Effective compliance and corporate governance

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Wells Fargo and CEO accountability

Speaking up

- **The greatest risk is silence**.
- There were **people who knew** of the issues but they **either kept silent or had their voices quashed** at an early stage. Those that got the information **declined to hear** it or **delayed acting** for a wide variety or reasons including a refusal to stand up and to be accountable.
- **Compliance** may not have known of the issues or, if they knew, not understood their significance. They, again with others, have simply **kept their head down**.
- Line business function continue to see compliance as a ‘business inhibitor’ and limit engagement.

Trustworthy and 'authority'

- 'Authority' in this sense comes in **two forms** and both must be present for the compliance officer to be effective
- First, authority where the individual has authority **bestowed upon them by the organisation**
- Second, authority which derives from the **individual's own innate capabilities**.
- The former authority is obvious and can be seen is the compliance officer's position in the firm's hierarchy, their reporting line, the unit's budget and other resources etc
- The second form of authority is very different and is more to do with strength of character and the individual's 'bearing'.
- These issues are that **organisations are frequently opaque and afflicted by an inherent lassitude**.
- **Large and complex organisations have an inherent inertia**
- The compliance department, consequently, requires people who are have **integrity** and who are **dynamic**, naturally **curious** and **persistent** - never letting go.
- All is as dust without these foundations and attributes.

Strategic Compliance

- Tendency for compliance officers to focus on the near horizon, not looking out much beyond the period of the next annual compliance plan and report. **Compliance needs to think much more strategically** working in parallel with the strategic plans for the business.
- The context behind this planning is the **continual reflection on the questions of what compliance is seeking to achieve** and what outcomes are desired.
- The purpose of this planning is to **ensure that compliance remains relevant** and best positioned. This may include a long-term investment programme in **new technology such as artificial intelligence**,
- The **role of compliance in changing** and **developing the right culture and individual ethics in the business**

Organisational silos and information flows

- Many organisations create **structural silos** and this may be exacerbated by the development of **cultural silos**. In an organisational silo information and expertise is hoarded and not shared.
- Many of the issues preventing operational compliance result from organisational ‘silos’. This can be found in job role profiles and in **committee structures**.
- Similarly, directors, or company group functions, may be insulated from disturbing news.
- Some risk managers tend to focus on compliance activities and regulatory requirements, via **formalised and standardised tools.**

FCA's approach to supervision

- The FCA has described a number of key factors which determine their attitude to compliance risk. **These are focused around the firm's business model**, its culture and the related area of senior management personal accountability.
- They include the consequences of the **firm's purpose, governance and its leadership in reducing the potential for harm** arising from the business model.
- Similarly, the regulator looks at whether the business model drives excessive risks to harm customers and the firm's financial position. This could be due to **high-growth strategies**, **low or rapidly declining profitability**, **cross-subsidies** and potential conflicts of interest and the competitive market context.
- How firm's address these issues may be influenced by **how senior management and the board perceive their own levels of personal accountability**

Business models, culture and personal accountability

- The FCA considers that the **roots of what drives misconduct are to be found in poor culture and lack of individual accountability**
- In parallel a firm's business model, coupled issues with culture and personal irresponsibility, may 'indicate high levels of risk". Risks can thrive where a business operates in a **highly competitive market** or on the **verge of failure**. These can drive the management to extremes setting targets which encourage mis-conduct and incentives which encourage wrong-doing

Compliance and corporate governance and the need to establish “authority”

- The senior management, including the non-executive directors, are responsible for ensuring that the strategy and business model reinforces the firm’s general and specific legal duties. They also need **to check that the strategy is not mis-interpreted by the organisations’ staff.**
- However, business management has tended to be regarded the **compliance function as a technical unit** called upon, from time to time, to provide advice. This may be seen in the compliance officer’s lack of authority within the organisation.
- Compliance, along with the other control functions, needs to be closely involved with the board and its strategic decision making
- There is a strong tendency among compliance staff to **focus on the details of regulation**. This over-focus can result in the **simulacrum of compliance while the business goes on very much as before.**

The operational tools of compliance

- 'Risk' and 'heat maps', the '**directed telescope', the 'spider's web'** approach all used to address organisational obstruction and delay
- However, compliance must **ensure that the business considers other all stakeholders**.
- It is also critical that the compliance function **understands the business and its operations thoroughly**. It must also have its own network for obtaining information and influencing outcomes.
- Further, almost all businesses of any size and duration will have **legacy systems and products**.
- Regular reviews of past business should be undertaken in a **customer centric style** and should not seek to gloss-over any of the concerns.
- The compliance function should also **'look over the horizon' for future risks ('up-stream' risks**).

Failures of leadership and ownership

- Many **compliance issues fester** when a problem is identified but no-one takes ownership of the issue to progress towards a rapid resolution. Instead, there is a range of internal bickering over who should take ownership and mobilise the budget and resources to address the matter
- It is a key element of the **compliance role to take ownership** and to raise concerns about delay at a very early stage and, if all else fails, quickly to take ownership itself to implement remediation projects on a timetable agreed with the regulator

Measuring and helping to improve 'culture' within a business

- **If the culture of the business is wrong then regulation will be ineffective. 'Culture eats regulatory compliance**'. Any business of any size will contain a number of cultures.
- It is also **important to measure culture** in the business since this may identify areas of compliance risk. Measurement can include a range of factors such as those directly affecting customers (eg customer complaint levels and type of complaint); those relating to staff which may indicate significant issues (eg staff long and short terms illness, staff repeatedly away sick, staff training participating levels, those who miss training sessions etc).
- It is possible that **many measures used may be too simplistic and too high-level and aggregated to be useful** and may be mis-leading. **This is particularly true of common indicators such customer satisfaction and net promoter scores**.
- **More useful are staff engagement surveys**.

Inward looking and self-deceptive organisations

- **Management self-deception threatens business compliance**. It is possible that an inward looking firm may develop its own set of '**tribal cultures'** and, together with elements of hubris and a narrow perspective, blindness and self-deception
- This self-deception allows the businessman to behave self-interestedly while at the same time believing that they upholds their moral principles based on a process which routinises decisions and employs a '**language of euphemism'.**
- **Individuals may rationalise "wishful thinking**" and to detach themselves from the emotions that would normally signify risks creating rational logical arguments which explain their decisions and actions.

Problems with the 'Three lines of defence'

- The compliance concept known as the 'three lines of defence' has been widely adopted and remains prevalent in the financial services industry.
- While this approach sounds conceptually attractive but it is difficult to operate successfully and has been described by the **Parliamentary Committee on Banking Standards** as providing 'a wholly misplaced sense of security.... Much of the system became a **box-ticking exercise whereby processes were followed, but judgement was absent**.' The same report stated that the 'three lines of defence' model also **promoted the use of an 'accountability firewall'** which seems to have developed 'to prevent those in senior positions having a strong sense of personal engagement with and responsibility for failings and misconduct within their line of management'.
- **An assertive, authoritative compliance function is central to this change of approach.**

Alliance and Leicester and PPI

- “During the period January 2005 to September 2007 A&L induction and adviser workshop trainers’ notes addressing the PPI telephone sales process made references to inappropriate sales techniques that put pressure on the customer to accept the recommendation. This was described as creating a “**pressure cooker effect**”.
- In November 2006 A&L launched training for advisers which advocated “assumptive” selling (i.e. including PPI in the quote given to customers on the assumption that they are going to agree, rather than providing customers with information for them to make an informed decision) as the most effective method of closing the sale in circumstances where customers did not raise objections.
- In February 2007 A&L put in place objection handling training which instructed advisers to offer life cover when faced with repeated objections to full PPI from the customer, rather than to make a recommendation on the basis of the customer’s demands and needs and the customer information obtained. All training material was submitted to, and approved by, Group Compliance prior to use.”

FSA, Final Notice, Alliance & Leicester (October 2008), 9, https://www.fca.org.uk/publication/final-notices/alliance_leicester.pdf

Lessons from regulatory enforcement

- There are many examples which can be drawn from regulatory enforcement cases which help to illustrate many of the points made in this book. For example, in 2017, **Thomas Haider,** the former compliance officer (CO) of **MoneyGram International**, had to pay a regulatory penalty and had restrictions placed on him working as a compliance officer. He had **made recommendations to management to discipline and terminate fraudulent employees at the firm but was overruled but the CO failed to take adequate follow action**

- In the UK there are a number of similar examples including the FCA's action against **Anthony Willis,** the compliance officer at **Bank of Beirut (UK), in 2015 for failing to be open with the regulator.** He claimed in his defence that "at times he felt under pressure from senior management to be "careful" in his communications with the Authority and that he was **not given "licence" to explain issues fully to the Authority.**" This defence was sharply rebuffed by the FCA.

Key lessons

- Integrity
- Authority
- Right culture – measure it
- ‘Directed telescope’ - know the business, its profitability models etc
- Action – do not delay
- Avoid hubris and self-delusion
- Close working with other risk functions
- Close working with board and NEDs
- Understand the regulator and their concerns

UCL Centre for Ethics and Law

You can find out more about the UCL Centre for Ethics and Law at:

Centre for Ethics and Law - UCL – University College London

There is also my recently published book on financial services compliance

Strategies for Compliance: Tools, Techniques and Challenges in Financial Services, (Routledge, 2021)

It is being launched online on 10th May 2021. You can register to attend on:

Dr Alan Brener : A double book launch | Centre for Ethics and Law - UCL – University College London

Questions?