

Compliance Monitor

The monthly briefing service for compliance specialists

Turn and face the strange

With the transformed landscape of financial services after the crisis gradually taking shape, industry professionals highlight the compliance challenges of the year ahead.

By *Esther Martin*

As we head into February, the fireworks and auld lang synes of New Year seem well behind us, along with the 'noughties', and we turn and face... surely it's not the 'teenies'?

Regardless of the name, and arguments about when the decade begins, it's clear that today's political, financial/economic and social climate is starkly different from that of the year 2000. This is largely a result of two far-reaching catastrophes: the appalling tragedy of 11 September 2001 and the financial crisis. If the first unthinkable collapse was the literal crumbling of the World Trade Center, it wasn't long before city towers were tumbling in other ways – illustrated on the television news by white-faced workers carting their belongings out of Lehman Brothers in boxes, and traders gaping at their screens in disbelief.

The legacy of these events continues to throw a very long shadow. "The words associated with the new order must surely be regulation, regulation, regulation," said Nigel Vooght, the global financial services leader for PricewaterhouseCoopers, in a January statement. "There is definitely more pressure and change to come, particularly when pending regulation hits."

A straw poll of professionals in the compliance world showed that, heading into 2011, they were concerned about specific legislative and regulatory measures, but another common theme was the restructuring of the Financial Services Authority – which is scheduled to operate in 'shadow' form from sometime in the first quarter.

"The big issue for 2011 has to be the move from the FSA to the new regulator," said **Julian Sampson**, chairman of the CISI (Chartered Institute for Securities & Investment) compliance forum and director of Fulcrum Compliance. "It's not just the process that we're concerned about, but the whole regulatory

atmosphere before and after the transition. With so many changes of personnel at the FSA, there's a danger of institutional paralysis creeping in, as staff defer decisions. The other side of this is that the new regulator may want to make a 'big splash'. Everybody's making sure it's not them that gets wet."

He's not alone in highlighting staffing issues at the regulator. Head of compliance at Nationwide Building Society Richard Warrington flagged up, "How will the intensive/intrusive approach of the FSA continue? How does the FSA intend to retain the quality of staff required to provide the right level of challenge to firms (both from a prudential and conduct perspective)? How will the proposed split impact on the quality of staff retained at the future regulatory bodies, and which will have the greater appeal?"

"The prudential focus of the FSA has increased over the past couple of years and we don't see this decreasing – the key will be how co-ordinated the two new bodies will be," he added. "[From about April] we shall have the opportunity to see how well it works, but we fear that information requests could increase, and could be disjointed – both the Prudential Regulatory Authority and the Consumer Protection and Markets Authority areas asking for similar data for different purposes, causing duplication of work at firms."

One commentator referred to the role of Europe as a driver for regulatory change and wondered how well the UK would be able to influence the outputs, while another stressed the need for market participants to keep up sufficient dialogue with the regulators on proposals.

And, of course, the volume of change will be a challenge. Denis O'Connor, director at the Association for Financial Markets in Europe, said: "With an overwhelming tide of regulatory proposals originating in both the UK and Brussels such as the regulatory structure, the Remuneration Code, the MiFID review and the Market Abuse Directive review, firms face a difficult task in analysing the effect on their own business models, while at the same time continuing to

keep on top of their regular day-to-day compliance work.”

“Just staying on top of the volume of output from the FSA – not to mention the EU – remains a massive task, and will continue to be so,” agreed Sampson. “Distinguishing ‘what really matters’ is becoming increasingly difficult, with so many different communication channels available to the FSA. There’s a danger of ‘white noise’.”

Amid the clamour of new developments, one of the most talked about is the Bribery Act. Indeed, its April commencement date has been postponed owing to intense lobbying by the business community. “There’s a lot of uncertainty about how this will be enforced,” said Sampson, “although the theory should be that a UK firm with no exposure in riskier jurisdictions should not have to worry. But people are concerned that a financial sector with few political friends could be an easy target. So a lot of time and money is being spent – perhaps unnecessarily – making sure that firms are not vulnerable.”

A spokesperson for the British Bankers’ Association highlighted this year’s MiFID review and particularly the new category of ‘organised trading facilities’, through which over-the-counter trading looks set to be made more transparent, as something they’ll be keeping a close eye on.

And Vooght commented: “Beyond banking, insurers are grappling with preparing for Solvency II and equivalence while investment managers are trying to design a solution for the new Alternative Investment Fund Managers Directive that won’t have to be later unpicked to comply with Dodd-Frank, UCITS IV or FATCA [the Foreign Account Tax Compliance Act]... Regulatory interpretations of new laws in the US are still pending.”

O’Connor also picked up on the American dimension: “Firms should be planning how they are going to address the significant challenges presented by the US FATCA requirements that come into effect in January 2013.” Here in the UK he mentioned the Bribery Act and changes to the FSA’s client money rules as key issues.

Being focused mainly on the retail side, Warrington is monitoring the progress of the Retail Distribution Review (RDR) and the development of product regulation. “From a conduct perspective, we are seeing

a bit of back-tracking in relation to the Mortgage Market Review (MMR) – we are supportive of much of the thrust of the direction, but there are a number of detailed areas where we believe the requirements could seriously impact the mortgage market at a time when the government wants lending to be boosted. We will continue to work with the Council of Mortgage Lenders and the FSA to find the most appropriate way forward, but our MMR programme is pulling back a little until the implementation impact is clearer.”

On the RDR, he said: “We are still concerned that the general public may not fully appreciate the cost of advice and the value on offer – particularly as the cost of advice provision is increasingly due to [higher] professional standards required, etc. However, from a compliance perspective we fully support more competent advisers, better explained products, clearer advice models and a more professional service... but will the RDR deliver?”

“In the meantime, we will continue to monitor closely key areas such as suitability of advice, competence of staff, quality of supervision, effectiveness of treating customers fairly embedding, and effectiveness of systems and controls for processes directly impacted by regulatory requirements (avoiding duplication with Audit activity as much as possible),” he added.

“We will continue to keep our resource requirements closely monitored to assess the impact of new regulation, new business activity and any change in our risk appetite,” he also noted. “One key document that we await with interest is the FSA’s own Business Plan and the Financial Risk Outlook, which both assist us in our overall assessment of what is on the mind of our regulator and what we may need to review in more detail.”

Whatever their challenges, compliance professionals need hopefully no longer feel they are just barking in the wind. “Every dog has its day and today’s dog is risk,” said Vooght. “One of the most career and earnings enhancing moves in the current environment is to ensure that you have the word ‘risk’ in your job title.” But he stressed that compliance now extends beyond just technical conformity to embedding the right culture. “People with the skills to move beyond box-ticking into strategic interactions with the board are commanding a premium.”