk is managed more effectively if there is an identifiable, properly resourced and independent compliance function within the organisation
- Compliance staff may be co-located with the business lines
- The responsibilities of the compliance function should be clearly specified, and its activities should be subject to periodic and independent review by the internal audit function
- However, ultimately, it is the responsibility of everyone, not just those working in the compliance function, to be accountable, and to inform themselves, so as to ensure compliance with applicable rules, codes and standards.

# Key oversight and operating committees - Asia

## ■ Regional Executive Committee Asia Pacific

- Objective: Responsible for reviewing, monitoring and decision making in respect of issues of group wide significance across Asia Pacific
- Composition:
  - Regional Business Heads
  - Regional CEOs, COOs, CAOs
  - CCOs for India, China and Korea

## ■ Regional Governance Board

- Objective: The Regional Governance Board provides a high-level supervision, on behalf of the Vorstand, of systemic issues relating to internal controls, reputation, regulatory relationships and issues. Conduct of business in relation to business ethics and practices, local governance structures (for each country/subsidiary within the region), Technology and Operational systems, Capital and Tax.

- Composition:
  - Chaired by CEO
  - COO, CAO
  - General Counsel, Head of Compliance, Chief Financial Officer, Chief Information Officer, Head of Market Risk Management

#### ■ Regional Operations Committee

- Objective: A regional chief operating officer forum for discussion of “administrative” issues of cross-divisional relevance including the cost control process
- Composition:
  - Chaired by Regional COO
  - COOs for each business division
  - CIO, CFO, Head of HR and Head of Corporate Development (Asia-Pacific)

## Other Regional Control Committees

<b>Asia Assets &amp; Liabilities Committee</b>	The regional/ local Asset and Liability Committees (ALCOs) provide a forum for managing the capital, liquidity and funding position of the entities under its jurisdiction to achieve compliance with external and internal limits and guidelines. Acting in conjunction with the Group ALCO it progresses and implements the Group policy on a regional/ local level
<b>Asia Pacific Legal Entity Committee</b>	The Legal Entity Committee (“LEC”) process was created to oversee the maintenance and development of Deutsche Bank’s subsidiaries with a view to optimising the structure and efficiency of the global legal entity network
<b>Regional Loan Screening Committee</b>	The mandate of the Loan Screening Committee is to review all proposed material loan transactions (including renewals) within CIB in order to ensure a rational allocation of capital, along with seeking formal credit approval by Credit Risk Management
<b>Regional Risk Committee</b>	For Asia the framework and agenda for the Regional Risk Committee meeting will present and cover resource utilisation and constraints, significant risk positions, material p&l events, risk limits utilisation, New Product Approval (NPA) and operational/reputational risk issues. Risk and resource is defined broadly and will cover credit, market, liquidity, operational/reputational and any other risk associated with CIB’s business.
<b>Regional Smartsourcing Committee</b>	The objective of the AP SSC is to provide a forum for decision making and implementation on smartsourcing current and potential activities as they affect all Asia Pacific countries
<b>Regional Space Committee</b>	The Committee is responsible for directing and overseeing the execution and implementation of DB global real estate policies, standards, service levels, cost allocations and other real estate related issues in the Region.

# The Role of the Compliance Department

- The Compliance Department's responsibility is to assist the various business units of Deutsche Bank in Asia to understand and comply with relevant local and international laws and regulations and with Bank policies.
- Asia Compliance's role and responsibilities can be categorised into four areas:
  - Information and guidance
  - Coordination
  - Surveillance and Enforcement
  - Control Room

# The Role of the Compliance Department: Information and Guidance

- Compliance develops policies, procedures and guidance that define the regulatory and fiduciary standards and requirements that apply to the Bank's business in the Asia region.
- Compliance provides advice concerning interpretation of rules and policies as they apply to the Bank's business in Asia.
- Compliance provides relevant training to the business people on a variety of regulatory subjects and internal standards.
- Compliance remains available at all times to consult with business units on specific transactions as necessary to ensure compliance with relevant laws, regulations and Bank policies.



## The Role of the Compliance Department: Coordination

- While compliance is ultimately the responsibility of Senior Management, the Compliance Department helps them to meet that responsibility by ensuring that all employees receive the information they need to stay in compliance with the relevant banking and securities laws, regulations and Bank policies.
- Coordination also involves the Legal, Controlling and Credit Departments when necessary and Compliance frequently works with these functions in assisting the business units.

# The Role of the Compliance Department: Surveillance and Enforcement

- Compliance monitors and reviews certain records and transactions in order to identify potential or actual problems.
- Compliance ensures identified errors, improper conduct or compliance exceptions to regulatory or policy requirements receive appropriate corrective action.

# The Role of the Compliance Department: Control Room

The Compliance Control Group performs the critical functions of identifying, assisting management in resolving conflicts of interest that arise either regionally and globally between the public and potential insider functions of the Bank.

Specifically, it carries out the following functions:

- **Managing the Chinese Wall Procedures** - that is controls over the flow of price sensitive information within the Bank. These procedures include:
  - Maintaining and monitoring the securities on the Restricted and Watch Lists;
  - Advising on and logging Chinese Wall Crossings;
  - Administering the Personal Account Trading Rules; and
  - Performing the Conflict Checking Procedures between all banking deals and transactions conducted in other parts of the Banks.
- **Review the Anti-Money Laundering aspects of the Client Adoption Process.**
- **Review Research reports to ensure potential conflicts with banking deals are resolved prior to publication.**



# Deutsche Bank Group Legal Services Mission Statement

The Legal Department's goal is to provide legal services of the highest professional standards to:

- **FACILITATE** the transactions of the Deutsche Bank Group by giving proactive, business oriented and creative advice
- **MANAGE** legal risk in order to make transactions viable and safe
- **PROTECT** the integrity and reputation of the Deutsche Bank Group

# Role of the Legal Department

- Retaining external counsel
  - Only through the Legal Department
  - Approved Law Firm List
  - Strong relationships with leading local, regional and global external counsel are a key part of the Bank's risk and reputation management strategy
- Documentation
- Legal advice regarding all aspects of the Bank's business and corporate needs
- New product approval process
- Work closely with all control areas, in particular Tax, Compliance, Controlling and Credit, to ensure that achievement of the Bank's commercial objectives reflect not only legal and regulatory requirements, but compliance with the Bank's own risk management and business practice policies and values as well

# Legal and Compliance: Relationship and Presence

- Legal and Compliance are partners
- Compliance does not report to Legal
- For Asia:
  - There are compliance staff physically located in each country where the Bank does business
  - Internal legal support for the Bank's businesses throughout the region is presently hubbed out of Hong Kong and Singapore, however the Bank is in the process of building up a Legal's presence in China, India and Korea.
- Legal and Compliance resource allocation strategy is driven by the needs of the Bank's various businesses, historical and cultural considerations, and optimal use of global systems and know-how acknowledging that the Bank seeks to run itself along global lines consistent with domestic law and practice.

# Key Control Issues

- Account opening
- Money laundering
- Disclosure requirements / regimes
- Conflicts of interest
- Controls around highly structured finance transactions (legal, regulatory, reputational and distribution risk)
- Independence
- Separation of functions
- Chinese Walls
- Handling of confidential information
- Personal account trading
- Complaints policy and procedure
- Market impact of trading

# Reputational Risk

- **What is it?**

The threat that publicity concerning a transaction, counterparty or business practice involving a client will negatively impact the public's trust in Deutsche Bank

- **Fundamental Principle**

Primary responsibility for the identification, escalation and resolution of reputational risk issues resides with the Businesses. The role of control groups, such as Compliance, Legal and Controlling, is to ascertain that such issues have been appropriately identified, escalated and resolved by the Businesses

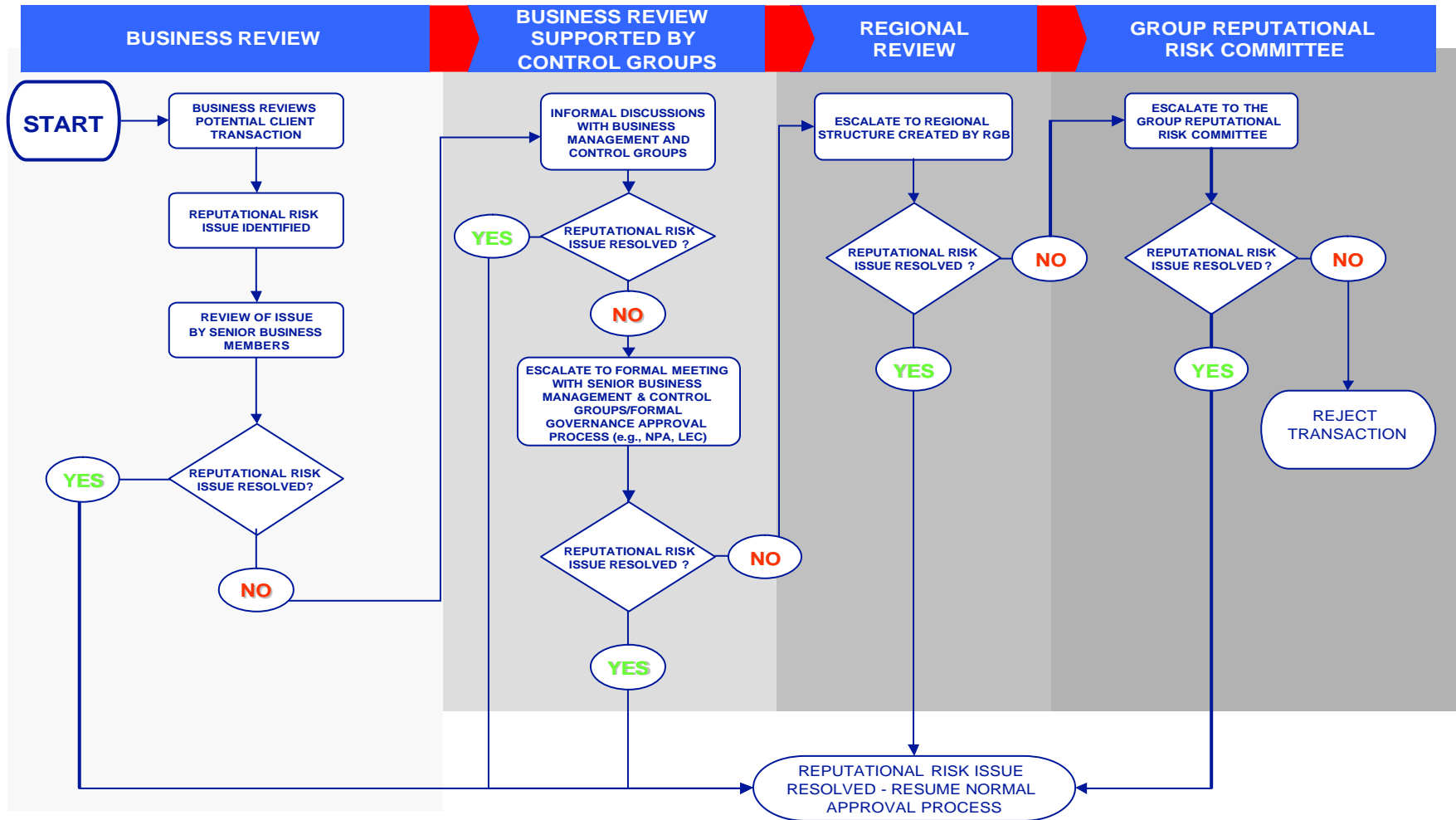
- **Challenges for global financial institutions**

- Imbedding the right culture
- Training
- Identification of reputational risks
- Proper escalation procedures
- Decisive action

- **Zero tolerance balanced against complexity of business model**



# Reputational Risk Escalation Process Diagram



# Incident Management Policy – The framework

- Issued by Regional Governance Board
  
- Sets out escalation and management procedures for any incidents which could
  - adversely affect the reputation of the Bank; or
  - involve breaches or violations of any regulations or laws
  
- Establishes a Regional Incident Management Group comprising
  - Regional Group COO
  - Regional Heads of Compliance, Legal, Audit
  - Regional Incident Management Co-ordinator

## Responsibilities within this policy

- Encouraging a corporate culture and maintaining adequate systems and procedures in which reputational and regulatory incidents are promptly identified and addressed
- Fostering an environment where any member of staff feels confident bringing to Country Management's attention matters or concerns that may be required to be escalated under the Incident Management Policy

## The Fundamental concepts embodied in the Policy

- A “Zero Tolerance” culture for Reputational and Regulatory incidents
- All Reputational and Regulatory Incidents must be promptly reported to Regional Head Office and promptly investigated
- Investigations of incidents will be co-ordinated Regionally by the Regional Incident Management Co-ordinator BUT most incidents will be investigated and reported by local resources
- Each investigation must be conducted by an independent person(s) who has access to proper resources and receives full co-operation from the relevant Business
- An Incident Report must be made for each incident and tabled at the Regional Governance Board

# Conclusion

- Some concluding observations in the words of Howard Davies (formerly FSA Chairman, now Director of the London School of Economics) on corporate governance failure and success:
  - “That people are more important than processes. Many of the failed firms, or near failed firms, had Boards with the prescribed mix of executives and non-executives, with socially acceptable levels of diversity, with directors appointed through impeccably independent processes, yet where the individuals concerned were either not skilled enough for, or not temperamentally suited to, the challenging role that came to be required when the business ran into difficulty.”
  - “Are the codes of practice, the International Regulatory Accords and the new legislation in the US in particular, focusing on the right things? ... Of course it

is right for banks to understand the detail of their credit appraisal processes. Of course it is right that Boards should take an interest in the risk management systems across the business, as Sarbanes-Oxley requires them to do. But the danger is that they concentrate on counting the leaves on the trees, and lose sight of the wood. It is not clear to me that either Sarbanes-Oxley, or Basel, or the Corporate Governance codes really focus attention on some of the big risks which have brought about failure in major financial institutions in the past. In other words, the dangers created by an over dominant Chief Executive, or the risk of pursuing unachievable strategies, or strategies which require management skills which their firm does not have.”

- Ultimately the Legal and Compliance functions play a fundamental role in placing a bank's board and senior management in a position to act properly and to assume a dynamic approach.