ON THE FRONT FOOT: INSTITUTIONAL CHANGE IN BANKING COMPLIANCE

To prove the efficiency of their compliance systems to regulators banks should learn a lesson from industries that address this question daily, such as energy and aviation

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Banks have invested significant time and resource in enhancing their compliance and controls environments in recent years. The fines of 2017 are still huge but not as hefty as in the past, and typically relate to issues that go back several years (for example, the Credit Suisse $5.2bn mortgage fraud settlement). The days of the blockbuster fine in the financial sector are drawing to a close. Instead, we are likely to see more individual prosecutions and fines.

Regulators and prosecutors are increasingly focusing on risk management functions, and demanding individual executive accountability. Key areas of interest remain within the traditional AML/BSA/sanctions compliance spectrum, but now also include conduct, tax evasion, anti-bribery and corruption (including use of proceeds), and data privacy. A good example is the recent personal settlement of MoneyGram's former chief compliance officer in which US regulators made it clear that they will hold compliance officers accountable for institutional failures, and we can expect more individual prosecutions, civil and criminal.

Regulators will continue to build their cases on historic instances of misconduct underpinning broader allegations, and institutions may struggle to provide evidence of compliance to contextualise exceptional behaviour. To address this, institutions will need to show the behaviours under scrutiny are anomalous in and not systemic behaviours they participated in, condoned or overlooked.

This heightened individual risk environment is pushing the industry to nuance and reformulate compliance protocols, and identify areas for improvement to get ahead of the enforcement curve. Further, compliance is not limited to the regulatory world but can affect institutional reputation. So the compounded damage from misconduct can be severe, and we see compliance-related risks becoming more prominent alongside (and at times even above) traditional market or credit risks. In some cases, sanctions for misconduct of institutional magnitude have invoked 'too big to fail' lines of defence, as the fines could negatively impact the broader economy.

So how can financial institutions and their officers better protect themselves and achieve an adequate compliance-risk balance that fosters trust with regulators without sacrificing their competitive edge?

We suggest two approaches:

Measuring tone at the top

To address regulatory demands for institutional 'culture change' management should consider measuring the effectiveness of 'tone at the top', understand whether the compliance and ethics message is being received at all levels and whether there are mechanisms in place that reward ethical behaviour and sanction misconduct.

Gathering data through surveys, focus groups and investigations, and testing the efficacy of hotlines and other reporting instruments (for example, through projects designed to strip out bias or subjectivity) can provide empirical evidence of whether tone at the top is an effective tool in the present environment.

Walking the walk

To identify anomalous behaviours and flag irregularities most organisations deploy compliance software as a first line of defence. Companies, however, should avoid being excessively reliant on automation or audit personnel who may lack the independence or the resources and leverage to identify and escalate issues.

Instead, banks should follow the lead of industries that address compliance risks daily, such as energy or aviation. They should conduct periodic independent bespoke testing of compliance systems and transactional data. This will provide tangible evidence of compliance and show breaches to be the exception rather than the rule, while redefining culture from the bottom up. It will also substantiate an empirical ground for any remediation requirement and affirm the efficient functioning of the compliance environment.

Continuous testing along with an architecture of responsibility in risk management will empower compliance officers, provide a strong signal of management and board engagement and help prevent reckless conduct. The return on investment will also generate a greater appetite for compliance and, in turn, protect consumers, guard institutional credibility and shape risk culture at the top, toned to address existing and upcoming regulatory challenges.

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