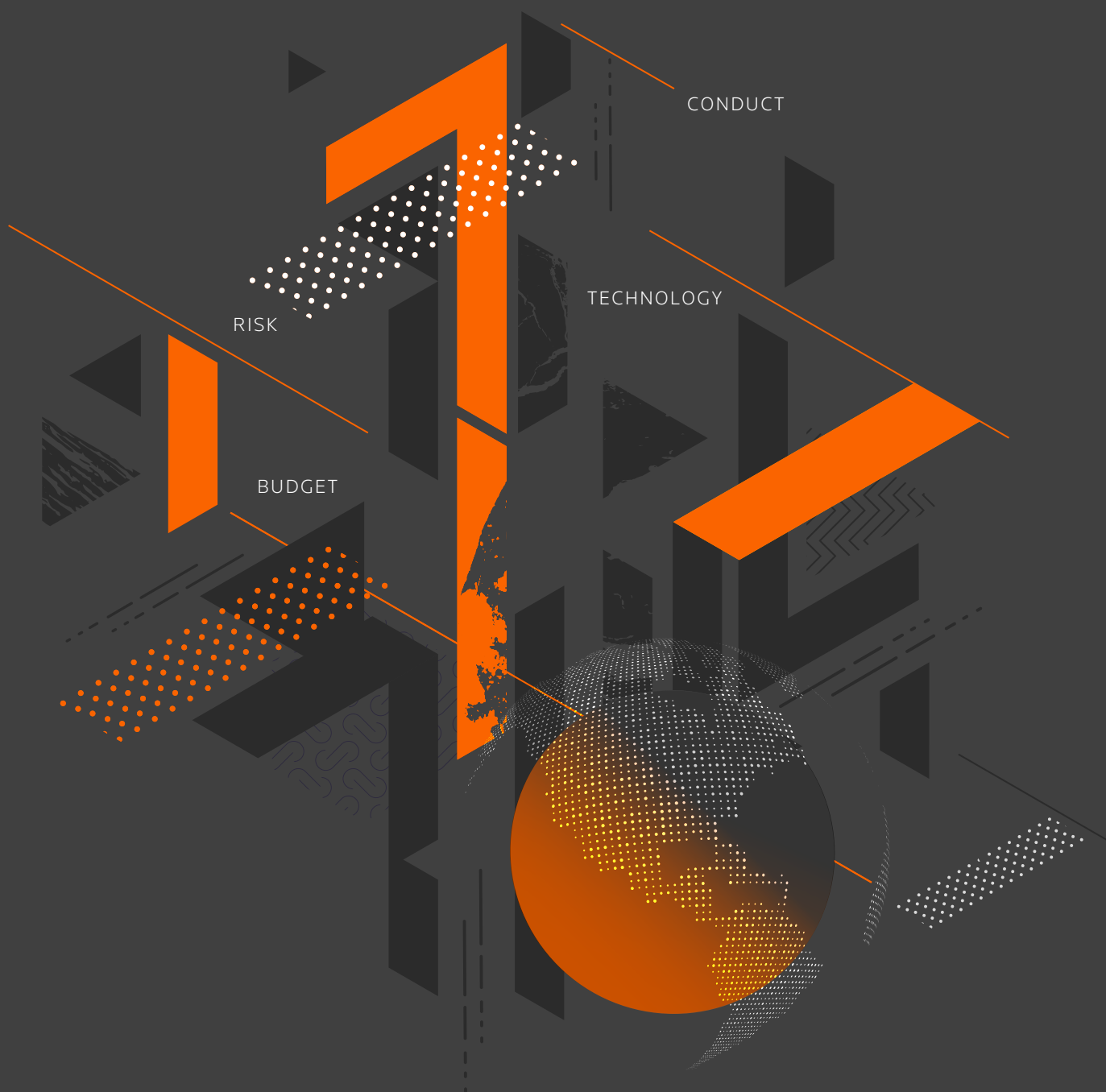


Cost of Compliance 2021: Shaping the Future

By Susannah Hammond & Mike Cowan



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With thanks to Brett Wolf, Chloe Bloomfield and Helen Camfield
All references to this report and its graphics must be fully cited, credited to Regulatory Intelligence

Shaping the future

2021 challenges and indicators for change

Cultural *indicators*

Biggest
board
challenges

- Volume of regulatory change
- Instilling a culture of compliance
- Meeting regulatory expectations

Biggest
challenge
to *culture*
/*conduct*

- Balancing competitive and compliance pressures
- Effectively managing and motivating remote workers
- Creating a unified compliance culture

Biggest
compliance
challenge

- Keeping up with regulatory change
- Increasing regulatory demands and expectations
- Lack of skilled resources

50%

Expect personal liability to **increase**

78%

Expect regulatory information to **increase** in coming year

33%

Have **turned down** a profitable business venture for cultural reasons

Operational *indicators*

34% Reported **regtech solutions** were affecting the management of compliance

36% Expect budgets to remain the same

34% **Outsource** all or part of compliance functionality

62% Expect more compliance involvement in **cyber resilience**

Biggest compliance challenge from COVID-19 is **remote working**



People *indicators*

47%

Expect cost of compliance staff to **increase**

68%

Expect staff turnover to **stay same**

Top three skills for ideal compliance officer

1 Subject matter expertise

2 Communication skills

3 Anticipate future regulatory trends
— Integrity

Equal top 2 reasons why cost of compliance staff would fall

— Remote working

— Budget cuts

The greatest compliance challenge(s) I expect to face in 2021 is/are...

"Rolling out a champagne and caviar trade compliance program on a bread and water budget."

Compliance Coordinator, United States



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EXECUTIVE SUMMARY

Regulatory Intelligence has carried out its 12th annual survey on the cost of compliance, focusing on the challenges the compliance functions at financial services firms expect to face in the year ahead. The report reflects unparalleled interaction with the financial services industry and the frank concerns shared by practitioners, which provide a unique insight into the conditions under which compliance officers are working.

The inflection point raised in last year's report has turned into a need for compliance officers to plan for the future and develop a vision that manages a firm's compliance and regulatory risks by providing direction and context to the social, economic and cultural environment the financial services world now finds itself in.

The COVID-19 pandemic has required people to make fundamental changes to the way they live. From social distancing to wearing masks, washing hands to lockdowns, everyone has been affected. Financial services staff have been working from home, card payments have become the main "currency" and the government has provided widespread help for businesses and the vulnerable.

The Cost of Compliance report was also affected. In 2020, there were two such reports – the customary annual report and a second update to take account of the impact of the pandemic¹. In keeping with the wider social environment, the message from both reports was the need for change. The pandemic was not the only driver; it came against a backdrop of widespread digital transformation, an evolving supranational regulatory change agenda and the shifting political expectations of supervisors.

Last year's report had already identified that firms were starting to reprioritize their compliance needs in line with the amended regulatory agenda. The pandemic then acted as a catalyst for these changes, and the update reinforced the need for compliance officers to focus on change management.

This mix of sometimes competing pressures has seen firms adopt changes in strategic direction, culture, governance operations and staff management. The crisis has shown firms can change and adapt at speed when necessary, but challenges remain.

The 2021 report highlights a need to support these wider cultural, operational (including technology) and people requirements but all will require future investment and resources. Financial limitations present a barrier to successful change, and in the aftermath of the pandemic firms will seek ways to reduce cost and maximize revenue. This year, boards cited cost and dealing with the pandemic as vital challenges.

Compliance officers seem to be taking a pragmatic view. The trend in recent years has largely been to keep budget levels the same, with perhaps slight increases. This year reinforces that trend. Out of more than 720 respondents to the survey, 36% of respondents predicted budgets will remain the same (an increase on last year) and only 42% predicting a slight increase (down on last year) with 10% predicting a significant increase.

Cultural

A risk-aware culture is perhaps the most valuable asset that a firm can develop, especially when confronted with a changing environment. Such a culture will enable it, and its employees, to weather uncertainty and change more effectively. Boards of financial services firms have responsibility for culture, but survey respondents reported that instilling a culture of compliance remained high on the list of challenges that boards foresaw for 2021.

The top compliance challenge that boards and compliance officers were expecting to face was the increasing volume of change, particularly driven by a new administration in the United States and the aftermath of Brexit. The amount of information expected to be published by regulators and exchanges was also expected to increase, with 78% expecting an increase in 2021 – the highest percentage since 2013.

Half of survey respondents expect the personal liability of compliance professionals to increase in the next 12 months, 10% of them expect it to increase significantly. In the light of these findings, perhaps, 62% of respondents said they expect the cost of time and resource devoted to conduct risk issues to increase in 2021.

The survey asked what respondents saw as the single biggest challenge to managing culture and conduct risk. Balancing competitive pressures and managing a remote team came out as the top two. A third of respondents said they had turned down potentially profitable business opportunities for conduct risk reasons in the previous year.

Given the increasing professional and personal risk to board members it is understandable they see compliance culture as a challenge for 2021. The pandemic will undoubtedly have changed the ways in which firms evidence culture, but if an effective compliance culture existed prior to the pandemic, boards should have confidence that those amendments will not reduce standards. This could be seen as an indication of where change is needed.

¹ <https://corporate.thomsonreuters.com/Cost-of-Compliance-2020>

Operational

Technology has been at the heart of the firms' ability to change. The Regulatory Intelligence report "Fintech, Regtech and the Role of Compliance for 2021"² found 16% of firms have implemented a regtech³ solution, with a further 34% reporting that regtech solutions were affecting the management of compliance. Compliance functions are not simply users of digital solutions, they are also required to report on them: 62% of all firms and 74% of global systemically important institutions (G-SIFIs) expect more compliance involvement in assessing cyber resilience in the next 12 months.

The wider use of technology has also made some firms more likely to outsource compliance functions. This year's Cost of Compliance report said a third (34%) of firms outsource all or part of their compliance functionality. In the G-SIFI population, however, compliance functionality has gradually been brought back in-house with 24% of G-SIFI firms outsourcing all, or part, of their compliance functionality (33% in 2020 and 36% in 2019).

The adoption of technology often influences the drive for change. Regtech can help with the prevention of financial crime, and with compliance monitoring and regulatory tracking, but if it is to have maximum effect, changes need to be planned, particularly where an external supplier is used.

People

Without sufficient staffing resources, management will be unable to achieve their objectives. The report said half (47%) of respondents expect the cost of senior compliance staff to increase (39% slightly more, 8% significantly more) in the next 12 months. This is the lowest percentage in the 12-year history of the survey. The potential reasons given for a significant fall in the cost of senior staff in the next 12

months were budget cuts (47%) and remote working (47%). In terms of likely turnover, 68% expected the turnover of senior compliance to stay the same in the next 12 months (60% in 2020).

Respondents saw a lack of necessary skills as one of the main challenges they would face in 2021. As firms and compliance functions develop, there will be a need for a broader range of skills. The top three skills required for an ideal compliance officer in 2021 were subject matter expertise, communication skills and the ability to anticipate future regulatory trends, according to the survey respondents.

Shaping the future

As well as problems, the pandemic also presented the financial services industry and compliance officers with opportunities. Compliance officers must now build on the changes which the pandemic forced on them. They will need to ensure their approach is strategically aligned with that of their firm, particularly with regards to the adoption of digital solutions and outsourcing.

A review, design, prepare, implement and support approach may prove a useful methodology for progressing changes. Compliance officers can review existing arrangements, from responsibilities to information flows, create a vision of how they wish compliance to look in the future and then invoke appropriate change management processes to achieve their goals.

Compliance officers could use the changes that took place during 2020 as an opportunity to develop more in-depth strategies for the future. For example, they can initiate cultural changes that focus more on individuals' behaviour rather than compliance with processes, or defining how future automation can be used to evidence compliance within the firm.

² <https://legal.thomsonreuters.com/en/insights/reports/fintech-regtech-compliance-report-2021>

³ "A subset of fintech that focuses on technologies that may facilitate the delivery of regulatory requirements more efficiently and effectively than existing capabilities." UK Financial Conduct Authority

INTRODUCTION

The 12th annual cost of compliance survey generated responses from more than 720 practitioners worldwide, representing G-SIFIs, banks, insurers, asset and wealth managers, broker-dealers and payment services providers.

The survey questions have been refreshed to reflect developments in financial services. Some questions have been retained to enable year-on-year analysis, while questions on topics such as culture and conduct risk have been added. Regulatory Intelligence has continued to pay attention to the responses to the free text questions and used these to build word clouds. For the second year running, the survey asked respondents to list the three main skills required for an ideal compliance officer in 2021. For the first time respondents were asked what the ideal compliance function would now look like – the resulting word cloud is in the “Shaping the future” section of the report and spans resources, automation, strategic direction and culture.

Some of the changes prompted by the pandemic will prove permanent. The unique pressures it brought should not mean firms can revert to, or develop, bad practices.

As the pandemic wanes, both compliance officers and senior managers have the chance to review and amend culture, governance and working arrangements. The report explores how firms might make the most of internal influences to drive for change and reduce the compliance risk.

Approach by regulators

It is important to acknowledge one external driver of change. The ability of firms and compliance officers to change culture, governance and processes is, to varying degrees, predicated on the changes being made by regulators. The pandemic has led to some soul-searching by regulators, policymakers and firms alike and has triggered a review of how operations have adapted to the challenges presented by the past year. Some examples are:

- *Global — Financial Stability Board* - The FSB has set out an “ambitious” work program for 2021 which seeks to address vulnerabilities directly related to COVID-19 and to increase resilience of non-bank financial intermediation. It also aims to support strong, sustainable and balanced growth in a post-pandemic world. The 2021 work program flows from the FSB’s report⁴ to the November 2020 G20 summit on the implementation and effects of the G20 financial regulatory reforms. At a high level, that report found
- *United States* — A change of administration, together with the ramifications of the GameStop market volatility, signal a potential change in supervisory approach.
- *United Kingdom* — Dame Elizabeth Gloster’s near-500-page report⁵, published late in 2020, was an independent investigation into the Financial Conduct Authority’s (FCA) regulatory oversight of London Capital & Finance Plc, which went into administration in 2019 leaving 11,600 investors with a combined loss of £236 million. The UK FCA is tasked with “delivering effective supervision”, against which the findings were deeply critical in terms of both process and culture. The FCA has accepted the nine recommendations made by the former High Court judge.
- *Ireland* — The Central Bank of Ireland has announced an internal reorganization designed to respond to the changes that have taken place in the nature, scale and complexity of securities markets activity conducted in and from Ireland, and the legislation governing that activity. The reorganization is designed to position the central bank to deliver its mandate and to simplify engagement between firms and their supervisors. The central bank is planning a new senior executive accountability regime modelled, broadly, on the UK Senior Managers and Certification Regime.
- *China* — The Ant Group withdrew its \$37 billion initial public offering and dual listing in Shanghai and Hong Kong at the behest of the Chinese authorities, as part of a “re-think” on how safe the products offered were for consumers. The regulators were concerned about the significant pace of digital transformation in parts of the financial sector which is “outpacing” regulation. The government is cautious about systemic risk and is pushing for reform. It is also introducing new rules for fintech firms with the aim of, among other things, reducing the risk of “too-big-to-fail”. The world’s

4 <https://www.fsb.org/wp-content/uploads/P131120-1.pdf>

5 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945247/Gloster_Report_FINAL.pdf

biggest online retailer, China's Alibaba, was fined the equivalent of \$2.75 billion for abusing its dominant market position for several years. The company said it accepted the ruling and would "ensure its compliance". Further reading about digital transformation in China can be found in Regulatory Intelligence's "China Special Report 2021 – digital transformation"⁶, which is available in English and Mandarin.

Regulatory bodies are also under review. Many regulators are seen to have had a "good" crisis, responding swiftly to challenges and seeking to enable firms to continue to deliver the required customer outcomes. Questions are nevertheless being asked both internally and externally about how the supervisory approach might evolve. Many firms will be considering a post-pandemic review and will be reassessing what the future looks like. Compliance officers will continue to support their firms but they must consider the best ways to shape their own futures in a post-pandemic world.

Internal drivers for change

Technology has perhaps been the greatest internal driver for change during the pandemic. The "Fintech, regtech and role of compliance report 2021" suggested financial services firms have started to deploy solutions with a focus on know-your-customer and onboarding processes, and the automation of compliance processes. The push to automate compliance will allow the compliance function to keep pace with technological investment in other parts of the firm.

Compliance functions need to embrace technology and must develop the skills to establish how best to use digital solutions which enable them to do more with less. They must also remain agile to continuing change as the world begins to recover from the pandemic. An emerging cultural (and indeed risk management) indicator is that any investment in the digital transformation of the front office must be matched in the back office to allow for continuing effective monitoring and oversight.

Cost of Compliance 2021: Shaping the future

Regulatory Intelligence thanks all respondents, with a continued assurance that responses will remain confidential unless permission to include an anonymized quote has been received. The findings are intended to help firms with planning and resourcing, while allowing them to benchmark their own approach and practices to assess whether their strategy and expectations are in line with those of wider industry. The experiences of the G-SIFIs are analysed where these can provide a sense of the stance taken by the world's largest firms.

2021 looks set to be another challenging year; we hope you find this report useful.

 | 



"Adaptability refers to the willingness to innovate and the pace of internal change..."

Bank of England Staff Working Paper No. 192 Organisational culture and bank risk. Suss et al. March 2021

⁶ <https://www.thomsonreuters.cn/zh/insights/china-special-report-digital-transformation.html>

CHALLENGES IN 2021

The greatest compliance challenges I expect to face in 2021 is/are...

“Keeping on top of, and implementing effectively and timely, legislative and regulatory changes that will come through. This includes making submissions for the development of future legislation as well.”

Risk and corporate governance manager, Australasia

Compliance officers routinely face a range of challenges. To add to these, the pandemic introduced a series of new difficulties. Historically, respondents have cited budget pressures, regulatory changes and concerns about compliance culture, but in 2020 new challenges were cited,

such as supervising staff at home and the operational difficulties of home working.

The survey shows a blend of the more common challenges and some of the new ones highlighted in the COVID-19 snapshot update.

The greatest compliance challenges the board expects to face in 2021 is/are...



Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

At board level, meeting regulatory expectations came out as a significant challenge. The volume of change was top, and meeting regulatory expectations was third. This reflects the ever-changing regulatory landscape and the additional changes regulators have made to deal with the pandemic. At board level, trying to manage change and the associated regulatory expectations can be difficult, especially in a low interest-rate environment where profit margins are squeezed, and shareholders' expectations

have to be managed. This comes with a backdrop of greater personal liability whereby in many jurisdictions directors and senior managers are being held personally accountable for decisions made.

When profit margins are tight it is logical for boards to try to reduce costs. Boards must, however, be careful to cut in the right areas and in the right ways to avoid damaging the cultural messages they wish to convey.

The greatest compliance challenges I expect to face in 2021 is/are:



Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

Compliance officers are also having to keep up with more stringent regulatory demands and expectations. Political changes in the United States and Brexit add further uncertainty.

Lack of skilled resource and improving the culture of the firm are dealt with in more detail below. Budget restrictions

fall quite low down on the list. This suggests that when firms review their costs it is not the compliance function that is being asked to make cuts. The economic climate means compliance functions inevitably will be asked to review their costs at some point, but boards' apparent focus on improving the firm's culture, highlighted above, may well explain why this has not happened yet.

The greatest compliance challenges the board expects to face in 2021 is/are...

"Ensuring their fiduciary duties are maintained, especially in relation to keeping themselves informed. Regulators are expecting boards to be more proactive and involved [and this] can create a blurring of lines of responsibilities between board and management. This will need to be carefully managed to ensure directors are provided with effective, efficient and timely reporting, while ensuring they don't become pseudo-management. Time management by directors may become challenging for some."

Risk and corporate governance manager, Australasia

BUDGET AND SKILLED RESOURCES

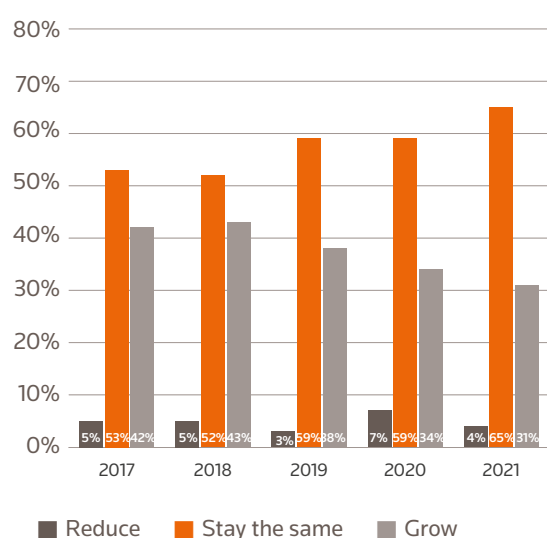
The greatest compliance challenge(s) I expect to face in 2021 is/are...

"Rolling out a champagne and caviar trade compliance program on a bread and water budget."

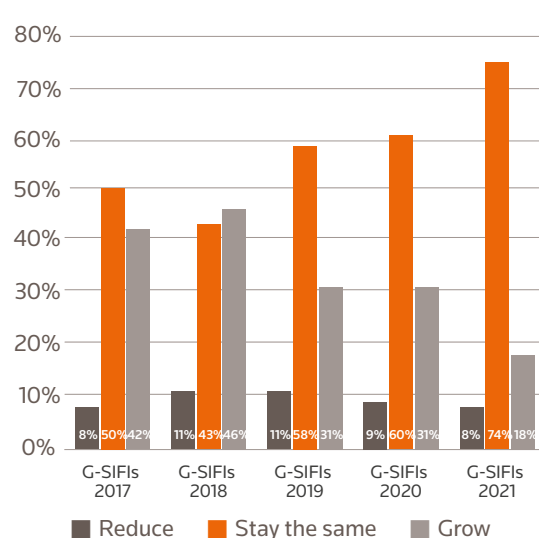
Compliance coordinator, United States

Without sufficient resources, management will be unable to achieve the organization's objectives. The same can be said of the compliance department. Over the years when it comes to budgets or staff, compliance officers have generally predicted a stable, no-change picture.

Over the next 12 months, I expect the size of my compliance team to...



G-SIFs: Over the next 12 months, I expect the size of my compliance team to...

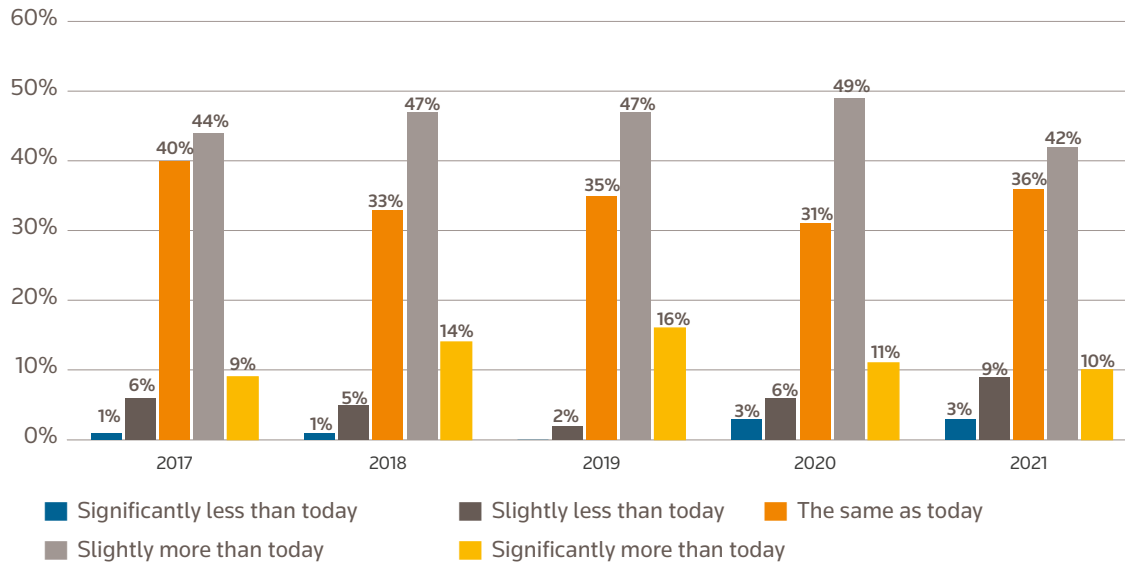


Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

This year's results will be heavily influenced by the pandemic and the economic fallout from months of lockdown and restrictions. This year fewer respondents expect their compliance teams will grow. In 2018, 43% of respondents predicted their compliance teams would grow but this year that figure is down to 31% (46% down to 18%

for G-SIFs). In the main, respondents envisage a stable picture where compliance teams remain the same, and this was underlined by this year's results. Four percent of firms (8% of G-SIFs) said they were expecting their compliance teams to reduce in size.

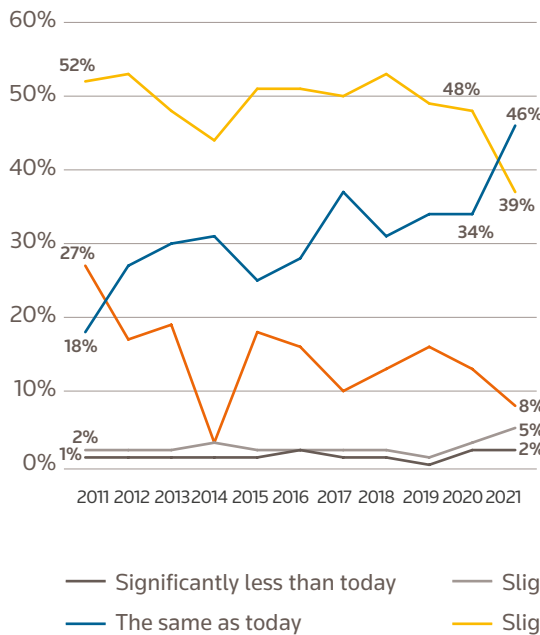
Over the next 12 months, I expect the total compliance team budget to be...



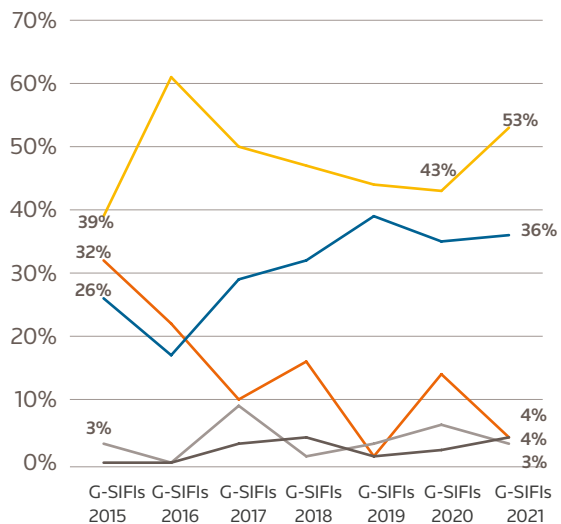
Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

Compliance officers are pragmatic about budget expectations. The trend in recent years has been to keep budget levels the same, with perhaps slight increases. This year reinforces that trend with 36% of respondents predicting budgets will remain the same (an increase on last year) and only 42% predicting a slight increase (down on last year) with fewer (10%) predicting a significant increase.

Over the next 12 months, I expect the cost of senior compliance staff to be...



G-SIFIs: Over the next 12 months, I expect the cost of senior compliance staff to be...



Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

There is a divergence of opinion between the wider population and G-SIFs. The survey indicates that the cost of senior compliance staff in the wider population is stagnating. Almost half (46%) of respondents expect costs will remain the same, a marked increase from 34% in the previous year. More than a third (39%) expect a slight increase. Those who expect cost of senior compliance staff to be significantly more has dropped even further to just 8%, from a high of 27% in 2011.

From a regional perspective, more than half of firms in Canada (61%) and the United States (55%), and half of firms in the Middle East (50%) expect the cost of senior compliance staff to remain the same in 2021. Almost a fifth (19%) of firms in Australasia expect the cost of senior compliance staff to increase significantly in the next 12 months.

A high-level analysis of the results may suggest two things. First, it follows that if compliance budgets remain the same there will be no extra money to pay for compliance staff. Secondly, it could be that more compliance staff are coming onto the market, perhaps because firms are failing or tightening their belts due to the pandemic, thus allowing firms to employ compliance staff at a reduced rate.

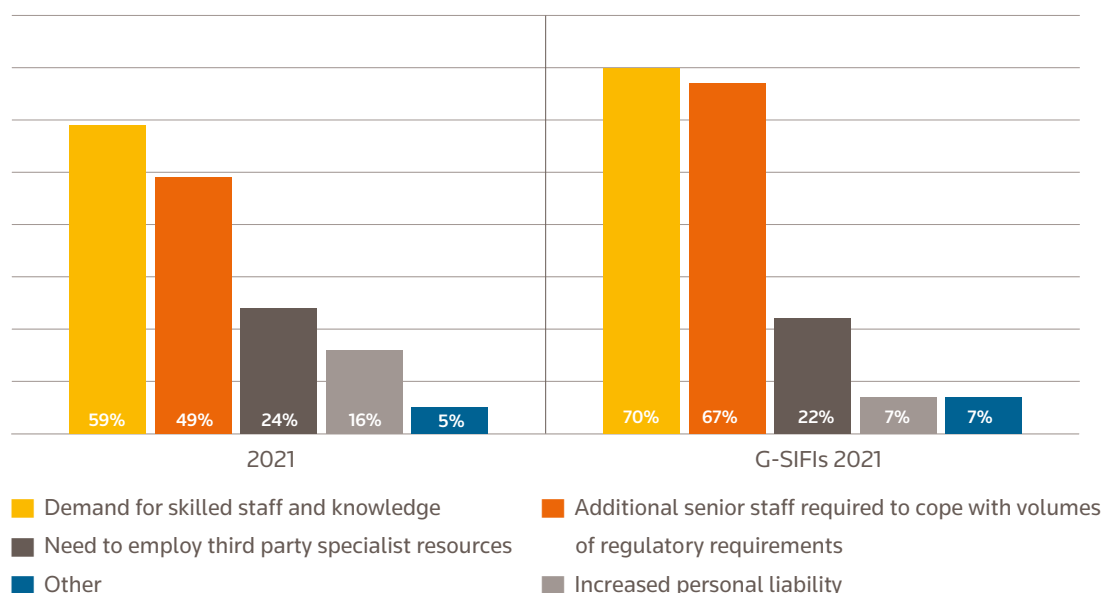
The G-SIFI responses contradict these results. Here, 36% predict staff costs will remain the same — a largely flat trend in recent years — whereas 53% see a slight increase,

a significant upward trend on last year, with a reduction in those seeing a significant increase.

This can partially be explained by analysing the reasons given for the increases. In the wider population more than half (59%) cite demand for skilled staff and knowledge. This rises to 70% in G-SIFs. This is closely followed by the need for additional senior staff to cope with volumes of regulatory requirements (49%), rising to 71% in G-SIFs. The greater size and complexity of G-SIFs makes it understandable for this to be reflected in the compliance function. Skilled staff, knowledge and seniority come at a premium.

Unlike the wider population, G-SIFs do not see personal liability as necessarily leading to higher staff costs. This may be because G-SIFs may have devoted more time and resources to complying with accountability regimes. They may have also had closer contact with regulators, who may have provided greater clarity and guidance about what is expected, and what is not. G-SIFs may also have taken legal advice which has allowed them to offset the personal risks to senior managers more effectively. Finally, it may be that the initial caution about senior managers regimes and how the regulators will use them has eased since their introduction, and new recruits in the market may see them as less of a barrier to recruitment than before.

I expect the cost of senior compliance staff to increase over the next 12 months because of...



Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

The greatest compliance challenge(s) the board expects to face in 2021 is/are...

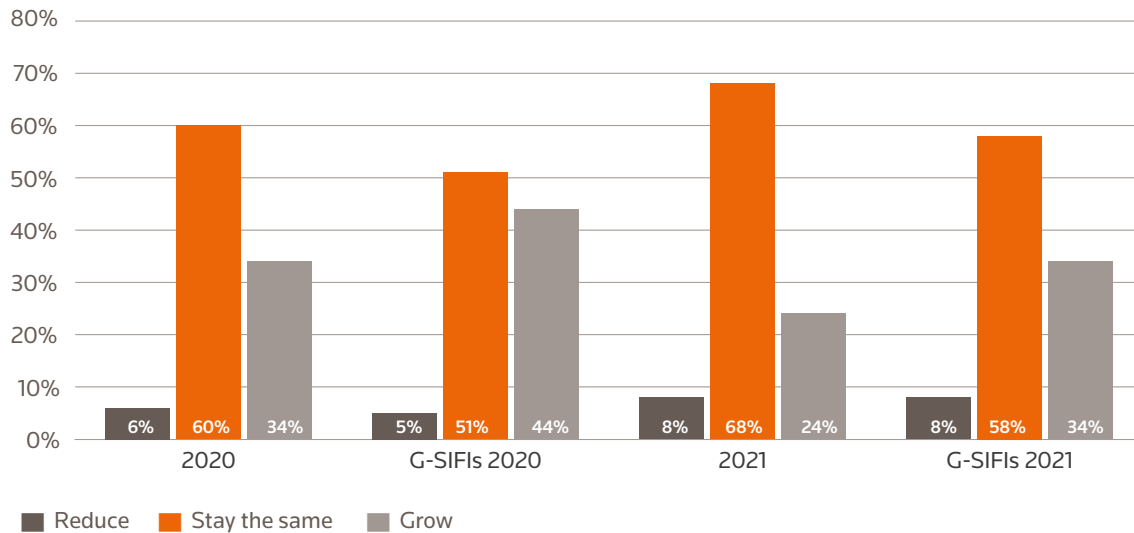
"Ensure that the business is not hindered by compliance, while preventing big compliance issues and within the compliance budget."

General Counsel, Continental Europe

Respondents reported that staff turnover would remain the same or would slightly decrease, suggesting the composition of compliance teams would remain as they are. In G-SIFIs those predicting turnover would remain the same

increased to 58% from 51%, and in the wider population from 60% to 68%. Those foreseeing increases fell from 44% to 33% in G-SIFIs and from 34% to 24% in the wider population.

Over the next 12 months, I expect the turnover of senior compliance staff to:



Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan



“A lack of diversity at senior management and board level is a leading indicator of heightened behaviour, culture and governance risks. As diversity is so interconnected with risk, resilience and financial performance, it will continue to be a priority for the Central Bank.”

Ed Sibley, deputy governor, prudential regulation, at the Central Bank of Ireland. March 2021

Skills

The compliance function needs a mix of skilled individuals who can cover the risks to which the firm's strategy exposes it. As the financial services industry changes these skills will diversify, and it is the responsibility of the compliance team to ensure it keeps up-to-speed with changing requirements.

This year's survey asked what skills compliance officers would require in 2021. Subject matter expertise came out top. This covers a wide range of disciplines including technology to address the cyber, regtech and artificial intelligence elements, business-related subjects such as payments or niche business areas that firms decide to undertake, and plus the softer skills regarding people, culture and change.

What are the three key skills required for an ideal compliance officer in 2021?



Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

The pandemic has added several new elements to the staffing difficulties that compliance officers face. The problem of supervising staff working from home was a feature of the 2020 snapshot update. As the pandemic progresses firms are getting to grips with managing these working arrangements and making plans to accommodate

a mixture of remote working and returning to the office. Recruiting staff in a pandemic was more problematic given the logistical challenges to conducting interviews and using assessment centres. Health and safety issues came to the fore with new requirements on firms to ensure a safe working environment.

CULTURE AND CONDUCT RISK



“Corporate culture comes from the top, and there is a strong need to incentivize companies to foster a culture of compliance, not misconduct. If companies believe they can profit from violations and are unlikely to be caught, they are more likely to break the rules.”

Caroline A. Crenshaw, commissioner at the U.S. Securities and Exchange Commission. March 2021

There has been a strong focus on technology and digital transformation as financial services firms responded, at speed, to the remote working and other implications of the pandemic. Of equal importance for firms is their culture and approach to conduct risk. Technology may greatly help people at firms to excel at their roles and ensure the required good customer outcomes. For the people themselves, the “how” is just as important as the “what”. A strong working culture supported by an effective approach to conduct risk will give firms and their employees the best possible chance of remaining compliant, not only in day-to-day business but also when the unexpected happens and changes are needed.



“The use of technology and new ways of working could bring opportunities to banks amid the pandemic situation, but they could also pose new challenges which do not exist in the traditional face-to-face environment [...] banks should be mindful that conduct and culture remains important when their staff interact with their customers through non face-to-face channels.”

Alan Au, Executive Director of Hong Kong Monetary Authority. November 2020

What is the single biggest culture or conduct risk your firm is facing?



Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

Among the areas identified as the single biggest culture or conduct risk facing firms in 2021 are:

1. Balancing competitive and compliance pressures.
2. Effectively managing and motivating remote workers.
3. Creating a unified compliance culture.
4. Evidencing good culture and conduct.
5. Financial crime.

This contrasts with the 2020 results, which had the top five biggest culture or conduct risks as:

1. Creating a unified compliance culture.
2. Balancing competitive and compliance pressures.
3. Increasing regulatory requirements.
4. Evidencing good culture and conduct.
5. Embedding accountability.

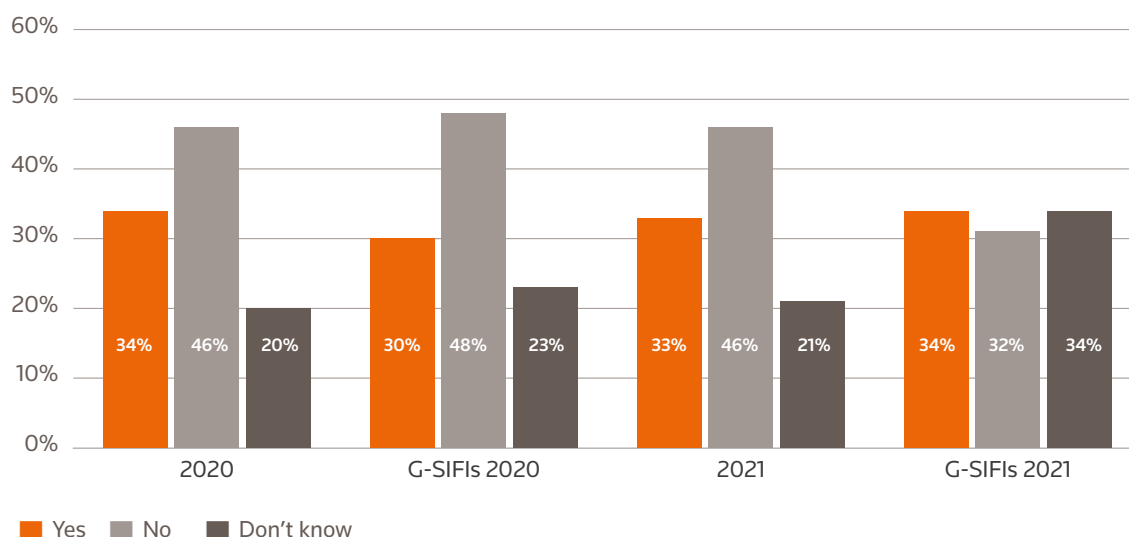
What is the single biggest change in compliance as a result of COVID-19?

"Different conduct risks arising from remote working especially in sales and trading. Accelerated technology rollout and agile working."

COO, Risk and CFCC, United Kingdom

The need to balance competitive and compliance pressures as well as evidence good culture and conduct can sometimes lead firms to discard potentially profitable business propositions due to culture and/or conduct risk concerns.

Have you in the last 12 months discarded a potentially profitable business proposition due to culture and/or conduct risk concerns?



Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

In a consistent, year-on-year finding, a third (33%) of respondents reported having turned down a potentially profitable business opportunity in the previous year because of culture and/or conduct risk concerns, compared to 34% in 2020. Firms should document, in detail, the basis on which business propositions are assessed. Retained records

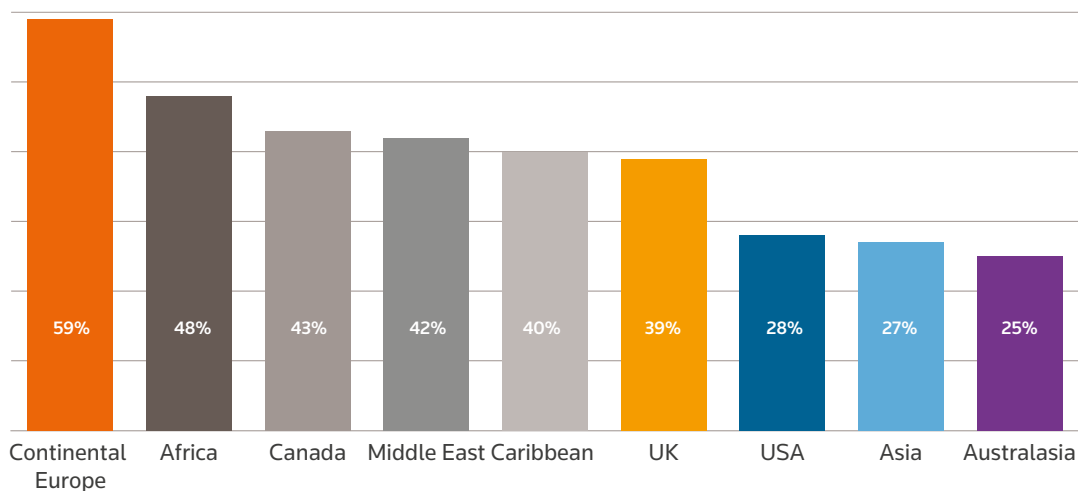
show not only that culture and conduct risk concerns were part of the decision-making process but also that potentially profitable business has been declined because of those concerns will be an invaluable source of evidence for the firm should there be any kind of regulatory visit or investigation.



"But time and time again, I and colleagues in the Bank have repeatedly told senior leaders in firms: consumer and investor protection begins with the firms themselves. Firms are responsible for selling their customers products that met their needs both now and into the future. Firms must have effective cultures and set the right standards."

Derville Roland, Director General, Financial Conduct at the Central Bank of Ireland. March 2021

Regions who have discarded a potentially profitable business proposition due to culture and/or conduct risk concerns over the last 12 months



Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

There are distinct regional variations. Firms in mainland Europe are more than twice as likely to have discarded business propositions in the last year for culture and conduct risk concerns than those in Asia and Australasia. The United States is also below the worldwide average of one-third. There is no lack of focus on culture in Asia,

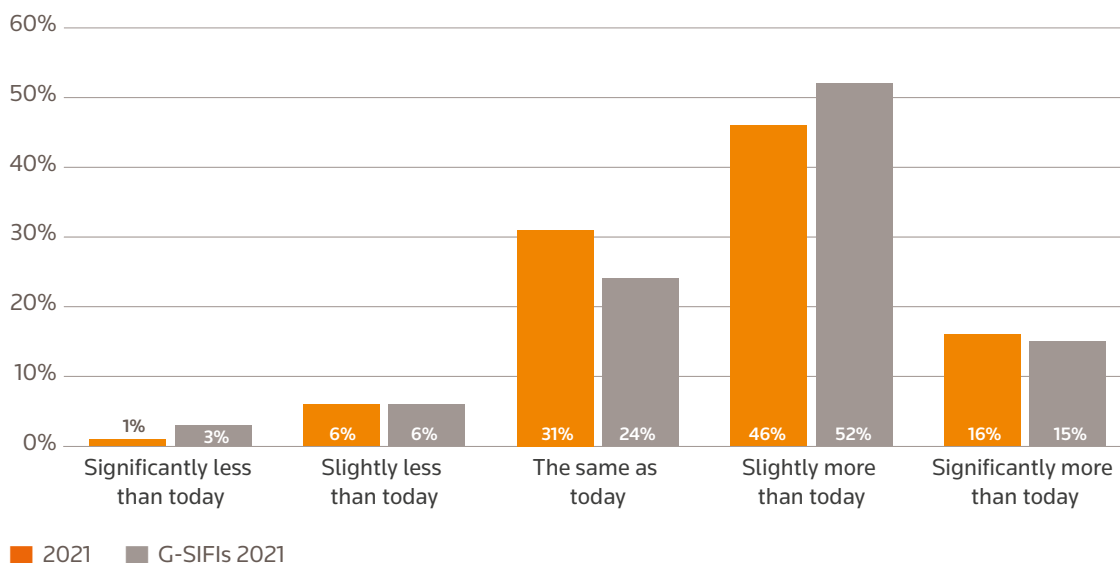
Australasia and the United States, and so firms with business activities in those regions may wish to reassess the criteria on which business decisions are made. If culture and conduct risk considerations are not part of the decision-making process, then it may be time to update the criteria.



“We care because diversity reduces conduct risk and those firms that fail to protect society run the risk of poorly serving diverse communities. And, at that point, diversity and inclusion become regulatory issues.”

Nikhil Rathi, Chief Executive at the Financial Conduct Authority. March 2021

Over the next 12 months, I expect the cost of time and resource devoted to conduct risk issues to be:



Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

The majority (62%) of respondents expect the cost of time and resource devoted to conduct risk issues to increase in 2021 (46% slightly and 16% significantly more). At least part of that increase is likely to be firms redoubling their efforts to create a unified compliance culture, something made more challenging by the need to manage workers remotely. It is one thing to build a strong approach to conduct risk when employees are in an office environment; it is a different challenge when there is widespread remote working.

The tone from the top on culture should take account of both remote working and any plans to return to the office, as well as acknowledge the personal challenges faced by employees dealing with the pandemic disruptions. Firms need to be, and be seen to be, inclusive and supportive of their employees in the face of a greater potential for mental and other health issues.

Compliance officers may well choose to work with HR to recast policies to better fit the post-pandemic world. The need to manage remote workers will require a shift in corporate thinking alongside the need to be able to monitor their activities.

What is the single biggest culture or conduct risk your firm is facing?

“Shortage of resources and time. People do not have time to invest in knowing all the facets of different compliance regimes. Those can lead to decisions being made that may have compliance implications. It’s not that people conscientiously make bad decisions, it’s that they make decisions without full consideration of all the impacts. And they don’t have time or understanding of all the impacts.”

Global trade compliance manager, United States

PERSONAL LIABILITY



“In evolving the individual accountability framework, we are of course keen to ensure that we do not unbalance the framework of collective decision-making and individual accountability by an increased focus on the individual aspects. In fact, we expect that enhancing individual accountability should result in better collective decisions due to a heightened awareness on the part of individuals of their own increased accountability for the discharge of their function, including with respect to their participation in collective decision-making.”

Ed Sibley, deputy governor of the Central Bank of Ireland. February 2021

Increasing the liability and accountability of senior managers is now a well-trodden path for regulators seeking to drive better risk-aware behaviour. There has been widespread regulatory forbearance during the pandemic, but regulators will nevertheless have been paying close attention and will not hesitate to act in future. Any senior individual found to have breached their obligations will

increasingly find themselves subject to enforcement action and unlikely to hold a senior position in financial services again.

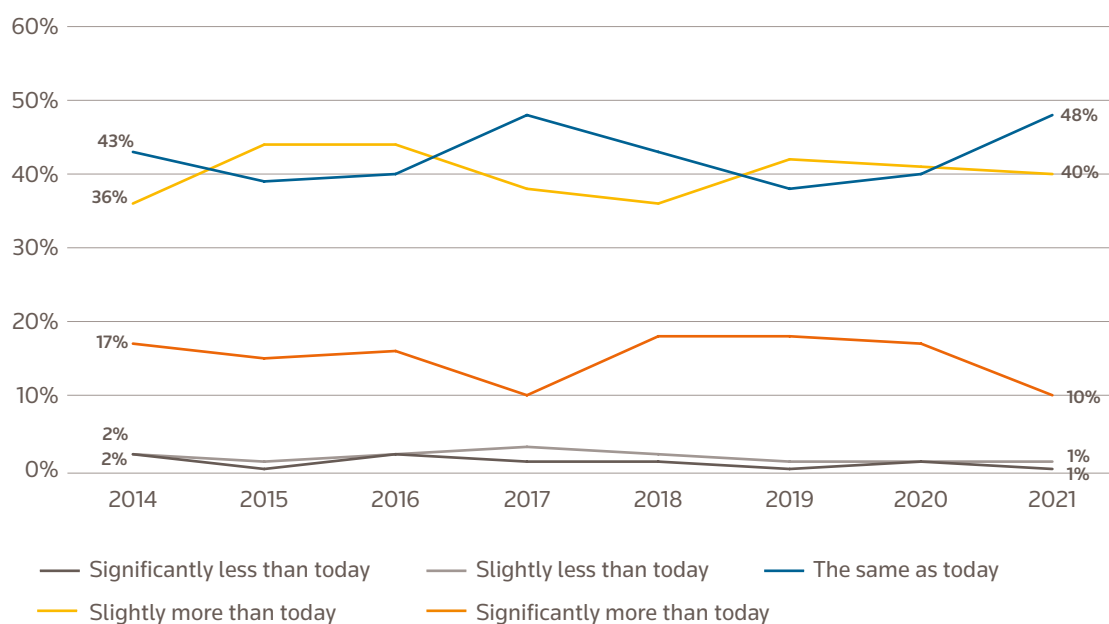
As part of any post-pandemic review, firms would be well-advised to review the decision making and (in)actions of senior managers and to collect evidence to show that, despite the chaos, the firm has acted appropriately.



“For the firms we regulate (both big and small), it means that, more often than not, we will work with you, not against you. We want to reward good performers with nudges, not grudges. We want to train ASIC’s radar on harmful misconduct, not on harm-free process breaches.”

Karen Chester, deputy chair of the Australian Securities and Investments Commission. March 2021

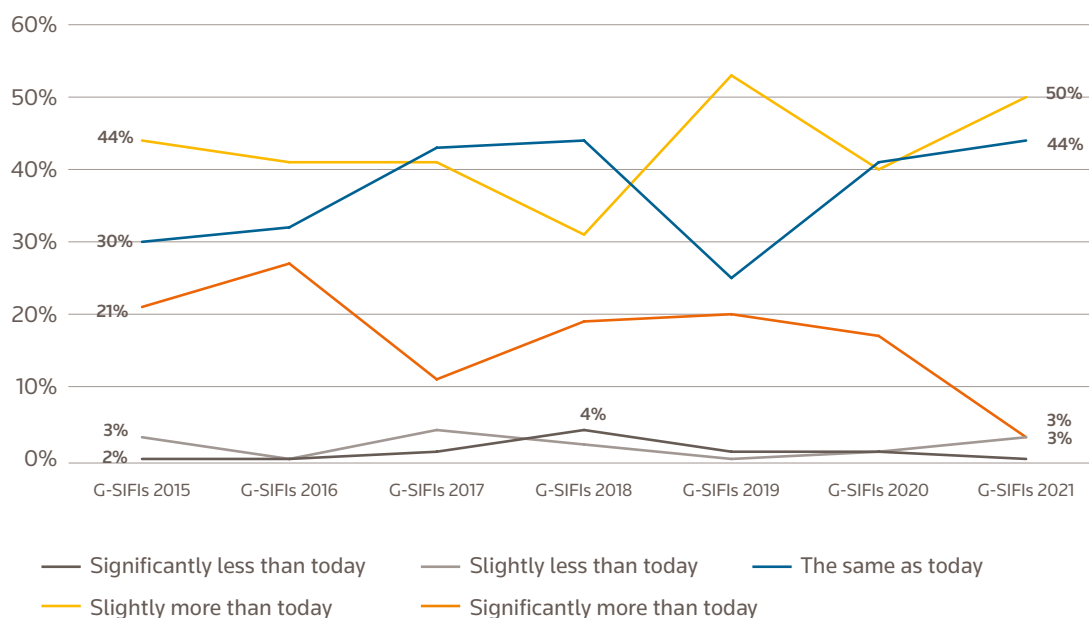
Over the next 12 months, I expect the personal liability of compliance professionals to be:



Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

From an already high base, half of firms expect the personal liability⁸ of compliance professionals to increase in the next 12 months (40% slightly more, 10% significantly more). The percentage of those who expect personal liability to significantly increase has ebbed and flowed from 17% in 2014 to 10% in 2021. Just under half (48%) expect personal liability to stay the same, with very few expecting the personal liability of compliance officers to decline.

G-SIFIs: Over the next 12 months, I expect the personal liability of compliance professionals to be:



Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

A similar picture is painted by the G-SIFIs, although those expecting the personal liability of compliance professionals to grow significantly has reduced to 3% in 2021. Personal liability is not seen to be decreasing but rather the rate of increase has slowed.

Accountability regimes have proliferated. In response to a need to “significantly improve how firms are being governed today”, the Central Bank of Ireland (CBI) has proposed the introduction of an enhanced “individual accountability framework” for individuals, particularly senior individuals, working in regulated financial services firms in Ireland. The four main components of the proposed framework are:

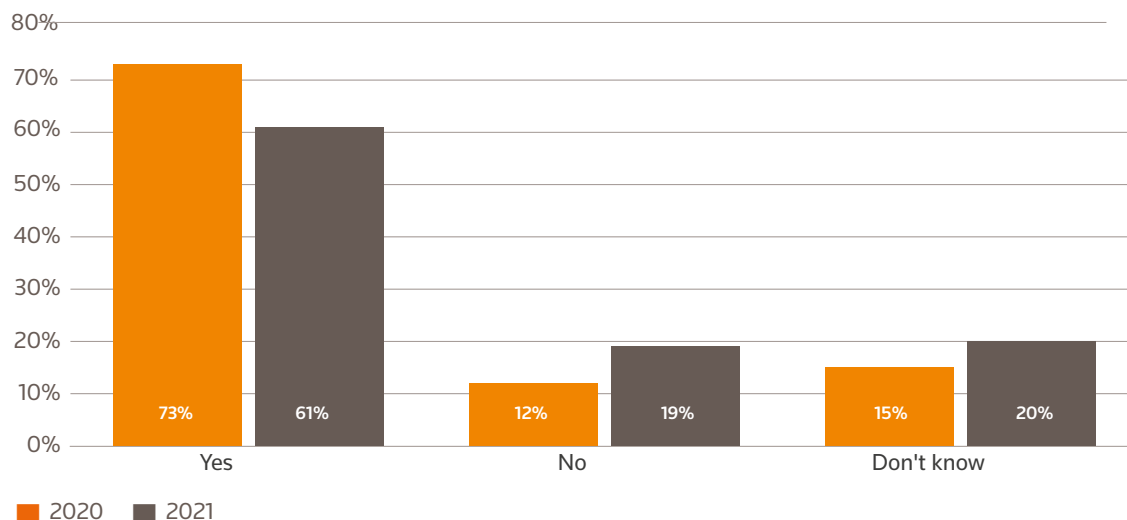
1. Conduct standards which will set out the behaviour the central bank expects of regulated financial services providers and the individuals working within them.

2. A Senior Executive Accountability Regime which will place obligations on firms and senior individuals within them to set out clearly where responsibility and decision-making lies for their business.
3. Enhancements to the fitness and probity (F&P) regime to strengthen the onus on firms to assess individuals in controlled functions on a continuing basis, and to surmount some limitations of the F&P regime.
4. A unified enforcement process, which would apply to all contraventions by firms or individuals of financial services legislation.

The CBI is working closely with the Irish Department of Finance to develop the individual accountability framework, so the necessary legislative proposals and public consultation can be brought forward as soon as possible.

⁸ the potential individual exposure of professionals to legal and regulatory sanctions

Do you think that the regulatory focus on culture and/or conduct risk will increase the personal liability of senior managers?



Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

There is a noticeable fall in the percentage of practitioners who consider the regulatory focus on culture and or conduct risk will increase the personal liability of senior managers. In 2021, this dropped to 61%, from almost three-quarters (73%) the previous year. There is a similar trend among G-SIFs (63% down from 81% in 2020).

There could be several reasons for this. It may be that culture and conduct risk controls are now seen to be more

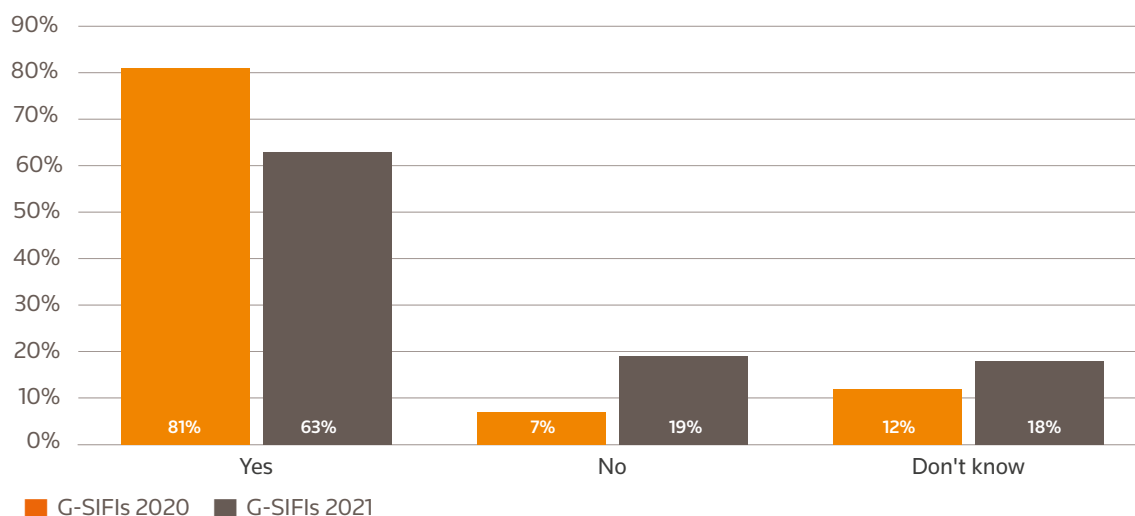
embedded and operating effectively within firms, and so senior managers are less likely to be held personally accountable for culture or conduct risk failings. The growth of accountability regimes which make it easier for regulators to hold senior managers liable for compliance breaches may make it seem more likely that personal liability will arise from breaches of the rulebook than from culture or conduct shortcomings.

The greatest compliance challenge(s) I expect to face in 2021 is/are:

“Strengthening middle management’s shared commitment and participation in the compliance programme.”

Compliance Manager, United States of America

G-SIFs: Do you think that the regulatory focus on culture and/or conduct risk will increase the personal liability of senior managers?

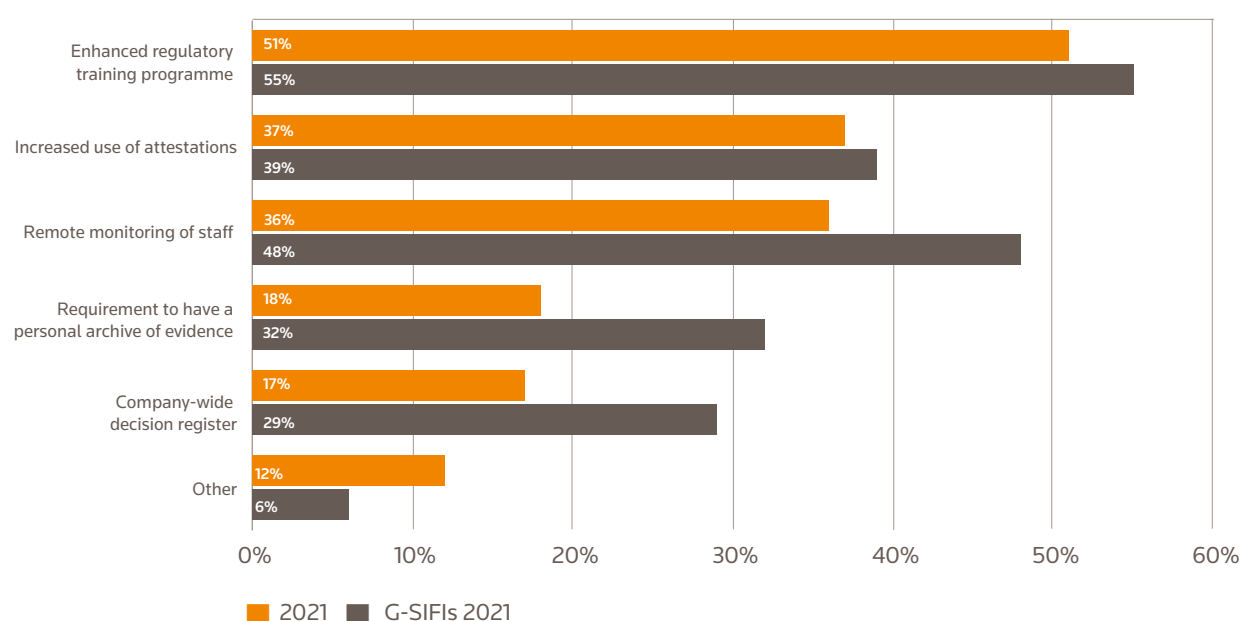


Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

Regionally, 75% of firms in Asia expect the regulatory focus on culture and conduct risk to increase the personal liability of senior managers, compared with 57% among practitioners in Australasia. In other regions, just more than half (58%) of practitioners in the Middle East and 63% of practitioners in Africa expect this to increase. At the other end of the spectrum, 29% of practitioners in Canada do not expect the regulatory focus on culture and conduct risk to increase the personal liability of senior managers.

Firms are using a range of measures to manage the impact of potential personal liability. Consistent with the previous year, the top option is the implementation of an enhanced regulatory training program. Other measures include the use of personal attestations and requirements to maintain a personal archive of evidence and a company-wide decision register. It is a potential concern that only 36% of firms and 48% of G-SIFIs have instituted remote monitoring of staff. This is challenging, but firms will need to consider how they will evidence the maintenance of compliant operations when almost all staff are no longer in the office.

What practical changes have taken place in your firm that affects the management of potential personal liability?



Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan



“Employees at authorised firms have a duty to act with integrity and professionalism, even more important for those employees who are responsible for dealing directly with clients and investors. When called to give an account of their knowledge and actions, the DFSA expects complete honesty and transparency. Anything short of that will result in significant penalties and restrictions. The fine is higher than it would have been as the DFSA has previously imposed sanctions for highly similar misconduct. We expect standards to improve and we will hold to account those who fail to learn.”

Dubai Financial Services Authority decision notice imposing a ban and fine of \$165,000 on Ashish Bhandari for AML breaches and obstructing the regulator. February 2021

As just one example, in January 2021 the UK Financial Conduct Authority (FCA) published Market Watch 66⁹, which stressed the much greater risk of misconduct associated with remote, or home working. The FCA cited the more widespread use of unmonitored and/or encrypted communication applications (apps) such as WhatsApp for sharing potentially sensitive information connected with work.

The FCA acknowledged the use of such apps can present “challenges and significant compliance risks” as firms are unable to monitor effectively, or indeed at all, communications using these channels. The regulator said it has acted against individuals and firms for misconduct which involved the use of WhatsApp and other social media platforms to arrange deals and provide investment advice. This included transmitting lists of trades to copy (“trading signals”) and making other investment recommendations to clients. The FCA said it views these actions as serious and had sought orders preventing such individuals from carrying out these activities in the future. In a warning to firms and individuals alike, the FCA said it expects this to remain an area of focus.

Firms must be able to monitor their employees no matter where they are working. Senior managers are responsible for employees’ activities regardless of geography, and as such should ensure they have line of sight to all (in)actions. Further investment in the capacity to monitor remote working may be required, particularly if the firm has no plans to return to a full office environment.

Firms should also consider the need to manage the likelihood that employees may be, in large numbers, unwell. While managing the (self) isolation or sick leave of employees is likely to be primarily the responsibility of the human resources function, the compliance function will need to be informed. It will, for example, need to ensure regulatory registrations remain up to date and the firm is not left with any undue long-term gaps in roles and skill sets. An interrelated issue is that of people governance. All firms will have an organization chart setting out who reports to whom. Many firms also capture, explicitly, who is responsible for what in the business. Those firms which do not already document who is responsible for what, and where, may wish to begin to build the next level of detail into their organization charts. It is much simpler for firms to respond with agility to events if there is immediate clarity as to who is able to take which of the required actions to remediate or offset an unexpected event.

⁹ <https://www.fca.org.uk/publications/newsletters/market-watch-66>

REGULATORY DEVELOPMENTS

The greatest compliance challenges I expect to face in 2021 is/are...

"Keeping on top of, and implementing effectively and timely, legislative and regulatory changes that will come through. This includes making submissions for the development of future legislation as well."

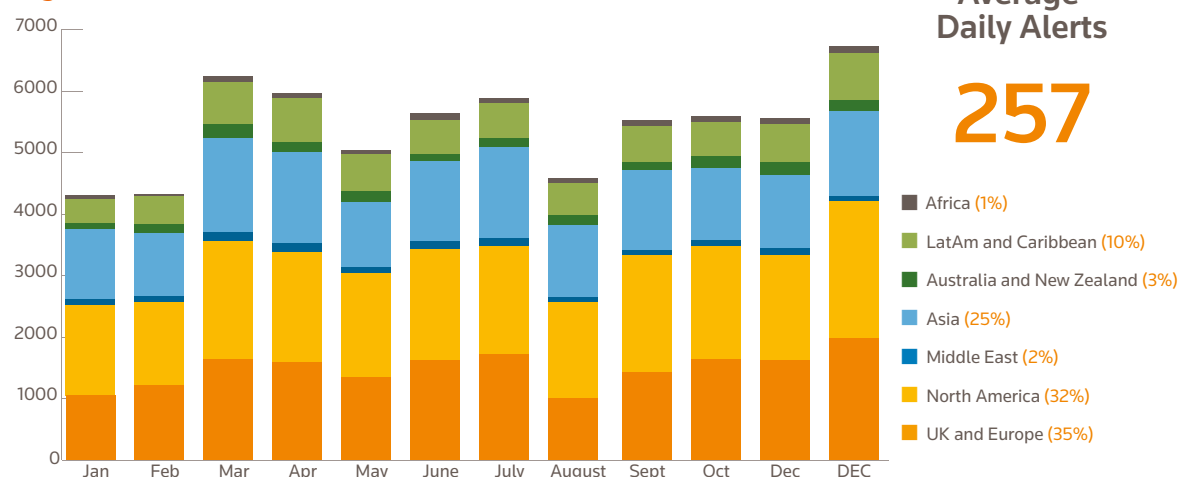
Risk and corporate governance manager, Australasia

Regulatory change and regulators' expectations were cited as challenges both for boards and compliance officers alike. Such change can be assessed both in quantity of alerts and the developments that have taken place.

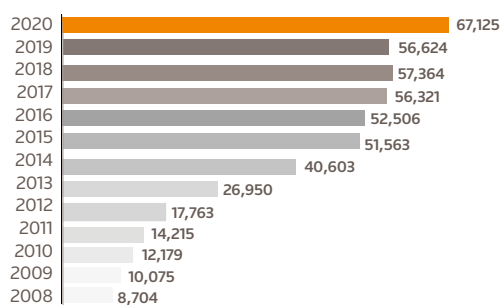
Regulatory alerts

In 2020, Regulatory Intelligence reported 257 average daily alerts across 190 countries.

Reg events in 2020

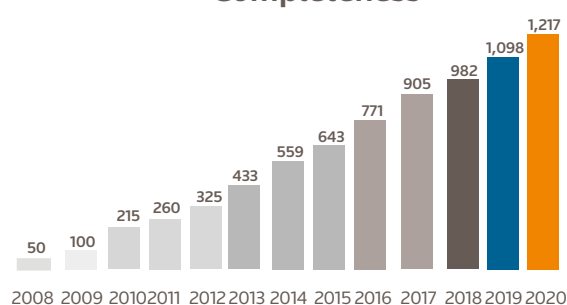


Volume*



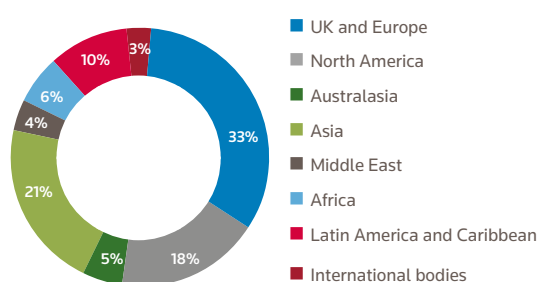
*Total number of regulatory events published each year.

Completeness*



*Total number of organizations tracked for regulatory events, year on year.

Breadth



Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

Regulatory developments

The increase in alerts reflects the significant social, political and economic developments that were seen in 2020. The new political administration in the United States and separation of the UK from the EU will have contributed to these increases. The social and economic landscapes have been redrawn because of the COVID-19 pandemic. This has prompted significant revisions to regulations, from prudential adjustments to capital and liquidity requirements to conduct changes such as limitations on short selling and lending and arrears-handling rules designed to reflect the shifting needs of customers.

Regulations governing operational risk have also changed to reflect the increasing popularity of automated payments. Health and safety and employee management regulations have been introduced to reduce the risk of contagion when employees are in the workplace. Cyber security and operational resilience have been common areas of focus for regulators. Financial crime regulations have also had to change to accommodate the new threats and opportunities presented by the pandemic. An update on developments in terms of financial crime in the United States is included in the adjacent text box.

State of play regarding the fight against financial crime

In the light of the extraterritorial rigor of U.S. anti-money laundering and sanctions enforcement, it is difficult to overstate the importance of the AML Act of 2020. The act will cause the U.S. Treasury Department to create or amend at least a dozen regulations and create a beneficial ownership registry which by some accounts may make compliance more, rather than less, burdensome for financial institutions.

The creation of the beneficial ownership registry will be accomplished via regulations which Treasury's Financial Crimes Enforcement Network (FinCEN) must finish by December 31. Once the registry rule is final, FinCEN will then have one year to amend its existing customer due diligence (CDD) rule and its requirement that banks, and certain other financial institutions collect and verify beneficial ownership information from customers.

Notably, it remains unclear whether financial institutions will have any degree of access to the registry, and if so, how they will be expected to address any inevitable inconsistencies in data. Some experts had initially supposed a U.S. registry might to a degree relieve the CDD burden on the private sector, but some now believe complexities are bound to grow. Much depends on how FinCEN drafts its rules.

Meanwhile, the Financial Action Task Force (FATF) has vowed to continue to crack down on opaque transactions tied to cryptocurrencies such as bitcoin. FATF has warned member jurisdictions that it continues to closely track their compliance with requirements that national regulators implement effective, risk-based regimes to address crypto risks within their boundaries.

FATF also has focused on trade-based money laundering, describing it as "one of the most complex and adaptive

methods of money laundering" and noting it is "widely used by many illicit actors to disguise and move the proceeds of crime alongside legitimate trade transactions". Manually monitoring trade documents for signs of potential money laundering continues to be a challenge for banks.

Although President Joseph Biden assumed office in January, his administration's policy on the use of sanctions against specific nations remains unclear. Most experts agree the use of U.S. sanctions will remain more or less consistent, even if Biden is apt to take a more measured and diplomatic approach than his predecessor, who was known for his shoot-from-the-hip style.

A senior member of Biden's National Security Council has said a review is underway, ordered by Janet Yellen, Treasury secretary, to evaluate the effectiveness of U.S. sanctions and to weigh unintended consequences, especially those tied to humanitarian aid. Biden will seek to unite U.S. allies when imposing sanctions, although Washington will continue to use unilateral "secondary sanctions" that demand compliance with regards to transactions with no U.S. nexus, the official said.

Technology costs have risen for many banks which have sought new solutions because of the pandemic. With more customers opening accounts online, institutions have turned to artificial intelligence- and machine learning-based tools for onboarding and verification, in some cases leaving themselves open to synthetic identity fraud. Even as additional institutions adopt the technology, banks and third-party providers are working to address inherent vulnerabilities exploited by tech-savvy criminals.

Brett Wolf
Senior AML correspondent, Regulatory Intelligence

LIAISON WITH REGULATORS

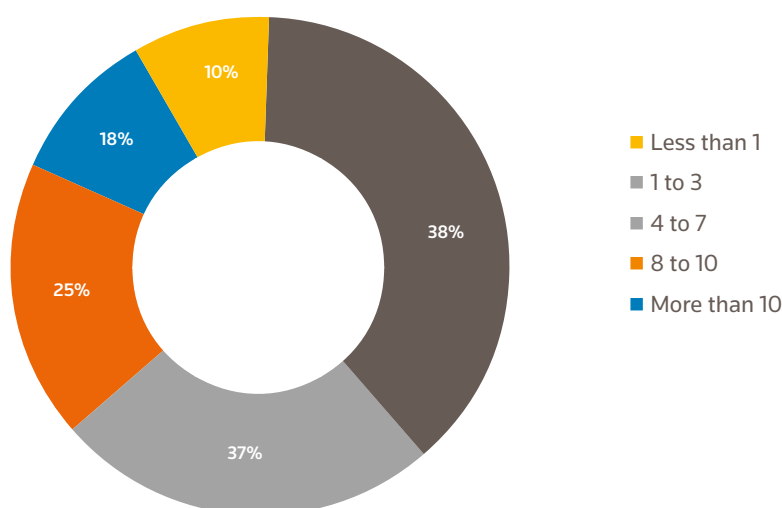
The greatest compliance challenge(s) the board expects to face in 2021 is/are...

"Increased regulatory scrutiny, ensuring the appropriate amount of oversight, continued education about the importance of compliance matters and keeping up with the ever-changing environment."

VP chief compliance officer and director of risk management, United States

The abundance of regulatory activity has a knock-on effect in terms of the cost and resource a firm must devote to managing it. There are several areas where the cost of doing regulatory business is most evident. First, the cost of the compliance function managing the regulatory developments; 38% of respondents reported their compliance teams spent one to three hours a week managing regulatory developments.

In an average week, how much time does your compliance team spend tracking and analysing regulatory developments? (in hours)



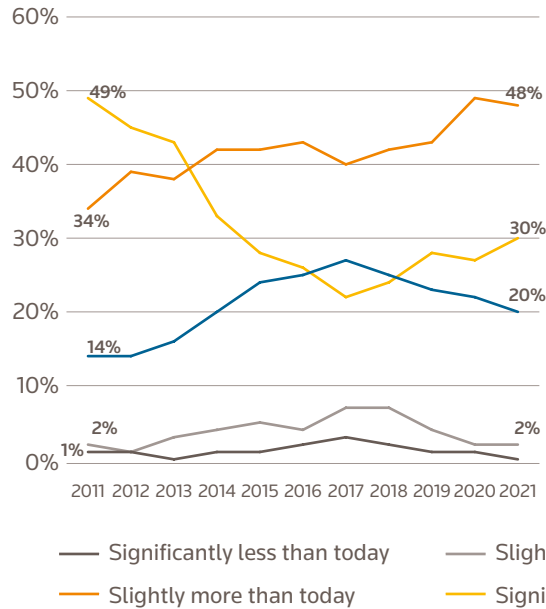
Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

This leads on to respondents' expectations about whether the volume of this activity will increase or decrease in the next 12 months. The trend since 2017 has been to predict a slight increase. This year 48% have predicted a slight increase, a decline on last year, but 30% have predicted a significant increase — an increase on last year.

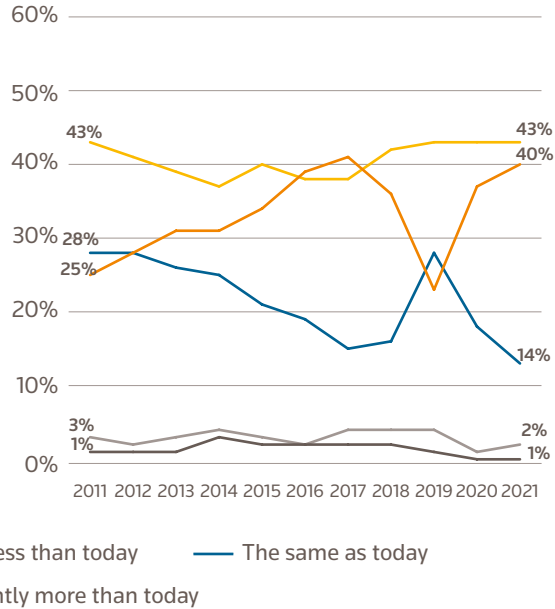
Secondly, the need to liaise and communicate with the regulator comes with a cost. Here too, respondents have historically predicted a slight year-on-year increase. This year's survey maintains that trend with 43% predicting a slight increase and 40% stating it would remain the same. The number of respondents expecting significantly more communication with regulators has decreased quite markedly since 2018, and this year only 13% predicted significantly more.

Regulatory tracking – information published by the regulator

Over the next 12 months, I expect the amount of regulatory information published by regulators and exchanges to be....



Over the next 12 months, I expect the time spent liaising and communicating with regulators and exchanges to be....



Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

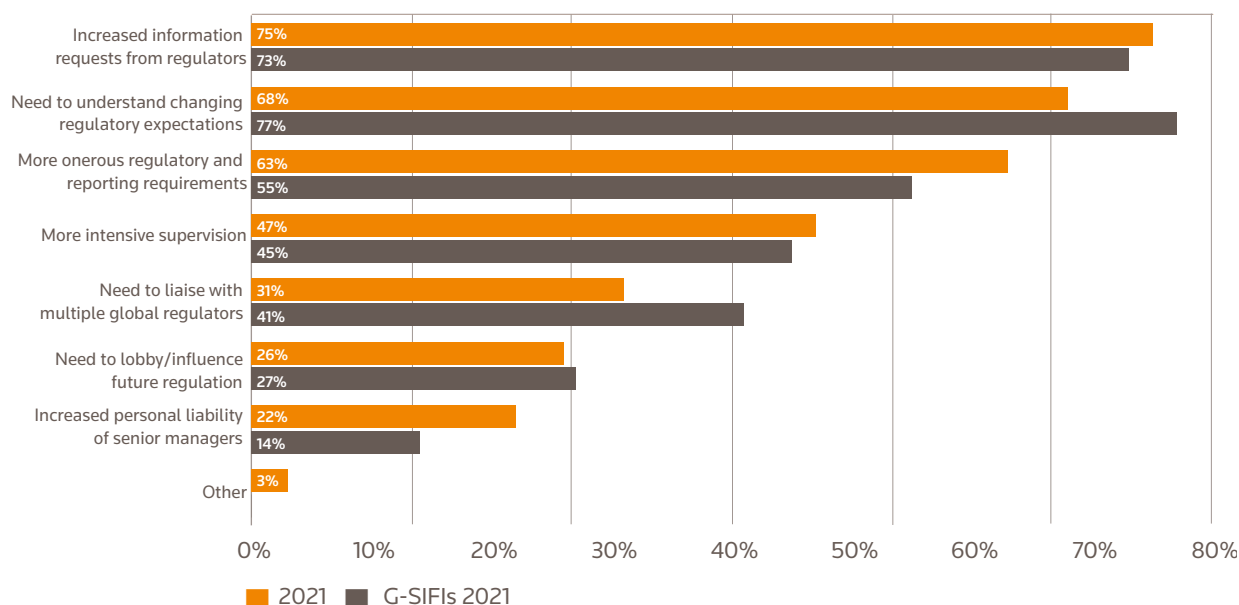
The pandemic means it is possible firms' communication with the regulators, or at least with trade bodies, has been at a high level during the past year. To predict the same as today may imply such communication will remain high and cover several subject areas.

These include information requests, understanding changing regulations, reporting requirements and supervisory problems. This year respondents have predicted that the need to understand changing regulatory expectations will be a substantial part of communication with regulators (77% of G-SIFI respondents and 68% of the wider population). This

follows the changes outlined in the previous section and also the need to seek further clarity as the changes made due to the pandemic are reversed or adapted in the future.

Respondents also think more onerous regulatory and reporting requirements will lead to more communication with the regulators. With many regulators advancing their data strategies and introducing new management, structures and systems to improve their data capabilities, this is likely to be the case for many firms. Both the industry and regulators lack good track records in this area, so it is prudent to expect bumps in the road.

I expect the time spent liaising and communicating with regulators and exchanges to increase because of ..



Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan



“Our market data processing capabilities continue to be a source of regulatory sunshine, combining transaction reports and the order books to provide us with [an] algorithmic radar across trading in close to real time. This means we are not wholly dependent on [suspicious transaction and order reports]. At the same time, STORs are vital additional sources of information, sending the message that it is not only the regulator that is keeping watch for market abuse, which I think is one of the cardinal features that makes our market work well.”

Mark Steward, executive director of enforcement and market oversight at the UK Financial Conduct Authority.
February 2021

LOBBYING

Lobbying is one way firms can seek to shape their own regulatory futures. Any strategy will need to be tailored to relevant business jurisdictions but there are some options for firms to consider.

- Firms need to invest skilled resources in responding to draft proposed legislation, rulemaking, consultations and discussion papers. Even if the apparent chances of getting a regulator to alter its approach are small, they will be nil if firms fail to respond. Firms may wish to work with one another and/or with trade bodies to add weight to arguments where compliance will either be unduly onerous, or the approach is unlikely to meet the required good customer outcomes.
- Firms also need to submit detailed written responses (preferably with practical examples) if they then wish to follow up with either domestic or supranational policymakers. Firms approaching either body without having submitted a detailed, reasoned response to any formal consultation process will be given short shrift.
- A well-trodden lobbying path has been for firms to engage with relevant civil servants and/or politicians to get their points across. Firms need to appreciate that politicians tend to deal at the legislative (rather than rulebook) level of proposed changes. Major concerns can be raised and discussed but all points made will need to cover relevant good customer outcome and investor protection issues.
- Any engagement with civil servants or politicians will need to consider relevant public statements already made on the future of financial services. A firm's lobbying strategy should acknowledge the statements made and then demonstrate how the changes being lobbied for support the stated ambitions.
- Board engagement is essential. Post-pandemic uncertainty about the future is also an opportunity to seek to shape the new world to a firm's advantage. As a first step, firms need to think through the potential implications for their own business and then take a senior-level decision as to what good looks like for their business. "Good" in this sense could include a scenario which is neutral for the firm itself but potentially a significant threat for its competitors. Equally, if a possible threat is bad for the firm it might end up being worse for competitors, leaving the firm in a relatively better position.

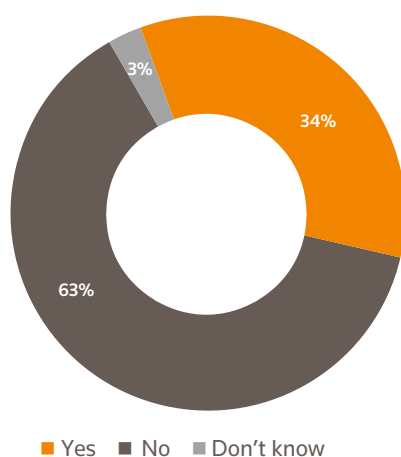
OUTSOURCING



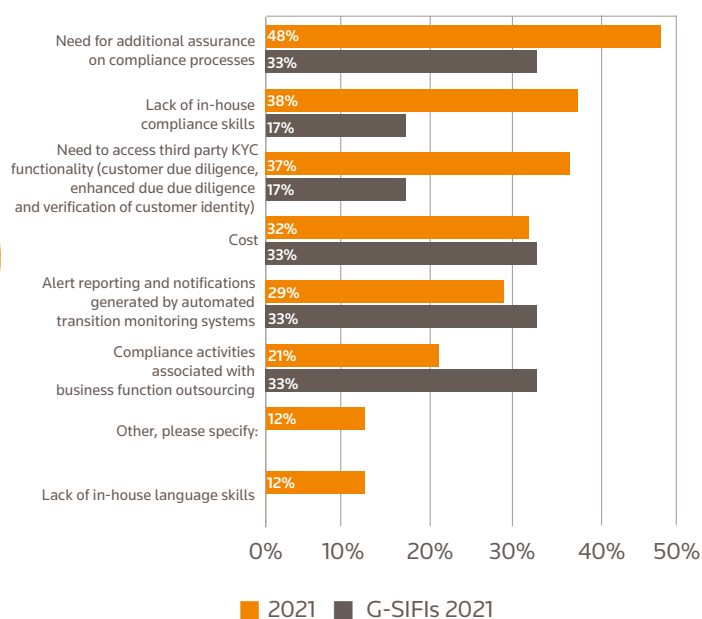
“While a number of good practices were observed, significant deficiencies were identified in board awareness and understanding of the extent of the reliance within their firms on. Furthermore, the paper highlighted major weaknesses with regard to the related governance and risk management controls and processes in place across all financial sectors. Ongoing supervisory engagement on outsourcing indicates that this has not changed substantially. Ultimately, boards and senior management of regulated firms retain responsibility for the functions and services outsourced and are responsible for the management of risks associated with outsourcing.”

Consultation Paper 138 Cross-Industry Guidance on Outsourcing, Central Bank of Ireland. February 2021

Do you outsource any or all of your compliance functionality?



If yes, what were the drivers for outsourcing?



Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

The overall percentage of firms which outsource all or part of the compliance function has remained at its highest rate since the question on outsourcing was introduced to the cost of compliance survey in 2016, with more than a third (34%) of all firms now outsourcing all or part of the compliance function. The percentage of G-SIFs which outsource all or part of their compliance functionality has fallen significantly from recent years to 24% in 2021 (33% in 2020, 36% in 2019).

Reasons for outsourcing include:

- the need for additional assurance on compliance processes (48% in 2021, 54% in 2020);
- lack of in-house compliance skills (38% in 2021, 34% in 2020); and
- need to access third-party KYC functionality (customer due diligence, enhanced due diligence and verification of customer identity) (37% in 2021).

The need for additional assurance on compliance processes and lack of in-house compliance skills have remained among the top drivers in recent years, but cost came in fourth (32% in 2021, 43% in 2020). Those who

selected “other” reasons for outsourcing cited cyber security, data protection, AML reviews, KYC, email call and communications monitoring, internal auditing, sanctions and sanctions screening, compliance testing, onsite visits, and whistle-blowing.

From a regional perspective, of the 50% of firms in Canada which outsource all or part of the compliance functionality, 43% outsourced for alert reporting and notifications generated by automated transaction monitoring systems, 43% due to lack of in-house compliance skills, and 43% due to the need to access third-party KYC functionality (customer due diligence, enhanced due diligence and verification of customer identity).



“While we do not expect all banks to monitor each and every misconduct incident in all jurisdictions, we encourage banks to keep track of key international developments and draw lessons from major overseas misconduct incidents as far as possible.”

Alan Au, executive director of Hong Kong Monetary Authority. November 2020

TECHNOLOGY AND CYBER RESILIENCE



“The COVID event has underscored the financial sector’s susceptibility to operational risks, especially those related to cyber security. The speed of technological change and a growing reliance on third-party, technology-based services is increasingly introducing new risks and vulnerabilities to the sector. To begin to address this, the FSB is focused on achieving greater convergence in areas such as regulatory reporting of cyber incidents, and we will deliver those recommendations to the G20 in October.”

Randal K. Quarles, vice chair for supervision, board of governors of the Federal Reserve System, and chair of the Financial Stability Board. March 2021

What is the single biggest change in compliance because of COVID-19?



Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

The biggest changes in compliance because of the pandemic have, by and large, been enabled by the deployment of technology. Without digital transformation firms would not have been able to shift to remote working and stay connected with teams. The top five areas of compliance change were:

1. Working from home
2. Communication and staying connected with teams
3. Volume of regulatory requirements
4. Remote oversight of conduct risks
5. Data privacy controls

What is the single biggest change in compliance because of COVID-19?

“Dependency on technology in support of a work-from-home environment.”

Senior compliance advisor, Asia



All business models are vulnerable to this pace of technology change and there are few, if any, that will be able to survive without change for more than a few years. The cost of inaction, insufficient action or misdirected action today, will probably be terminal for businesses large and small over a short time horizon. We still see that significant improvements are required at board and executive levels in the understanding of technology and technology related risk.”

Ed Sibley, deputy governor, prudential regulation at the Central Bank of Ireland, February 2021

Remote working, while essential during lockdown(s), is a compliance challenge. Rulebooks apply regardless of where individuals may be working. Regulators have remained technology and digital solution-neutral, leaving it to firms to meet all compliance requirements and to flex policies, procedures and control infrastructures together with appropriate monitoring and reporting to continue to evidence compliance.

The more widespread use of technology and its rapid deployment at the start of the pandemic to facilitate remote working means many firms will need to ensure they have up-to-date policies and that they are tested as working effectively in practice. Given the changes in working arrangements many firms may well have needed to

update their policies; these should be in writing, version-controlled and signed off under the relevant governance arrangements. Training will also be needed to inform staff about any new or amended policies.

A similar process is required as and when the firm allows a new medium of communication – policies should be updated through the usual governance infrastructure and training provided to staff on the new technology, the conduct risks arising and the approved policy.

Regulators are not interested in the geography of where individuals are working but rather in a firm’s ability to have fit-for-purpose procedures in place to minimize the potential for misconduct.



“...we found out that while the big banks are generally on pace with their digitization initiatives, smaller banks are yet to catch up. The discrepancy is because of the lack of right technology, insufficient in-house skills, lack of budget, and over-reliance on legacy technology.”

Benjamin E Diokno, Governor of Bangko Sentral ng Pilipinas. December 2020

The increasing reliance on technology has its own risks, with one of the biggest being cyber resilience. With any crisis comes the inevitable rise in those seeking to take advantage to perpetrate crime, in 2021 that crime will be increasingly associated with cyber risk. Firms, now more than ever, need to remain vigilant and ensure they have deployed the best possible defences against all forms of technologically-enabled attack.

This was highlighted by a May 2020 paper¹⁰ published by FATF, which reported an increase in COVID-19-related crimes, including fraud, cybercrime and misdirection or exploitation of government funds or international financial assistance, which was seen as creating new sources of proceeds for illicit actors. The paper identified challenges, good practices and policy responses to new money laundering and terrorist financing threats and vulnerabilities arising from the pandemic.

Emerging risks and vulnerabilities could result in criminals finding ways to:

- bypass customer due diligence measures;
- misuse online financial services and virtual assets to move and conceal illicit funds;
- exploit economic stimulus measures and insolvency schemes as a means for natural and legal persons to conceal and launder illicit proceeds;
- increase use of the unregulated financial sector, creating additional opportunities for criminals to launder illicit funds;
- misuse and misappropriation of domestic and international financial aid and emergency funding;
- exploit COVID-19 and the associated economic downturn to move into new cash-intensive and high-liquidity lines of business in developing countries.

¹⁰ <https://www.fatf-gafi.org/media/fatf/documents/COVID-19-AML-CFT.pdf>

The need for firms to focus on cyber-enabled financial crime became even more pertinent at the end of 2020 when the United States issued an emergency warning after discovering that “nation-state” hackers hijacked software used by almost all Fortune 500 companies and multiple federal agencies to gain entry to secure IT systems. The U.S. Department of Homeland Security’s cyber-security arm ordered all federal agencies to disconnect from SolarWinds’ Orion platform, used by IT departments to monitor and manage their networks and systems. FireEye, a cyber-security company that said it had fallen victim to the hacking campaign, said it had already found “numerous” other victims including “government, consulting, technology, telecom and extractive entities in North America, Europe, Asia and the Middle East”.

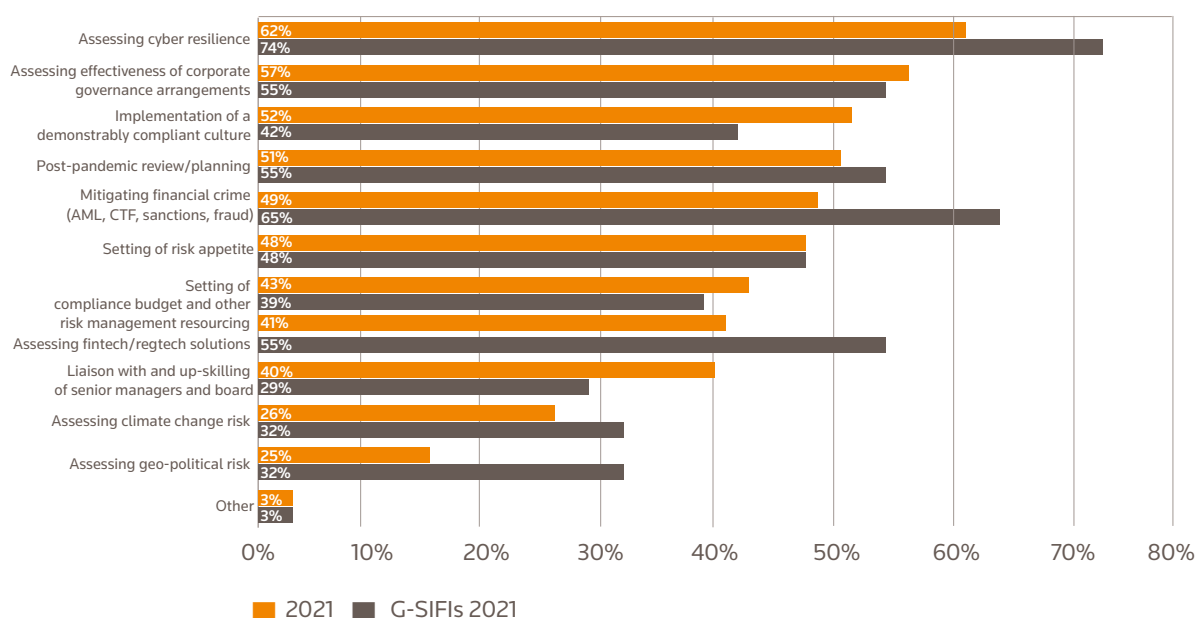
In January 2021, the Reserve Bank of New Zealand confirmed its systems had been hit by a cyber-attack that saw a malicious

illegal breach of a third-party file-sharing application. The bank’s core functions are “unaffected, sound and operational” but the investigation remains the bank’s highest priority. This included supporting stakeholders to help them manage risks and take appropriate action.

In Q1 2021, the European Banking Authority gave a series of updates on a cyber-attack. Since it became aware of the vulnerabilities, the EBA has carried out a thorough assessment to detect any network intrusion that could compromise the confidentiality, integrity and availability of its systems and data. Besides re-securing its email system, the EBA remains in heightened alert and will continue to monitor the situation.

With numerous high-profile cyber-attacks being reported, the cyber resilience concerns are reflected in the areas in which it is expected there will be more compliance involvement in 2021.

Over the next 12 months I expect more compliance involvement in



Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

Assessing cyber resilience has moved to the top of the priority list for compliance involvement in the next 12 months, superseding the implementation of a demonstrably compliant culture and tone from the top. Almost three-quarters (74%) of G-SIFs expect more compliance involvement in assessing cyber resilience, closely followed by mitigating financial crime (65%),

assessing fintech/regtech solutions (55%) and post-pandemic review/planning (55%).

Assessing the effectiveness of corporate governance arrangements remains among one of the main areas, year-on-year, for growing compliance involvement (57% in 2021, 58% in 2020).



“the many reports of cyber-attacks, data privacy breaches, and weak cyber security risk management at major companies has pushed cyber security to the top of boards’ agendas. Directors need to understand management’s view of cyber risks; the potential likelihood and impacts or risks events; and the steps taken to address the risks. It is neither practical nor possible to protect all digital assets equally.”

Sean Hughes, Commissioner at the Australian Securities & Investments Commission. February 2021

SHAPING THE FUTURE



“As I have stressed on several earlier occasions, the strength of a banking system depends on building its capital base while at the same time focusing on corporate governance and ethics driven compliance culture. Banks and NBFCs need to enhance their skillset to identify risks early, measure them, mitigate the risk proactively and build up adequate provisioning buffers to absorb potential losses. They should also augment their internal stress testing framework with severe but plausible stress scenarios. Upgradation of IT infrastructure and improving customer services together with cybersecurity measures are other key issues which also need attention.”

Shaktikanta Das, Governor, Reserve Bank of India. March 2021

In 2020, the financial services sector was asked to make significant changes to its approach to operations, finances, customers and employees. These changes were successful overall. Regulators also made changes to react to the situation. These changes too were well received. But now the sector is left at a crossroads about whether it returns to previous ways of operation or adapts and moves forward in a different direction. Compliance officers and the functions they manage are also at this crossroads, awaiting instruction on direction of travel while trying to prepare a function that is effective for future challenges.

What does the ideal future of the compliance function now look like?



Source: Thomson Reuters Regulatory Intelligence: Cost of Compliance 2021: Shaping the future, by Susannah Hammond and Mike Cowan

A new question for 2021, respondents were asked about the features of an ideal compliance function. Respondents said their ideal future compliance functions would be adequately resourced with human and financial capital, with more automation of compliance activities. The compliance function would be seen as a strategic business partner which was integrated throughout the business, with culture and technology appropriately enabled. These are a solid base on which to build, but the opportunity perhaps exists for compliance officers to create a more radical vision of how a firm can best meet its obligations.

The overarching objective of a compliance function is “to assist senior management in managing effectively the compliance risks”. Compliance, however, is the responsibility of senior managers and the board and not the compliance officer, but the ultimate objective of both is the same: to ensure the firm operates within the rules.

Change management process



It is important for compliance officers to have a path to follow so all the angles of proposed changes can be considered. This is a version of a standard change management methodology.

- **Review** — The key to the future lies in the past. Firms may undertake a post-pandemic review, but if this does not happen, compliance officers should undertake a root-and-branch review of the fundamentals of their role at an early stage. This should include, but not be limited to, current roles and responsibilities, budget process and requirements, processes, skill sets required and in place, governance arrangements (including text book rules on governance), reporting lines, information requirements and how these are achieved (both coming into the function and also leaving the function, reporting requirements and stakeholders and their needs).
- **Define** — Before compliance officers can start to implement changes, they should have a view on what the ideal future looks like.; then planned steps can be put in place to achieve this vision over time. Some ideas will not be achievable from the outset, but it is just as valuable to know what is outside of scope as well as those items that will form achievements.
- **Prepare** — Compliance officers should look to manage the impact and risks of the vision for the future. Communication with stakeholders and relationship managing senior management is essential. It has always been part of a compliance officers' remit to forge strong relationships with senior executives and non-executives and these relationships need now to be used to extol the virtues of a change programme. Some of the changes required for an effective culture that manages compliance risk effectively will sit outside compliance officers' remits, and their influencing skills need to be honed to get senior management onside with their plans.
- **Implement** — Employing effective project management disciplines will help with implementation. There needs to be a plan that includes the right people from the organization who have bought into the goals and objectives.
- **Support** — Once made, change needs to be evaluated and monitored for achievement against the original objectives. Some of the changes may be quite fundamental to the firm, and the board or a governance committee may require regular progress reports.

Specific areas of change

Compliance officers may wish to structure their thinking in terms of culture, operations and staffing.

- **Culture** — To minimize risk, firms need an effective compliance culture. This leads us to explore individuals' conduct and behaviour. Any move toward behavioural compliance focuses the organization and compliance officers on values. The compliance officer's role becomes more about whether the values are appropriate, the "bar" has been set sufficiently high; that those values are defined correctly and whether, and how they can be demonstrated throughout the firm. There needs to be a greater emphasis on the compliance of individuals rather than processes.

Making the individual the heart of the organization rather than an operator of a process may drive improved performance and compliance. Compliance officers should consider these implications on the compliance function. A move to improving behaviour and conduct potentially away from the more traditional compliance with processes may see compliance teams getting more involved with adequacy of conduct policies, standards for new recruits, staff training and other perhaps less tangible elements of conduct. This may move compliance functions closer to overseeing organizational processes that are used to manage employees. After the pandemic, this shift may happen organically, as organizations' focus turns to enhanced health and safety requirements and home working. Compliance officers need to be clear where these facets of working life fall in their responsibilities.

- **Operations and technology** — To meet these challenges compliance officers must ensure their approach is strategically aligned with that of their firm, particularly with regards to the adoption and use of digital solutions and outsourcing. Big Tech companies will in future try to develop their own solutions in the financial services sector. Compliance officers must prepare for how they will address these developments. More detailed competitor analysis or a review of internal IT platforms may be needed. Change management procedures may need to be updated.

It may be necessary to review the wider compliance processes for effectiveness. Compliance with regulations has become a procedural exercise. Over the years, firms have demanded more clarity so that, in places, existing rules are prescriptive and give firms little flexibility in their application. Operators tend, therefore, to be far more focused on putting a tick in

the right box on the right form rather than assessing whether customer, shareholder and regulatory needs are being met. At times, compliance functions can be accused of the same. Once they see the tick, they look no further. The pandemic and home working have hastened some of this thinking, but time should be given to the more value-added tasks, e.g., control assessment and problem solving.

The reporting process may need to be assessed to establish whether arrangements should make way for more workshop-based, ideas-led solution groups. Automation of processes will play a pivotal role here, but should be considered on a firm wide-basis.

- **Skills** — The compliance department of the future will need to think strategically to assess future requirements given the direction of the firm and taking into account the views of other stakeholders (regulators included). The firm may require more generalist compliance officers with a range of skills and experiences. This might be more appropriate where more basic processes have been automated and fully embedded. Alternatively, firms may decide to focus on specialist regulatory areas such as cyber security or payments where the strategic objectives heavily lean one particular way. Firms must also factor in the need for staff development.

Compliance officers do not operate in a vacuum and are not solely responsible for the firm's culture and strategic direction, but they must have sufficient influence at board and senior management level to be able to contribute to its direction. This influence on cultural and strategic decisions will make it easier for compliance officers to achieve their objectives. Regular sessions with the board, testing cultural and compliance messages, bringing forward both process and behavioural weaknesses and recommending appropriate ways to remedy concerns are all useful ways for the compliance function to contribute to the firm's strategic direction.

Firms may argue their approaches are partly determined by the regulatory approach; regulators may already be further down this route than expected. Their focus on customer outcomes is only a step away from values, and the senior manager regimes have already begun to establish a framework for the ways in which regulators wish senior managers to operate. Regulators are perhaps waiting for firms to begin discussions about ways to dovetail approaches without compromising standards and increasing risk.

CLOSING THOUGHTS



“As we look to next year, we are also turning our attention to the future regulatory framework. Following the government’s recent consultation, one important question will be how we balance the need for regulators to have enough flexibility to act quickly — as we have in recent months — while maintaining proper democratic oversight of our work. We will play our full part in ensuring any updated accountability arrangements work smoothly and transparently.”

Nikhil Rathi, chief executive of the UK Financial Conduct Authority. November 2020

The inflection point raised in last year’s report has turned into a need for compliance officers to plan for the future. Firms must remain agile as working arrangements continue to flex; for example, some firms have already indicated a wholesale return to an office environment, while others intend to continue with remote working or hybrid arrangements.

Radical change may well emerge from post-pandemic (and other) reviews of and by regulators. It is not only the rulebooks that are to change but potentially also supervisory approaches and the associated use of technology. Add to this the knock-on effect that the subsequent internal changes within an organisation will have to the culture and the change management environment being experienced will continue.

The pandemic has changed ways of working, probably permanently. Many firms have cut bureaucracy to focus on decision making. Governance and reporting structures have been made more flexible. Boards, committees and teams often are meeting more frequently, sometimes in smaller groups made up of senior decision makers, and usually online. These changes have extended to the compliance function itself with new governance structures being adopted to ensure the flow of management information remains tailored to the evolving circumstances to facilitate better awareness of the risks at the most senior levels within the firm.

The crisis has shown firms can change and adapt with speed when necessary but future changes need to be harnessed and carried out in a structured, controlled way. Firms must take the time to assess successes and failures when they invoked their business continuity plans at the outset of the response to the pandemic.

The context of post-pandemic change within a firm is important. Compliance officers must develop a vision of the future that provides that context and adds direction to their assessment of changes that have been made and are due for revision. Part of this analysis is understanding the limitations of what can, and cannot be, changed.

Being able to act at speed is to be commended but does not change the rules, requirements and expectations applicable to firms. They must still be able to evidence both compliance and the good customer outcomes.

Any future change programme should ensure a strong, continuing focus on recordkeeping. Firms must ensure all changes to policies, procedures and oversight have been recorded, and decision-making documented. Accurate recordkeeping and retention will prove firms have followed (revised) policies and procedures and have remained compliant during the pandemic.

The test of a policy is once it has been used. Detailed jurisdiction-specific policies and procedures may look good on paper but until they have been tested in the often-controlled chaos of an unexpected adverse event there is no way to know whether they are fit-for-purpose. Post-pandemic reviews should be used to refine and update both policies and procedures to reflect any new ways of working and to initiate a new round of training for firms.

Regulators have already committed to post-pandemic reviews. Firms may consider that now is the time to engage with them about strategies for change and to raise any concerns, and thus capitalize on early feedback and direction.



“Frictions underlying existing processes span multiple legal, operational, processing, technological, and structural issues, which can differ greatly by region. To break down the magnitude of our task, the roadmap includes a set of practical actions designed to address specific topics, which we refer to as “building blocks.” We are taking a comprehensive approach and engaging the public and private sectors because both need to be a part of the solution if we are to achieve the ambitious goals we have set for ourselves.”

Randal K. Quarles, vice-chair for supervision, Board of Governors of the Federal Reserve System, chair, Financial Stability Board. March 2021

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