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Preparing for a regulatory visit

Though for many firms a visit from the Financial Conduct Authority may occur just once in four years, this encounter is their most pivotal event. **Julian Sampson** outlines how best to handle the process, as well as other interactions with the regulator, so as to avoid unwelcome outcomes.

It used to be the case that the be all and end all of the Compliance Officer's life was the visit from the regulator. A regular occurrence, this was the time when the CO tested him or herself – and their firm – against an objective yardstick. Much hung on the successful outcome of this visit.

Is this still the case? Do regulatory visits matter any more? Indeed, do they actually happen at all? And if they remain an important part of the regulatory landscape, how best to prepare for one?

One might be forgiven for thinking that the visits were no longer something that the vast majority of firms had to worry about. The FCA made clear in March 2014 when it published 'The FCA's approach to supervision' that for most firms, the visit was a once every four year event – perhaps not something that the Compliance Officer need have at the forefront of their mind every waking moment. And that four-yearly visit might not be a 'visit' at all, but a 'regulatory interaction' – a phone call or perhaps an invitation (not to be declined) to take part in a survey. More about these 'interactions' later.

But the general picture is clear – unless you're the Compliance Officer in a systemically important firm in supervisory category 1 or 2, you could spend your whole career at your firm and never have the regulator darken your doors. That might seem an attractive prospect.

But therein lies the rub. While the regulator does lack the boots on the ground to visit more firms, and though it does indeed prefer what it considers to be more efficient and effective means of electronic supervision, visits are still very much part of the regulatory toolkit. Even if the visit is not part of routine supervision, it is used for fact finding, themed reviews and as part of the process of the regulator building its understanding of current market practice, often ahead of the issue of formal guidance or consultation.

And don't kid yourself that these non-supervisory visits are a walk in the park. Far from it – they are every bit as important as a full-on visit to your firm. Perhaps more so, given that the



regulator's visit team will have had little time to study your business ahead of their visit, and may have little time to get to grips with the nuances of your business model, and why you do things differently from the firm they saw yesterday.

It's tempting to see such visits as 'educational' for the regulator. You're helping them, going out of your way, practically doing them a favour by spending time with them. What could possibly go wrong? Such a view would be a mistake. Adopting an open-handed approach to the regulator is entirely commendable, but if they don't like what's in your hand they won't hesitate to smack it and take you to enforcement. All of the firms who were fined for client money breaches in the run-up to and aftermath of the FCA's new rules in this area are testimony to this.

And the danger for the firm increases as time goes on and compliance staff have forgotten how to prepare the firm for this visit, or have never had the experience before.

So best get ready. And the first thing that the firm and Compliance Officer need to do is understand what's at stake and what's going to happen.

At the risk of over-dramatising, both the firm and the Compliance Officer need to treat this visit as the single most important event that will happen to them in this firm – bar none. Remember – clients, no matter how good, come and go. The regulator is forever. Get this wrong and the consequences will be personal, costly and long-lasting.

When preparing, I'd suggest that the firm would find it helpful to have a model of their relationship with the regulator. How should the firm characterise the relationship? As one of equals,

with give and take on both sides? One of mutual trust and support? Or is it altogether different, characterised by, at best, mutual distrust and lack of understanding, where one side holds all the cards and the other side is supplicant, at the mercy of changing personnel and unreasonable demands? Or something more neutral – more like strangers in the night?

Even if one has the best possible relationship with the regulator, I'd advise against preparing for a visit or meeting as if the regulator was your most important client. Remember – your most important client likes you. The regulator will show you no such empathy.

So having got that straight, what's next? This is where the compliance staff need a plan for the periods before, during and after the visit. And they need to be clear about their role, relative to senior management. The temptation will be for the compliance staff to think that it should be they who lead the visit and its preparation. Indeed, senior management may encourage them to do so. Don't let them. The regulator wants to see senior management taking responsibility for compliance, so will expect senior management to lead the visit. For this reason, all preparation for the visit should be sponsored and led by a board member, with compliance staff carrying out the bulk of the work.

So – they're on their way. You've been notified, you have a date. (In most cases, you'll get some weeks' advance warning). It's time to get the defences in order. But before we do that and look at the specifics of the regulator's requests and our responses thereto, we need to stop and think. Is this actually convenient for us? Don't think that you are obliged to accept the regulator's suggested dates as if written in tablets of stone. If this is your busy time, tell them! If senior people whom the FCA wants to meet would have to be called in from holiday, suggest alternative dates. The regulator will be flexible about this, as long as they can complete their programme of visits within a few weeks of their original timetable.

So you've agreed a date. Now you can begin to prepare. But before you set off and pull together the mountain of documents required by the pre-visit letter, ask yourself this – why are they coming? The answer to this is not necessarily in that letter, but in other regulatory pronouncements as long as six months ago. Have a look back at the FCA's website. What speeches have senior officials made about your sector? Does what they say affect you? Have there been any enforcement cases of peer group firms? Any new policy initiatives in your area? The answers to these questions will probably tell you more about the underlying purpose of their visit than the visit letter (and let's assume that you do get one).

So now you know the agenda and the sub-plot. It's time to start sharing that information throughout the firm and different colleagues will have different requirements. You'll need to spend your greatest amount of time with your CEO. He or she will have to give a convincing display

to the regulator that they are in command of all strategic issues and have detailed knowledge at an appropriate level. Rehearse them. The same applies, to a lesser extent, to any other board director in a controlled function as well as to any non-executive director, again to a lesser extent. The FCA may, depending on the visit, want to meet them. Given their necessarily limited knowledge of the firm, they may need bringing up to speed. But they won't be expected to have the same level of detailed knowledge as executive management.

Senior management below board level are an increasing area of interest for the regulator. We've all heard about 'tone from the top' – the regulator is finding out that the tone is filtered through middle management, and may end up sounding somewhat different by the time that message reaches the troops.

And everybody else? Yes, they need to be told. A lunchtime briefing, or email update may suffice to get over your key messages. This may sound like overkill, but it serves two important purposes – it binds everyone in to the common goal, and gives you some measure of protection if one of your visit-team stop by someone's desk and say to them something as seemingly bland as, "Who do you go to when you've made a mistake?"

So, with everyone briefed and rehearsed, it's time to inspect the defences. All firms will have two types of defence – general ones that surround it like a force-field of protection, and specific defences, designed to counter specific threats. It may not be fatal if there are isolated failures of either defence system, but in order for them to be effective they both have to be up to date, well maintained and known as well as understood by their users.

So what are they? In the former category I'd put those overarching controls that govern how the firm behaves. Its ethical construct. Its governance mechanisms. Its recruitment and remuneration policies. (There will be others). All of these set the tone for the way in which the firm responds to more detailed issues. In the specific camp are those detailed policies and procedures that govern how any individual transaction or issue is handled. Both specific and general may be enumerated in the Compliance Manual, or elsewhere. So in the time you have left to you, check these. Are they up to date? If not, can quick changes be made? And do people know where to find them?

There won't be time to do much more. Last minute things – book a room, security passes – and make sure everyone tidies up! Nothing will undermine your portrayal of a well-run, efficient and secure firm than an office that looks like a hurricane just passed through.

They're here. The CEO has given them the tour of the office, giving them a sense of the scale of your operations and the calm efficiency of your working environment. Meetings seem to be going according to your well-laid plans. What could possibly go wrong?

And then it happens. One of your junior members of staff rushes into your office, white as a sheet. He tells

you that he was sitting in on the visit team's meeting with the head of sales. All initially went well until 15 minutes into the discussion, when they seemed to lose their concentration, forgot key elements of their control environment and generally just seemed out of touch with the business.

Now it may not happen quite like that. But something like that will happen. Someone will go off message. Or give the wrong answer. And you need to react. So you should aim to meet with the visit team each day, to correct any misunderstandings, provide any additional material, or just to see how it's going. And if you're not lucky enough to have sufficient resource to put a note-taker in every meeting (that is on the assumption that the visit team are happy for someone to be in the meeting taking those notes), make sure that the interviewee feeds back to you immediately they're done and tells you frankly how it went.

Before the visit team leave, try to get them to disclose to you their findings. The extent to which they're willing to do this will depend on the nature of the visit. If you're part of an industry-wide themed review, it's very unlikely that they'll tell you anything. Unless, that is, they've found something that they really don't like. If this is a specific review of your firm, they may be more forthcoming, but again the regulator is increasingly reluctant to open their hand here. They prefer to return to their office, mull things over, compare your practices to other firms and get back to you when they're ready. And they don't like being pinned down in your office so that you can come back to them later saying, "You never mentioned that was a problem when you were here." Which is exactly why you should ask them.

Find out whether to expect a report. Again, this depends on the nature of the visit. If you're part of a themed review, you may not get a specific report. You may have to wait and see whether the regulator issues a publication based on the visits of which you were a part. If you are to receive a specific report, find out when to expect the draft version.

After the visit, it's time to do some immediate assessments. What went well? Did you get your key messages across? Are there immediate rectifications that you need to carry out? An email from the CEO to the whole firm thanking them for their co-operation and help would be timely now.

You should get a draft of any report from the FCA ahead of the final version. On receipt of the draft, you can

do two things – correct any factual inaccuracies and start to put in place the changes the regulator has suggested. What you're unlikely to be able to do is argue the toss with the regulator as to whether their opinion is valid. It's their opinion and they're unlikely to change it. If you need to do this, make sure you go well armed, with supporting opinions, as to why their opinion is unfounded.

If the report is not too bad, you might as well accept that you are where you are, anticipate the final version and get on with the work required – and in so doing, give yourself the extra time to work on the response. The final report (when it eventually arrives) should then contain no surprises.

And it's at this point that the whole cycle starts again. The receipt of the final report – and your response to it – should be the cue for you to set up a new project team and a renewed focus on those areas of the firm that you looked at in the short period before the visit. Next time the regulator comes, you'll be more ready.

All of the foregoing may sound fine, but you may be in that fortunate position where you are unlikely to be actually visited by the regulator. In which case, you'll be on the receiving end of the 'non-visit interaction'. Although these will be a lot less stressful than a face-to-face visit (and that's on the assumption that there isn't a face-to-face element in this interaction – you may be asked to come to the regulator's offices yourself) they will benefit from exactly the same approach.

Don't assume that because you've received nothing more than, say, an email survey from the regulator that you should regard it any more lightly than if they were coming in person. The wrong response would be to regard such a survey as if it were another marketing-type enquiry. The same model of the relationship should govern your response as for the in-person visit. You should still form a project team to gather together the information and respond. There may be further follow-ups required. And you should evaluate any response you receive from the regulator and adjust your procedures accordingly.

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