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The Future for Compliance –
Best Practice and Delivering Value



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The Future for Compliance – Best Practice and Delivering Value

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Foreword

This paper is a contribution to the continuing debate over the increasingly important and influential role of Compliance Departments in enabling a financial services firm to meet its strategic and financial objectives. It is addressed both to Compliance Directors and to Senior Management who have a significant interest in better aligning themselves and their firms to maximise the return to stakeholders from those objectives. It proposes some answers to those who seek best practice for their Compliance function, and some criteria against which the leading Compliance Department should be benchmarked.

The requirement for change in most Compliance Departments if they are to deliver value effectively comes across clearly. Departments must re-equip and re-skill themselves with new frameworks and methodologies for risk assessment; they must obtain enhanced management information to measure and monitor Compliance. They will need to make better use of new technology if they are to report on and demonstrate Compliance to boards of directors and the Financial Services Authority. In making these changes, they must ensure that they are properly aligned with their firm's business strategy and the expectations of its major stakeholders.

The research for this paper has been led by Andrew Podd of PricewaterhouseCoopers' Financial Services Regulatory Practice who together with other colleagues, most notably Andy Gordon, has prepared this paper, which as well as reflecting best practice, is also based on discussions with a number of leading Compliance Directors in the financial services sector and on soundings from senior regulators, leading industry executives and other PricewaterhouseCoopers colleagues. We are most grateful to all of these individuals for their contribution.

A handwritten signature in dark blue ink, reading "John Tattersall". The signature is written in a cursive style with a horizontal line underneath the name.

John Tattersall

Financial Services Regulatory Practice Chairman, PricewaterhouseCoopers
October 2002

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Introduction

Today, the directors and senior management of financial services firms demand a contribution and breadth of expertise from their Compliance Departments far beyond the traditional role of those departments. From internal audit to finance to Compliance, every department is being challenged to contribute to and meet the overall business objectives.

Against this background, Compliance has emerged as one of the most important areas of risk that an organisation faces. Perhaps least understood by senior management, Compliance risk, together with reputational risk, have “leapfrogged” more traditional risk areas, such as credit, market and financial risk to jostle with operational risk at the top of the agenda. Whilst most financial services firms have well developed identification, assessment and management expertise in the more traditional risks, new risks such as Compliance are now rightly the cause of both focus and concern of Boards and senior management, particularly in the UK in light of the Financial Services Authority’s (FSA) new senior management responsibilities regime introduced at N2.

However, Compliance should be viewed not only as a subset of risk, to be managed like all of its cousins, but also as an enabler or catalyst for significant value creation within an organisation. Many progressive financial services firms have woken up to the discovery that Compliance has a key role to play. The once narrow focus of Compliance as another internal control or watchdog function for the business is starting to erode and in less than a decade will probably be gone forever.

“Good Compliance is, and always will be, good business sense.”

Lori Richards, SEC Director¹

More and more firms are encouraging or demanding that their Compliance Departments make a “Step Change” to a more value added frontier of: enhancing strategy, improving business processes, better managing risk, providing a consultancy to management and unlocking new possibilities in their markets of choice.

This “Step Change” requires a substantial refocus in the mindset, skills, and delivery of the traditional Compliance Department. To achieve this “Step Change” Compliance Departments will have to regenerate themselves both from within and from without by aligning themselves with the business strategy and the expectations of their major stakeholders.

For those that achieve this change, the rewards and benefits for their firms are significant.

¹ Mid-Atlantic Securities Forum, Philadelphia, Pennsylvania, March 2002.

Best practice Compliance

A frequently asked question by Compliance Directors and other members of senior management:

“How does our Compliance Department compare with best practice?”

Any answer to such a question points out that all Compliance Departments are as different as the financial services organisations in which they operate. That said, those Compliance Departments which can justifiably claim to be proponents of best practice manage to combine and blend four ‘aspects’ of operation with eight essential ‘ingredients’ into a formula that enables them to contribute and deliver to meeting the overall business objectives.²

Key functions

The four aspects of operation are:

Demonstrating Compliance with relevant regulations

Embedding Compliance within their organisation

Managing the cost of Compliance; and

Identifying, addressing and resolving regulatory failures

Aspirational Compliance Directors have indicated that they generally spend too much time on the first and last of these aspects, whereas they would like to be focusing their efforts and resources on the middle two.

Most also recognise that by directing their efforts and resources towards embedding compliance and managing the associated costs within their organisations that they will, in all likelihood, reduce the need to spend time on the first and last aspects.

The dichotomy, however, that Compliance Directors face is how to deploy their resources in such a way as to ensure that all four aspects of operation are simultaneously managed while at the same time shifting the emphasis to the middle two.

“Good administration and good compliance with regulatory requirements is also good business. It is what customers expect, first and foremost, but it will also keep firms out of regulatory trouble.”

Sir Howard Davies,
FSA Chairman³

² We found that although other functions and ingredients have been suggested to us, they are usually just subsets of these items, therefore we have limited them to twelve in all.

³ London Human Resource Group Conference, June 2001, London.

PricewaterhouseCoopers Financial Services Regulatory Practice

PricewaterhouseCoopers is the leading provider of regulatory advisory services in the financial services sector. Our international network, comprising offices in 150 countries, enables us to offer a truly global regulatory advisory service.

Our dedicated Financial Services Regulatory Practice has been offering pro-active regulatory advice to regulated firms and other financial institutions around the world for over a decade.

Our practice, comprising over 500 specialists worldwide, has extensive experience of regulatory rules, codes of conduct and prudential supervision. The teams blend the experience of former senior regulators and Compliance Managers with assurance skills. This depth of expertise means that we are well placed to:

- Explain how detailed regulatory requirements need to be applied;
- Advise regulatory agencies on ways of enhancing their regulatory and supervisory regimes, including assisting in investigative and enforcement actions;
- Assist in the implementation of new requirements such as responsibilities for senior management;
- Work with management to establish or review the effectiveness of Compliance policies, structures, controls and processes to manage the risks better for the business, including advising on the use of technology to maximise the effectiveness of monitoring and to minimise costs; and
- Advise on how to manage regulators' expectations properly and build relationships based on mutual trust.

Conclusion – the imperative for change

We have outlined in this paper the drivers for change in Compliance Departments to achieve significant value creation for their firms. We have also discussed many of the aspects of Compliance Departments that have already been implemented or are well on the road to completing this transformation. These aspects constitute best practice in the Compliance Department.

“Good Compliance is Good Business.”

Stephen L. Hammerman,
Merril Lynch & Co Inc⁶

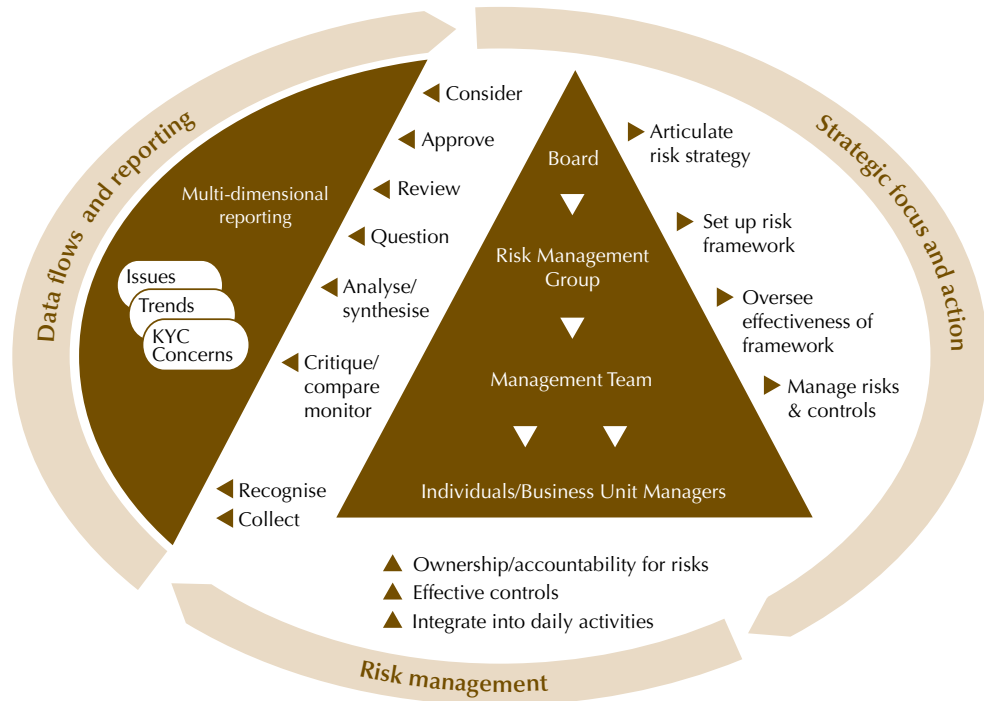
The greatest catalyst for bringing about the change to such best practice is alignment with the business strategy and the expectations of the major stakeholders. Behind that alignment the refocusing of resources and skills offers the next greatest lever to the Compliance Director to effect the transformation. However the transformation does not, and should not, end there. As we have outlined in this paper, the change in the Compliance function should be all encompassing and pervasive in order that senior management and the organisation achieve the greatest benefit. Against achieving the outward “Step Change”, Compliance Departments must also be able to demonstrate their contribution towards achieving both a compliant culture and actual Compliance – the importance of which can never be overstated.

In order to achieve these twin goals, as we have discussed, Compliance Departments must also re-equip and re-skill themselves with new frameworks and methodologies (for risk assessment), enhanced management information (for measurement and monitoring) and new technology (for reporting and demonstrating Compliance).

Group Compliance Directors are uniquely poised to become business consultants and value creators for their CEOs. For many, this change of role may be a challenge that they are reluctant to take or find unsettling. However, this opens up new frontiers and challenges for the Compliance profession to gain greater management exposure, enrich its skill base and contribute to the business success of tomorrow.

⁶ Symposium on Crime and Punishment in the US, September 1995, Washington DC.

This is where Compliance Directors need to focus imaginatively and pro-actively on their role in the compliance conceptual framework that we have illustrated in the diagram below.



As well as being described as a compliance conceptual framework, this diagram could also be labelled the continuous life-cycle of compliance, which needs to co-exist alongside the four aspects of operation that we have already identified. Those Compliance Directors, operating in the middle of the arc labelled “Strategic focus and action”, are generally the most influential in their organisation, but to achieve this they will need to feel sure that their colleagues are playing an active part in the other two arcs, otherwise the life-cycle will fail.

Essential ingredients

The eight essential ingredients we have identified are:

Centralised **oversight**

Control objectives and operational **accountability**

Staff **knowledge** and understanding

Documented **policy** and **practice**

Documented and **monitored** action plans

Communication both up and downstream

Regular **monitoring and reporting**

Independent **verification**

We have found that even the absence of just one of these ingredients can have a profound impact on the ability of a Compliance Department to deliver at the highest level. We will consider each ingredient in the remainder of this paper.

Managing the regulatory relationship

Central to managing the regulatory risk that an organisation faces, the Compliance Department, perhaps unsurprisingly, has a key role to play in managing the relationship between the firm and the regulator. However, Compliance has a far greater contribution and involvement than perhaps many Compliance professionals would realise.

For instance, if the relationship between the business and the regulator is allowed to exist/continue solely at a transactional (rather than relational) level then it will be almost inevitable that the business will be reactive to the regulator. Once there, breaking out of the continual circle of keeping apace with regulatory change, responding to regulators' requests, meeting the stated commitment, etc. becomes a not insignificant challenge. Furthermore if it is the business rather than Compliance that owns the regulatory relationship, then there will be little opportunity to influence the senior management, the organisation and indeed the regulator.

Leading Compliance Departments not only own and manage their business' regulatory relationships – with the implicit message that that sends to senior management – but also pro-actively manage their agenda/relationship in step with the regulator, almost as synchronised swimmers or ballroom partners. With any dynamic relationship, this must be constantly adjusted and fined tuned.

However, if a Compliance Department already knows where its regulator stands on a particular business development, then that Compliance Department is well placed to act as a trusted adviser to the business.

The list of KPIs that could appear on a Compliance dashboard is huge and it would not be appropriate to show them all in this document. From our work in this area we have learned a number of lessons relating to the use and effectiveness of Compliance dashboards:

“As a rule, he or she who has the most information will have the greatest success in life.”

Benjamin Disraeli

The first lesson is that the most effective dashboards do not concentrate solely on the purely Compliance-related KPIs (such as persistency and NTU rate), but also include some reference to the broader business performance of the organisation, such as sales performance and T&C statistics. This provides management with a much broader view of the organisation’s Compliance performance and allows for more immediate identification of the underlying issues that may be causing the poor Compliance performance in the first instance.

The second lesson is that the dashboard should be devised in such a way that it enables the cross-referral of KPIs and makes for easy identification of correlations. An obvious example might be the possible correlation between the average span of control and the number of sales observations outstanding. However we have seen instances where correlations have been identified between two KPIs that would not at first glance seem connected, but which on investigation, and over time, have proved to be linked and of significance. The dashboard must show the KPIs as trends, and not just as one-off figures. What is of interest to management is the ways in which the KPIs change over time, and not just the absolute figures.

Finally, a feature of Compliance dashboards that we have not yet seen, but which we would like to see and have discussed with clients. Hitherto the dashboards we have seen have all been historical; they report what has happened in the recent past. If dashboards contain the trend and correlation analysis capabilities described above, we see no reason why they should not then become a tool for use in planning the future. By extrapolating trends, and by using as predictive tools the correlations already identified, it should, in our view, be possible to use the dashboard as a tool for scenario planning and impact assessment. This would enable the Compliance Officer to fulfil his role as strategy adviser more effectively; the dashboard would give him the means to say to management “if you do this, that will happen”; he would be able to show the cause-and-effect linkages between the various factors involved in running a regulated firm.

Establishing a new Compliance dimension

In the introduction to this paper we spoke of the substantial refocus in the mindset, skills, and delivery of the traditional Compliance Department in order to achieve the required transformation to become a leading Compliance Department.

Aligning Compliance with the business strategy and expectations of the major stakeholders is a key step to this objective as are all of the other areas covered in this paper. However, the whole transformation needs to be achieved in a manner which brings to the fore a complete new dimension for Compliance.

The success of bringing about the change will be as dependent on the manner in which the change is brought about, as on the change itself. Those Compliance Departments which commit to a full-scale change program will have the greatest chance of success. Those which decide to be cautious and bring about change on a gradual basis will lose momentum.

Implementing new methodologies and investing in new technologies for Compliance will probably effect the greatest and longest lasting change. Traditionally, these two areas have not received the focus they deserve from Compliance Departments which have been characterised, in the main, by deep technical specialists, rather than visionary business thinkers. Investing here will be just as important as investing “good” compliance cost in new resources and new skills. Methodologies and technology can be valuable in bringing about change as they will both drive and enable change rather than allowing the change to occur at just a superficial level.

Investing in people – new resources and new skills – will probably bring about the second greatest change. As we will discuss later, achieving the right blend of skills, old and new, will be a catalyst in achieving the transformation – particularly of mindsets within Compliance and the business.

So, in the sections that follow, the new dimension will be as important as the changes that are described. Project management and timely implementation will be key.

Setting the Compliance strategy and priorities – aligning with the business

There was a trend, which seems to have gone out of fashion to some extent, for organisations, and even departments within organisations, to draw up ‘mission statements’, for public display and communication. We have come across quite a few Compliance Departments with mission statements, all of which have been perfectly laudable being centred around the fundamental requirement that:

“We are here to help our parent organisation stay out of regulatory trouble.”

This is, of course, an absolutely fitting and indeed essential objective for all Compliance Departments. But we observe that many of the more interesting Compliance functions have developed a strategy that goes well beyond avoiding regulatory problems. Other objectives have become an integral and vital part of their raison d’être:

- Helping the firm implement its strategic objectives
- Acting as the ‘champion’ of the consumer
- Providing the sales force and back office customer-facing personnel with training, support and guidance
- Acting as the liaison between the firm, the FSA and other statutory bodies
- Helping the firm achieve quality of service and product (however ‘quality’ – a loaded word – is defined)

These objectives, however they are articulated and communicated, seem to go quite a way beyond the obvious one of avoiding regulatory censure, and have an intimate connection with the firm’s business strategy and success. There is an awareness that in an industry that is, for the foreseeable future at least, driven and shaped by regulation, the Compliance Department has a fundamental role to play in helping the firm steer a path that is commercially viable and sustainable.

The key to Compliance’s role in this regard is the simple truth that regulation, but particularly conduct of business regulation, is an expression of how the customer would like to be treated, whether the customer is an individual investor (in the case of retail firms), or a distribution business (in the case of product-manufacturers and other business-to-business concerns).

Getting the customer experience right is the principal interest of the Sales Director, the Strategy Director, the Marketing Director, the Training Director, and ultimately the entire senior management team. It is inevitable therefore that the Compliance function, for which achieving the desired customer experience is an almost overriding concern, will find itself involved in discussions related to the business as a business.

“Compliance has become accepted as more than a cost of business. Increasingly it has been regarded as a codification of good business practice, which provides real value in terms of customer confidence. Good compliance should be indivisible from good business practice.”

Deborah Glass,
Chief Executive⁴

⁴ IMRO Annual Report 1999/2000, July 2000.

Management information and technology

Across the financial services industry, Compliance Departments have developed a wide range of Compliance “dashboards” in order to help them perform their role as monitor of the Compliance risk profile of the business. They all have the same purpose; to provide a digest of the KPIs of the organisation, allowing Compliance and line management to monitor the Compliance risk profile of the firm. Most dashboards are presented as paper-based reports and summaries.

The examples we have seen (and in some cases helped develop) vary hugely in terms of their content, sophistication and presentation style, but they all have one feature in common; feedback to management regarding a number of KPIs, a fundamental requirement of good corporate governance. Examples of the KPIs we have seen are:

- Business quality statistics arising from various activities
- Exception reporting (e.g. KYC checks, fact find quality, market transactions)
- Results from Compliance field audits
- Complaints statistics
- Other Management indicators (e.g. Life industry – persistency rate)

Some dashboards go further and amalgamate KPIs relating to sales activity:

- New account openings and business volumes by product and customer type
- Market share information (e.g. Market commissions or premium income)
- Activity statistics (number of client appointments, interviews and presentations and the conversion rates for each)
- Spans of control

Training & Competence statistics are also sometimes found, such as:

- Number of appraisals conducted (sometimes showing key results such as satisfactory/not satisfactory)
- Number of sales observations conducted
- Appraisals and observations outstanding
- Advisers achieving competence

Optimal structure and reporting lines

One of the questions most often asked of the authors of this paper is:

“Is Compliance an essential ingredient of management or another oversight control?”

We have seen Compliance Departments operate in both capacities – mostly at the oversight control end of the spectrum. However the most effective Compliance Departments that we have observed act in both capacities simultaneously, and do so in a dynamic fashion, recognising the changing demands of the business and the regulatory environment. This dual role is required both to effect the change that is so necessary, and also to act as the required counterbalance to ensure that the change is effective from a Compliance monitoring perspective.

Such “best practice” Compliance Departments usually have another interesting characteristic in that they have not only addressed with clarity their *own* internal organisation, structure and reporting lines, together with those between the *business* and Compliance, but they have also clearly understood and established the basis of working between themselves, internal audit and risk – who are two of primary oversight controls – together with senior management, within a modern 21st century financial services organisation.

So often in many organisations’ Compliance Departments, this is the missing ingredient whereby internal audit, Compliance and risk operate in isolation – perhaps at best displaying a “joins where it touches” approach – and by so doing, fail to truly grasp not only their own role within the organisation but also the contribution that they can bring to other areas of the business.

Elsewhere, reporting lines need to be clear and appropriate to the business needs. Local Compliance Directors will normally report directly to the CEO of that business unit, whilst reporting indirectly to either or both the local Risk Director and the Group Compliance Director. This multifaceted reporting will usually be replicated in turn in the direct reporting line of the Local Compliance Director. Rarely have we seen effective Compliance Departments where reporting has been in one but not both directions.

Whatever the structure and reporting lines, communication should be two-way, and in addition to providing management and the regulators with the information and assurances they need, Compliance should always be willing to solicit views and respond to the changing agenda.

Spurring change and adding value – the new role of Compliance

The Compliance Officer, whether he likes it or not, is also a Sales Director, Strategy Director, Marketing Director (etc). The ‘good’ Compliance Officers have come a long way from the “You can’t do that” school, to one in which he or she is more than prepared to give advice and assistance to all areas of the business. This has been described to us by one Compliance Officer as “the art of the possible”; helping the firm understand what *can* be done from a regulatory viewpoint, coaching on best practice, passing on lessons learned outside the firm (and even outside the industry), acting as a sounding board and in general showing management that getting the customer’s experience right from a commercially-driven viewpoint achieves, by happy accident, most if not all of the regulatory requirements. Or the other way around.

The present UK debate around the role of product distribution and customer experience, provoked by CP 121, the Sandler and Pickering reviews and other market pressures, provide, clear examples of where the visionary Compliance Officer can add considerable value to the business strategy.

Of course, this migration to a more rounded and business-focused role has placed enormous challenges on the individuals who make up the Compliance Department. Gone are the days when the Compliance Department was the final resting place of the failed salesman, the general dumping ground for the organisation’s low-achievers.

The challenges of modern Compliance work has led to a Compliance function which is quite the opposite, staffed by people who are high achieving, self-motivated, professionally qualified and career-minded. A broad range of skills and knowledge is now required within the department for it to meet the firm’s demands and need for a high value service.

We are well aware that the Compliance Department has changed from being the dead-end of a career gone wrong, to an opportunity for ambitious individuals to gain a broader understanding of the workings of their organisation and the industry. In this respect the Compliance Department has followed in the footsteps of the Internal Audit Department, which for some time has been seen as an excellent stepping-stone for the career-minded, ambitious individual.

Purism vs pragmatism

We have also seen the emergence of two types of Compliance Director: the “purist” and the “pragmatist”.

“Occasionally the business should be allowed to fail.”

A Purist
April 2002

The **purist** sees his department’s role as an audit and advisory function, and no more than that. His department exists primarily to monitor the regulatory environment in which his firm exists, and to advise management accordingly. He is happy to monitor – on a sample basis – his organisation’s activities in the context of that regulatory environment and provide analysis and advice, but the job of addressing his findings is outside his remit. His department does not exist to check fact finds or trades for quality, or to review investor complaints, or to remedy past mis-sales or trades; that is management’s job.

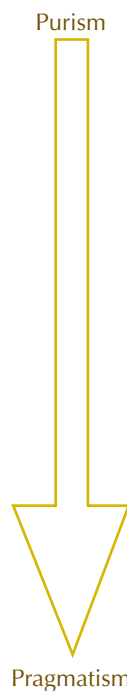
The **pragmatist** on the other hand has a more flexible approach. Like the purist, this Compliance Officer accepts the role of regulatory monitor, adviser and auditor. But he is also happy to provide his organisation with a more pro-active level of support, in which his team will review the quality of sales on a day-to-day basis, handle and resolve complaints, remedy past mis-sales, and even go so far as to participate in the running of the sales force.

The distinction can perhaps best be illustrated thus:

“Protecting the good standing of the organisation and the integrity and reputation of the brand is paramount.”

A Pragmatist
April 2002

- Monitoring the regulatory environment (this is the ‘purist’ or ‘weathervane’ role described above)
- Drafting and issuing guidance to management on the regulatory requirements, including, where appropriate, assistance with designing processes and procedures, and advice on designing training material
- Audits of operational activities, such as branch visits, or sample reviews of records relating to sales, recruitment and training, complaints, etc., with reports going to senior management
- Mystery shopping
- Routine monitoring of the quality of transactions, such as fact-find checking, sign-off on all regulatory advertisements and recruitment decisions, etc.
- Handling regulatory complaints
- Interviewing potential new recruits
- Provision of training for authorised staff
- Supervision of authorised staff



Where does Compliance fit?

In the very early days the Compliance Department had little seniority and its position in the organisational hierarchy was a lowly one; somewhere around the Stationery Department and the people responsible for cutting the grass. Compliance has had a somewhat meteoric career however, and these days we normally find it at the highest level within the organisation. The Compliance Director is normally a board-level executive, or at least reports directly to someone at that level, and dotted reporting lines to the Chief Executive are common.

During their climb up the organisational ladder many Compliance Departments have found themselves on something of a collision course with two other departments: Internal Audit and Operational Risk. (Both departments are often given other names, but we will use these for the purpose of this discussion.) These two potential “competitor” (or partner) functions have also enjoyed a rapidly developing profile, driven by the industry’s adoption of corporate governance principles and the need to manage “risk” in its broadest sense. Indeed ‘risk’ has become the four-letter word of the hour, to the point where some observers wonder whether the industry – which was born of the opportunities in buying, managing and selling risk – is becoming too risk-averse for its own good.

Whilst this can prevent a small problem from growing into a bigger problem – detection becoming prevention – reliance is invariably placed on after-the-fact KPIs: information arising from sales that have already been made, complaints that have already been received, policies that have already lapsed. The nature of the KPIs commonly used by the industry gives rise to a detective approach; identifying misdeeds that have already taken place.

An example of a control approach that *appears* to be both detective and preventative is so-called ‘mystery shopping’. Whilst a single ‘mystery shop’ will primarily identify one adviser getting it wrong on one occasion, it is often argued that it can also reveal that he is routinely getting it wrong with all his clients, and that his supervisor may be failing in his duties both with the adviser under review and the rest of his team. Surely then this is an example of detection being used for prevention? The point however is that the mystery shopping exercise in itself has not and cannot prevent errant behaviour; it can only detect it.

“There are no secrets to success – it is the result of preparation, hard work and learning from failure.”

General Colin L Powell
1989

Whilst some detective and remedial activity is an inevitable part of a Compliance function’s activities, it is ultimately self-defeating. The better Compliance becomes at detecting potential breaches of the rules, the more breaches will be found and the greater the cost in investigating and correcting them. Departments which place emphasis on detection and remediation at the expense of prevention quickly find themselves very busy indeed and in constant need of more resource, but not actually achieving a great deal in terms of improving their firm’s underlying Compliance performance.

It is of course the preventative controls that help the organisation avoid the regulatory issues in the first instance, but the degree to which Compliance Officers see their role as preventative rather than detective is linked to the purist/pragmatist debate. Many see the move towards prevention as a move away from the Auditor/Advisor role towards a line management function; for some, a step too far.

Of course, this is a simplistic view, and most Compliance Officers have responded to their many external and internal pressures by falling somewhere in between. They take a purist line when it suits them; normally when line management is seeking to abdicate responsibility for an activity that can only rest with itself. And when it is clear that management is less than fully capable of the task in hand, the Compliance Department steps in to provide the independent talent required to get the job done properly; a pragmatist's response.

The Financial Services & Markets Act 2000, implemented on 'N2' (1 December 2001), will have a huge impact on this debate. One of the cornerstones of the new Act is the acceptance by senior management of its responsibilities. Compliance should now be forcing line management to accept its responsibilities, allowing the Compliance function to focus on its role.

Releasing and refocusing resources

Achieving the major “Step Change” that we have discussed in this paper requires a major cultural shift at all levels within an organisation if the transformation is to come about.

New skills will need to be introduced into Compliance departments and certain existing resources either redeployed or re-skilled. Boards and Senior Management will be pleased to hear that it is not simply a question of increasing the Compliance headcount (with the consequent impact on the bottom line), although to achieve this transformation there will need to be an investment in “good” Compliance cost. However, the incremental revenues should far outweigh the additional costs. Put simply, Boards need to look elsewhere in an organisation for cost savings and not in the Compliance direction.

“There is often a temptation to cut back, or skimp, on Compliance assurance, on the theory that Compliance and legal staff do not increase the bottom line. That view of course is terribly mistaken... they assure that their firms retain and improve their reputation.”

Lori Richards, SEC Director⁵

However, this is not the only change required at Board level. Boards need to pro-actively support the transformation of Compliance which should be seen as just as important a part of value creation within an organisation as the corporate strategy department, or the most profitable business unit.

In the corporate pecking order, the Compliance Department should be seen (and promoted) as a training ground for management talent, an internal radar screen on the health of the business, and an instrument of senior management to help bring about lasting business change.

Boards need to break the culture of paying lip service to the importance of Compliance with one hand whilst talking down or cutting the budget for Compliance with the other. Against both the ever-increasing regulatory demands on the business and the imperative for change, this is an approach destined for failure.

Not unsurprisingly, perhaps, the greatest change needs to be achieved in the Compliance Department itself. Leadership, vision, creativity, pro-activity and outstanding communication skills all need to emerge in abundant supply. These skills will enable Compliance to align itself better with the business and to be seen as the catalyst for change that is essential. Group Compliance Directors need to recruit the required skills from industry, from the regulators and most importantly, from within their organisation, to blend the new with the old and to form a potent mixture that will effect change.

⁵ Mid-Atlantic Securities Forum, Philadelphia, Pennsylvania, March 2002.

Effective Compliance monitoring

In order to be most effective, Compliance monitoring needs to be both “preventative” and “detective”, focusing both on the controls to avoid failure – QED – and on those designed to isolate instances of failure where they are most likely to occur. The distinction between prevention and detection is, to our mind, a critical one, particularly in the retail environment where regulatory issues relate to human behaviour. We take:

- ‘detection’ to mean any management activity which can identify potential breaches of the rules, but which in itself can do nothing to drive behaviour that is inherently compliant; it identifies weaknesses that have already occurred and is therefore related to the past.
- ‘prevention’ actively influences the customer’s experience, or the organisation’s adherence to regulatory requirements; it is related to the present.

Some examples of what we mean:

Prevention	Detection & Remediation
Timely quality assurance to ensure that only fit and proper individuals are recruited to the organisation	Post-recruitment reviews of recruitment records completed by Personnel to identify recruits who may not fit criteria
Induction training for new recruits	Remedial training
Field-based coaching	Post-sale fact find checking
Live observations of sales/ transactions (e.g. sales calls, monitoring of telephone conversations)	Complaints handling
Desk-based monitoring of KPIs	Desk-based monitoring of KPIs
Mystery shopping	Mystery shopping
	Reviews of past business

It can of course be argued that detective measures can also be preventative, in that detection of a smaller problem can prevent a bigger problem from developing. The classic example is the implementation of the risk-based monitoring approaches adopted by most if not all Compliance Departments. These generally consist of some form of desk-based monitoring of a set of Key Performance Indicators (“KPIs”) designed to identify suspicious trends or transactions; Compliance scrutiny is turned upon those areas which have warning signs attached to them.