Compliance Monitor

The monthly briefing service for compliance specialists

Keeping it simple in a complex regulatory world

If you feel you are spiralling into a vortex of regulatory confusion, fear not, says ***Julian Sampson****. It's the simple things that tend to get you into trouble – so getting the basics right should keep your head well above water.*

Compliance staff in today's financial services industry can be forgiven for thinking that they live in an increasingly complex environment. Indeed, this is a proper reaction, as the fallout from the financial crisis continues to land. Not only are we facing increasingly complex prudential regulation but also the abolition of the Financial Services Authority – albeit after a protracted demise over the next couple of years. This alone will generate a slew of new forms, processes and personnel for compliance staff to get to grips with, having successfully navigated their firm into its new regulatory berth. Meanwhile, on the European front, sundry directives continue to absorb compliance and adviser resource as they seek to ensure the firm is able to weather further regulatory squalls.

Complexity is institutionalised by the nature of EU rule making. 'Principles-based regulation' is by nature high level, rather than a detailed prescription of how the desired regulatory outcome is to be achieved. The result is a patchwork of practice as firms in a sector adopt similar yet distinct approaches to common situations.

In these situations the regulator will focus its attention on firms whose procedures represent outliers from the pack, whose practices cannot successfully be benchmarked against the majority of their peers. The FSA will use its investigatory powers and a range of tools, from surveys and themed visits at one end, to skilled persons' reports at the other, to ensure that these firms' practices are not posing a threat to its statutory objectives. But, given preparation and forethought, the outcome of these interactions should be successful for the firm, if (in the case of skilled persons' reports) expensive. Unless the firm is shown as an outlier, it should be safe from regulatory enforcement.

Therefore those firms against whom FSA does enforce are likely to be doing something fundamentally wrong – something basic. Recent examples have highlighted a failure in firms to, for example, segregate client money, be open with the FSA, or adequately check the sanctions database.

So, it is generally the basic things (or rather a failure to do them) that will get a firm into trouble. Complex matters are rarely enforced against – for the very reason that they are complex. The regulator's chances of a successful enforcement outcome in these cases, where the firm is within the swim of peer group practice, are much reduced.

Therefore the motto for the compliance department should be this: 'keep it simple'. Watch out for the basics. Easier said than done? Perhaps, but there are a few pointers for keeping on the right track.

Compliance monitoring programme

Whatever the programme format, the principal outcome should be that the firm knows it is attending to the basics. These will differ from firm to firm, but the important point is that at certain times in the year, the monitoring programme will require the compliance department to say, "what compliance risks do we face and are they mitigated?" The programme also serves a wider purpose – it gets the compliance staff out more and gives them an excuse to speak to the rest of the firm. This develops relationships and allows for dialogue. And it is this dialogue that will tell the compliance staff what they need to know.

Yet routine monitoring is often a neglected area. Immediate events carry all before them, resources are strained and routine lacks glamour and excitement. In these circumstances, the routine review of standard processes can easily be postponed or, at worst, omitted. And it is in this hiatus that poor practice can take root, unobserved.

Training

This is far too important to be left to trainers, and yet this is what many firms do, even when the logistics of the firm mean that it is entirely possible for the compliance department to carry out periodic (if not necessarily frequent) face-to-face training. Which is not to say that there is no place for computer-based training – indeed, the size and scope of many firms means that this will always be an efficient and cost-effective means of delivering the compliance message to the greatest number of people.

But the compliance department staff should try – at least once a year – to deliver a 'state of compliance' update to personnel. Again, it gets the team out and allows the front office to fit faces to names.

And what about the training of the compliance department staff themselves? I am constantly surprised by the number of compliance or anti-money laundering staff who work in a vacuum, away from their peers in comparable firms. The ability to consult on a confidential basis with peers is essential to ensure that you are in that broad consensus of accepted practice, and not an unwitting outlier.

Governance

A recurring theme of recent regulatory concern, and one that the compliance department should have at its heart. This is not just for the good of the firm, but also for the sake of the compliance department's work itself. It is far harder to achieve successful compliance outcomes where the governance structure is weak or diffuse. Even the smallest firms should have a clear decision-making process and accountability lines. Otherwise, it is too easy for hard decisions to be avoided, or responsibility side-stepped.

Ethics

In a way this issue is both an outlier and a basic. An outlier, because it has only recently come within the sweep of the regulator's radar, and then only in the public musings of its senior executives. A basic, because a sound ethical construct is, well, basic.

The key at this point is for compliance staff to at least consider this issue. Many firms are insisting on staff taking specific ethical exams, supported by group discussion. Where this is beyond the scope of the firm, it should be asking itself how it would evidence its ethics, if asked.

All of the above points are structural – to do with the management and organisation of the compliance department, and how it interfaces with the rest of the firm. It is entirely true that operational issues – such as client take-on, suspicious transaction monitoring – will be basic to particular firms. But that's not the point here. While every firm will face different basic issues of an operational nature, all will face the same structural issues outlined above. And it is within the context of these structural issues that any operational process issues are addressed. You can't have one without the other. If you do stumble upon a major breach in procedures, you'll need the structure to guide you as to what to do about it.

If firms are looking for a benchmark, they might consider the voluntary British Standards Institution standard in development (BS 8453 Financial services compliance – Framework), which is due to be published later this year. I represented the Chartered Institute for Securities and Investment on the steering committee drawing up this standard. Much of what the draft standard says will be axiomatic to larger firms and compliance departments. And indeed, that's the whole point – it should be. It may be basic – but that's just it: keep it simple.

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ISSN 0953-9239 © Informa UK Ltd
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