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# RISING PERSONAL LIABILITY - PERCEPTION AND REALITY: HOW BEST TO MANAGE PERSONAL REGULATORY RISK

BY STACEY ENGLISH AND SUSANNAH HAMMOND



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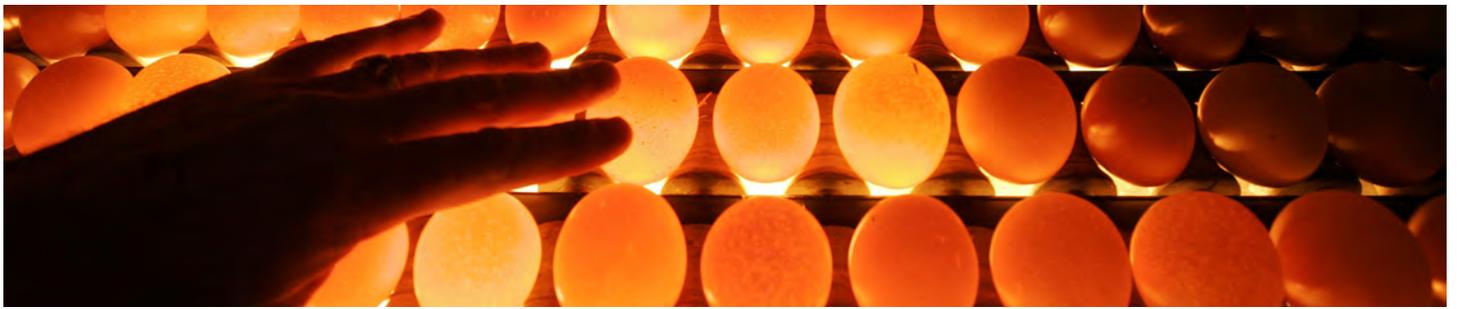
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## INTRODUCTION AND MAIN FINDINGS

*Survey results can tell one many things but when the data all points in the same direction it validates the underlying point, in this instance the focus on personal liability in financial services.*

It is not perception. In the last couple of years, compliance officers at firms as diverse as Swinton Insurance, MoneyGram, Bank Leumi, Bank of Tokyo-Mitsubishi, Brown Brothers Harriman, Deutsche Bank, Aegis Capital and BlackRock have been fined, banned, suspended or asked to leave.

*“Ultimately, we need more individual accountability. Good corporate governance is forged by the ethics of its individuals. That involves moving beyond corporate “rules-based” behavior to “values-based” behavior. We need a greater focus on promoting individual integrity.”*

*Christine Lagarde, managing director, International Monetary Fund, during a conversation with Janet Yellen, chair of the Board of Governors of the Federal Reserve System (May 2015)*

Thomson Reuters has gained views from a wide range of sources across the financial services industry both through its events and as part of a series of surveys. Compliance practitioners were asked for their views at customer summits in New York, London and Sydney in the second quarter of 2015. Insight has also been gained from surveys including Thomson Reuters Cost of Compliance 2015<sup>1</sup>, Conduct Risk 2014/15<sup>2</sup> and from a specific survey on personal liability, which closed at the end of July 2015.

More than 2,000 risk and compliance practitioners have contributed their views to this Thomson Reuters analysis on personal liability. Comments were received from across Africa, the Americas, Asia, Australasia, Europe and the Middle East. Respondents and participants represented banks, brokers, insurers and asset managers, ranging in size from small to international conglomerates including the majority of global systemically important financial institutions (G-SIFIs).

This report shares best practice and practical steps on how best to manage this enhanced personal regulatory risk.

Some of the main findings include:

- There is widespread expectation that personal liability is going to increase, emphasized in particular by the results of voting at the Thomson Reuters New York customer summit, where 93 percent of practitioners expected the personal liability of compliance officers to increase in the next year (64 percent expected a significant increase).
- The regulatory focus on accountability and introduction of new regimes appears to be being exacerbated by an apparent lack of oversight or awareness from senior managers. This is reinforced by half (49 percent) of participants in the personal liability survey reporting that senior managers ‘do not really know what is going on in their business’.
- An expectation that the regulatory focus on holding senior managers to account will be extended internationally. Sixty-four percent of respondents to the personal liability survey expect that regulatory regimes introducing individual accountability will be replicated around the world.
- The potential effectiveness of any new regulatory legislation on increasing senior manager accountability (such as the UK Senior Managers Regime (UK SMR)) is in question. Only 53 percent of respondents to the personal liability survey think that new legislation will change behavior for the better.
- Compliance officers are feeling particularly vulnerable. When asked which role now carries the most personal liability 67 percent of practitioners at the New York summit and 59 percent of customers at the London summit responded with the compliance officer. In contrast the chief executive came in second place with 22 percent of participants in New York, and 30 percent in London.
- Greater personal liability is expected to have an impact on resources. Two-thirds (67 percent) of respondents to the personal liability survey reported that the focus on accountability will have an impact on the ability to recruit and retain skilled senior staff.

<sup>1</sup> Thomson Reuters Cost of Compliance 2015 - <https://risk.thomsonreuters.com/sites/default/files/GRC02332.pdf>

<sup>2</sup> Conduct Risk 2014/15 - [https://risk.thomsonreuters.com/sites/default/files/Conduct\\_Risk\\_Report\\_Jan2015.pdf](https://risk.thomsonreuters.com/sites/default/files/Conduct_Risk_Report_Jan2015.pdf)

# INCREASING PERSONAL LIABILITY

The focus on personal liability has put more emphasis on senior individuals' ability to manage and mitigate their own regulatory risks. The near-universal view is that personal liability is increasing, with compliance officers feeling particularly vulnerable.

While the questions asked at events were tailored to particular geographies, the coherence of the views expressed are clear, and further reinforced by the results of the personal liability survey. The marked coherence of views is also borne out in previous survey results:

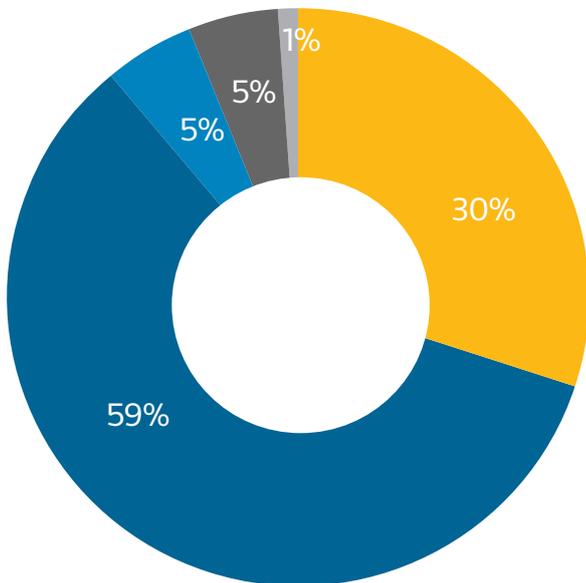
- The Thomson Reuters Cost of Compliance survey 2015 reported that 59 percent of compliance officers expect their personal liability will increase in 2015, with 15 percent expecting a significant increase. In the G-SIFI population those expecting a significant increase in personal liability rose to 21 percent.
- The results of another survey gave an insight into a source of the perceived increase in personal liability. The Thomson Reuters Conduct Risk survey 2014/15 reported that 67 percent believed that the regulatory focus on conduct risk would increase the personal liability of senior managers. The figure rises to 75 percent in the G-SIFI population.

The evidence from more than 1,100 attendees at the Thomson Reuters customer summits worldwide paints a picture of compliance officer concern, with a growing perception that compliance officers are in the regulatory firing line with regard to personal liability. In London, the audience was asked whose job-related personal liability was likely to increase most with a resounding 59 percent responding with the compliance officer.

At the Thomson Reuters New York customer summit, also held in April 2015, there were two related 'ask the audience' polling questions. When asked which role now carries the most personal liability, 67 percent responded with the compliance officer, with the chief executive role coming in second place at 22 percent. The point was made even more strongly with the responses to the question as to whether the personal liability of compliance officers will increase in the next year. Sixty-four percent responded 'yes, significantly' and a further 29 percent of the audience responded 'yes, slightly'.

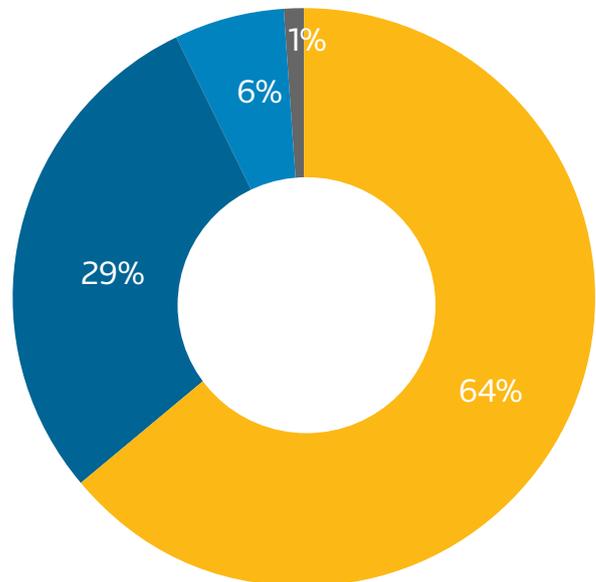
Further context was provided by the analysis of G-SIFIs in the Cost of Compliance 2015 report where not only were the results in line with those at the customer summits but that compliance officers at the largest of firms reported that 21 percent expected significantly more personal liability in the coming year.

**WHOSE JOB-RELATED PERSONAL LIABILITY IS LIKELY TO INCREASE THE MOST? (LONDON SUMMIT)**



- Chief Executive
- Compliance officer
- MLRO
- Head of Risk
- Head of Internal Audit

**DO YOU THINK THE PERSONAL LIABILITY OF COMPLIANCE OFFICERS WILL INCREASE IN THE NEXT YEAR? (NEW YORK SUMMIT)**



- Yes, significantly
- Yes, slightly
- No change
- No, liability will reduce

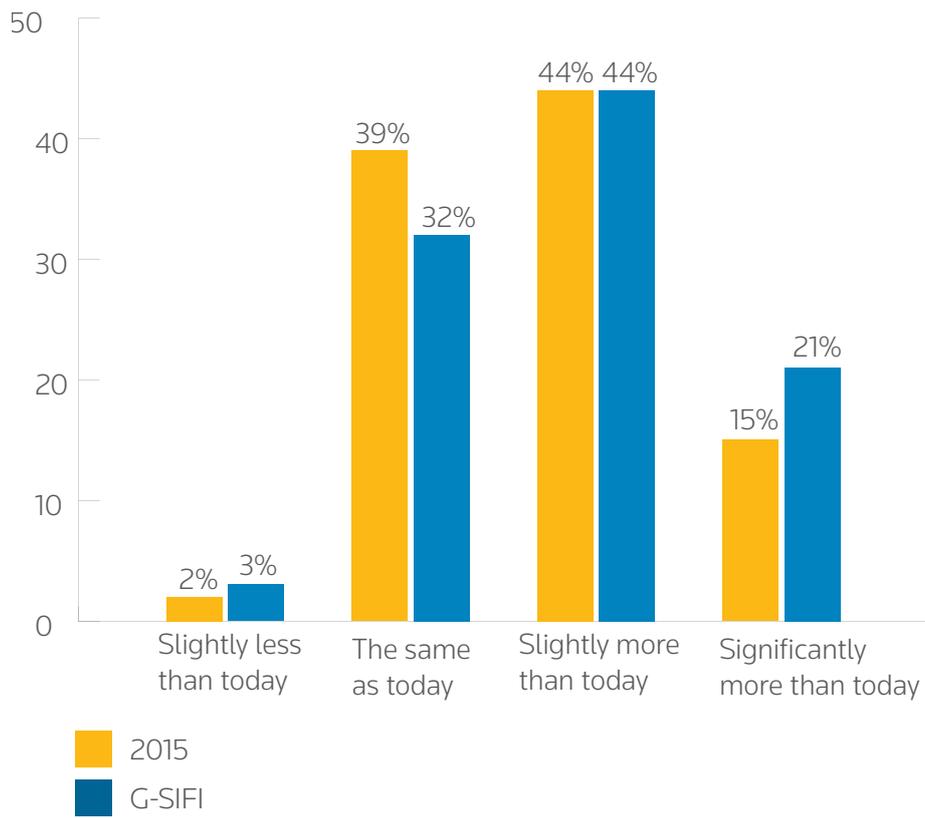
Source: 'Ask the audience' question at Thomson Reuters GRC customer summit London, April 2015

Source: 'Ask the audience' question at Thomson Reuters GRC customer summit NYC, April 2015



REUTERS | Denis Balibouse

**OVER THE NEXT 12 MONTHS, I EXPECT THE PERSONAL LIABILITY OF COMPLIANCE PROFESSIONALS TO BE**



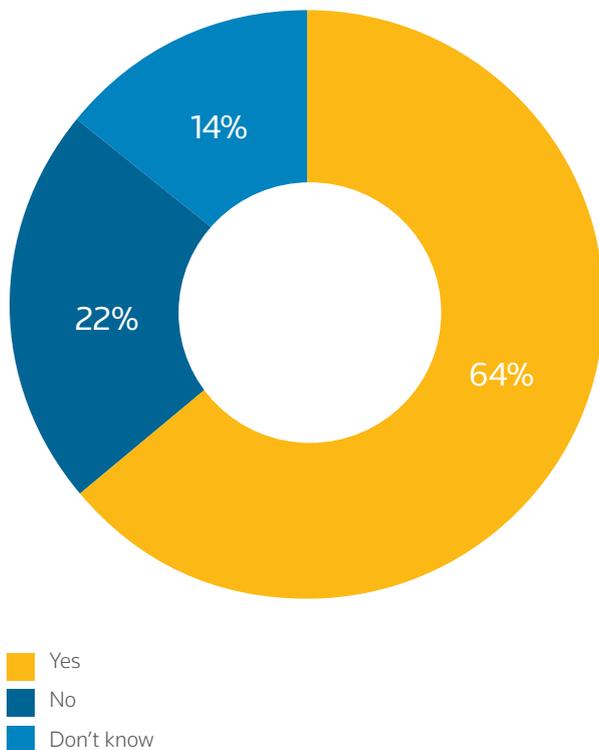
Source: Cost of Compliance 2015 report

# REGULATORS' PLANS AND APPROACH

Regulators have come under criticism for their approach to senior individuals and in particular for not having been seen to hold key personnel to account for the failings which led to the financial crisis. While previous iterations of rulebooks did enable regulators to enforce against senior managers it was often a costly exercise in terms of both time and money. Firms were (and still are) seen as much easier to enforce against. National policymakers, guided by the supranational Financial Stability Board, have made a point of revamping their approach to supervision to make holding individuals personally accountable much simpler. The aim was not only to make it easier to sanction poor senior manager behavior but also to facilitate the use of improved individual compliance standards as a means of driving better overall firm behavior.

Regulators have made it clear that the intention is not to increase levels of enforcement but to encourage improved risk-aware and compliant activities, and thus more consistently good customer outcomes. One of the most direct methods employed by regulators is the use of personal attestations, which are seen as an effective method of focusing senior manager attention. There is the additional benefit of either failing to give the required attestation or a compliance breach in the attested area that it is a relatively simple matter to pursue enforcement against the senior manager involved.

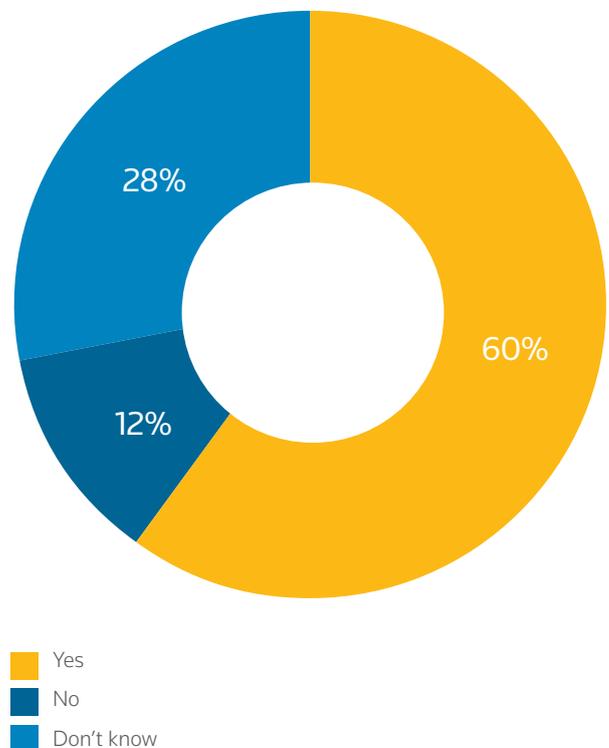
## DO YOU THINK THE REGULATORY FOCUS ON HOLDING SENIOR INDIVIDUALS TO ACCOUNT WILL BE REPLICATED AROUND THE WORLD?



Source: Personal Liability poll 2015

The UK has perhaps taken the most decisive steps toward changing the requirements and expectations for senior managers. From March 2016, banks and the largest asset managers (UK Prudential Regulation Authority-designated investment firms) will be subject to the new Senior Managers and Certified Persons Regime which requires firms to allocate prescribed responsibilities clearly to individuals and document the accountabilities in formal 'responsibility maps'. The UK SMR rules join the ever-growing list of extraterritorial requirements that firms need to obey. After the Libor scandal, the UK is also demonstrating that individuals will face serious consequences, following the 14-year prison sentence handed down to trader Tom Hayes for fraud.

## DO YOU THINK THE UK SENIOR MANAGERS AND CERTIFIED PERSONS REGIMES WILL BE EXTENDED TO ALL FIRMS IN UK FINANCIAL SERVICES?



Source: Personal Liability poll 2015

"Our absolute preference would be to have a single regime. For all the faults of the previous Approved Persons Regime, obviously people did understand it and it worked pretty well across [sectors]. So that's where we would like to get to; there are quite a few obstacles to get there, so it might take us a few years to achieve."

*Martin Wheatley, CEO, UK Financial Conduct Authority (FCA), during a question and answer session at Bloomberg (March 2015)*



REUTERS | Andy Clark

A similar regime to embed a clearer system of accountability and responsibility for senior individuals working for insurance firms and groups is being rolled out too with the potential for all regulated firms to be covered. Sixty percent of survey respondents thought that the UK Senior Managers and Certified Persons Regimes would be extended to all firms in UK financial services.

It is already clear regulators will be paying close attention to the efficacy of the new UK regime and may choose to adopt similar measures if it is seen to curb the wilder excesses of toxic cultures, poor compliance and inappropriate risk taking. This point is borne out by survey results which show that 64 percent of respondents think that the regulatory focus on holding senior individuals to account will be

replicated around the world (22 percent responded 'no' and 14 percent said 'don't know').

Other jurisdictions which have made policy moves include Canada and Australia. In 2014 the Canadian Office of the Superintendent of Financial Institutions (OSFI) published a revised guideline on regulatory compliance management (often known by its rule designation of OSFI E-13) which includes revised provisions for responsibility and regulatory expectations. In Australia, Greg Medcraft, the chairman of the Australian Securities and Investments Commission (ASIC), said ASIC is planning to incorporate culture into its role as a conduct regulator with the associated implications for personal liability.

"To be clear, the Senior Insurance Managers Regime should not be operated in such a way so as to put good people off. The desired outcome is that of effective governance, not enforcement."

*Confronting the challenges of tomorrow's world, speech by Paul Fisher, deputy head of the UK Prudential Regulation Authority and executive director, supervisory risk and regulations, at the Insurance Supervision Economist's Insurance Summit 2015, London (March 2015)*

The application of increased personal liability in practice is raising concerns. It is not that risk and compliance officers appear to be objecting to the concept of accountability but more that they feel it should be aimed, visibly and consistently, at all senior individuals. At the Sydney customer summit, 97 percent were in favor of the introduction of a professional code of conduct for investment professionals and financial advisers. More than half (51 percent) went one step further and thought senior manager liability should be introduced in Australia.

"We think that when an officer breaches a law ASIC administers — and culture is responsible — then the officers and the firm should be responsible. We think the officer and the firm should be subject to civil penalties and administrative sanctions, as accessories."

*Statement by Greg Medcraft, ASIC chairman, to the Senate Estimates Committee (June 2015)*

## EXPERIENCE TO DATE

Regulators have made a point of targeting poor customer outcomes, with compliance officers, other control functions and directors often being held to account.

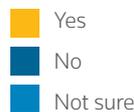
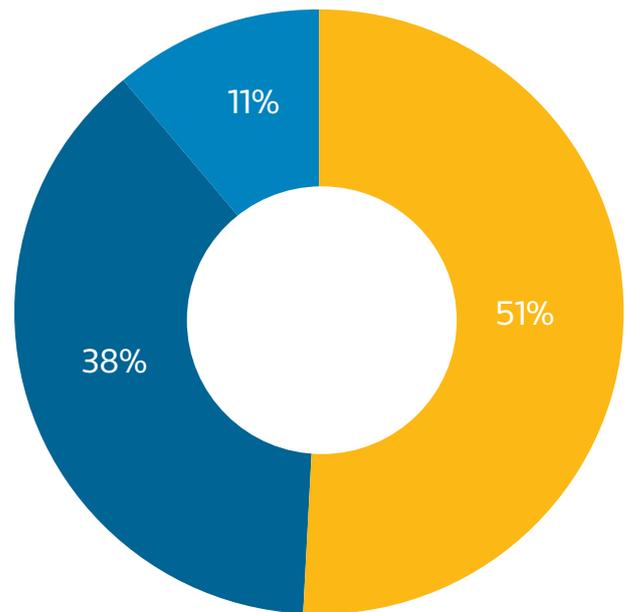
"Why the recent increase in litigation? This may reflect an increased focus on individual liability, aggressive enforcement of the securities laws and the significant sanctions that the Commission has been seeking. Whatever the reason, the increase is noticeable."

*Andrew Ceresney, director of enforcement, U.S. Securities and Exchange Commission, keynote speech at New York City Bar 4th Annual White Collar Institute (May 2015)*

The reputational damage associated with being the subject of enforcement looks likely to be far more profound than the monetary size of any actual fine. A snapshot of recent cases from around the world includes:

- The U.S. Financial Industry Regulatory Authority (FINRA) fined and suspended the CEO and two chief compliance officers of Aegis Capital. Charles D. Smulevitz and Kevin C. McKenna, who served successively as chief

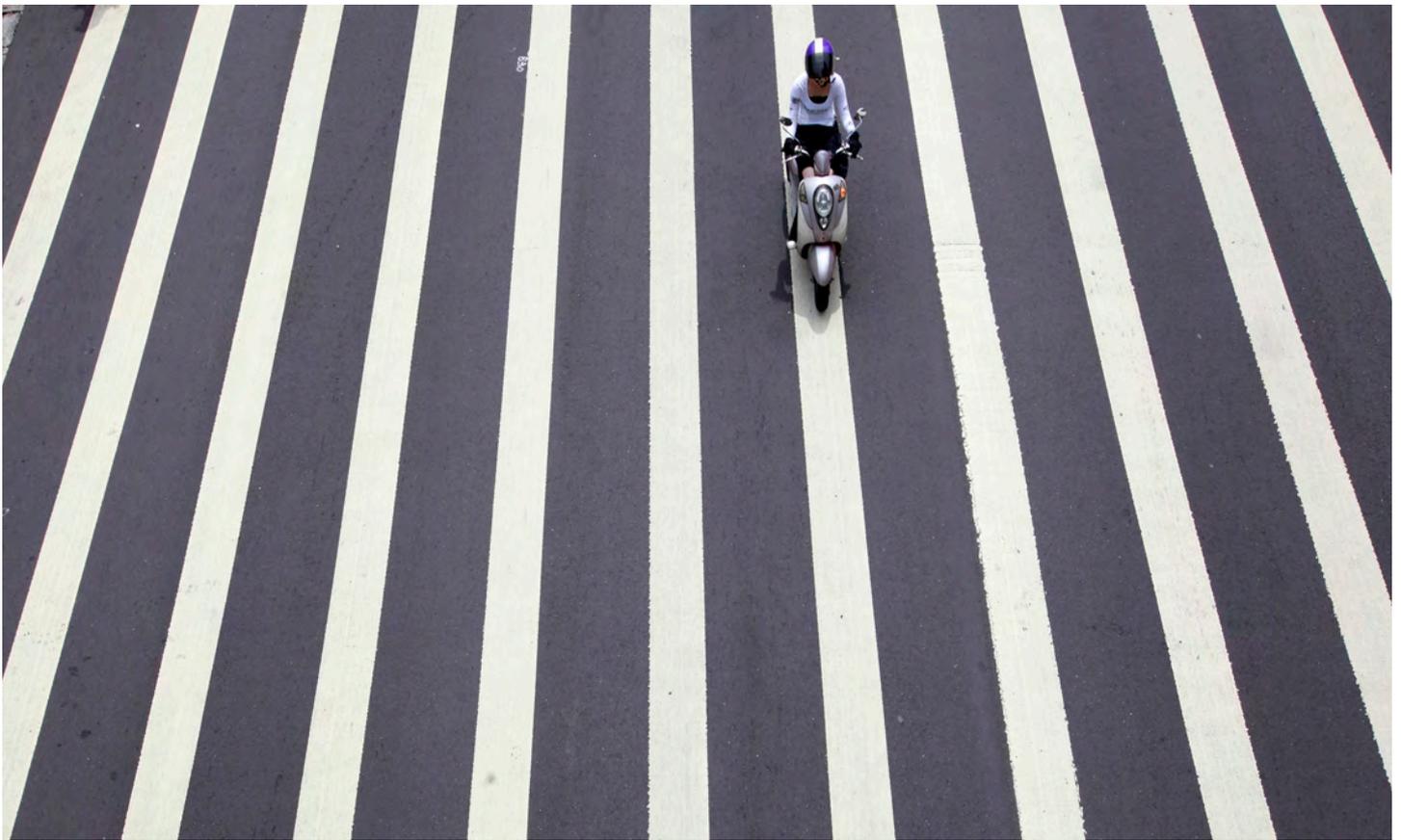
## SHOULD SENIOR MANAGEMENT LIABILITY BE INTRODUCED INTO AUSTRALIA?



Source: 'Ask the audience' question at Thomson Reuters GRC customer summit Sydney, June 2015

compliance and AML compliance officers at the time of the violations, agreed to 30- and 60-day principal suspensions, and to fines of \$5,000 and \$10,000, respectively, for their supervisory and AML failures. In a separate proceeding, Robert Eide, Aegis's president and CEO, was suspended for 15 days and fined \$15,000 for failing to disclose more than \$640,000 in outstanding liens (August 2015).

- The U.S. Securities and Exchange Commission fined Eugene Mason \$25,000 for failures as chief compliance officer of SFX after Brian Ourand, the president of the company, stole \$670,000 from client accounts (June 2015).
- BlackRock compliance officer, Bartholomew A. Battista, fined \$60,000 by the U.S. SEC for failing to disclose conflicts of interest, failing to have the required written compliance policies and procedures and for causing registered funds to fail to report properly to the funds' boards of directors (April 2015).
- The U.S. Financial Crimes Enforcement Network (FinCEN) issued a \$1 million civil money penalty against Thomas E. Haider, money laundering reporting officer, for failing to ensure that MoneyGram abided by the anti-money laundering provisions of the Bank Secrecy Act (December 2014).
- The UK FCA fined Anthony Wills (£19,600), former compliance officer and Michael Allin (£9,900), internal audi-



REUTERS | Nicky Loh

tor at Bank of Beirut for failing to deal with the regulator in an open and cooperative way (March 2015).

- The UK FCA fined (£33,800) and prohibited Stephen Bell from performing any compliance oversight function after the regulator found systemic weaknesses in the design and execution of network Financial Group's compliance systems and controls (March 2015).
- The Hong Kong Securities and Futures Commission reprimanded Hung Lai Ping, a former responsible officer of Delta Asia Securities Ltd (Delta Asia), and fined her \$150,000 for managerial and supervisory failures. Hung was responsible for overseeing the compliance function and all front and back office operations of Delta Asia, including its settlement functions (August 2014).
- The U.S. FINRA fined Harold Crawford, global AML compliance officer at Brown Brothers Harriman & Co, \$25,000 and suspended him for one month (February 2014).
- The Dubai Financial Services Authority (DFSA) fined Hany Lotfy Awwad Abdelwahab \$45,000 and banned him for three years for misleading the regulator in connection with a change of control application and then obstructing the DFSA's investigation by failing to comply with requests for information or to attend an interview (April 2015).
- The DFSA banned Abdul Rahman Al Ansari and Anthony Robert D'Aniello, former directors of First Capital

of Switzerland Investment Bank Ltd, for misleading the regulator and a lack of integrity (February 2015).

#### POSSIBLE BACKLASH?

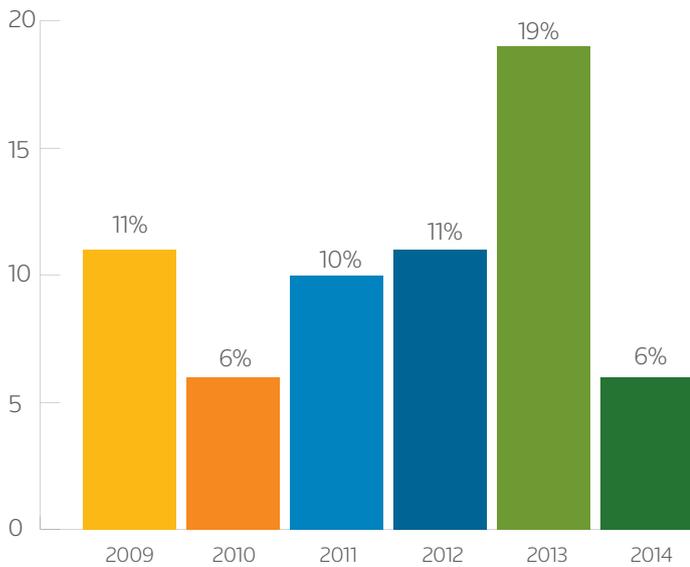
The perception and reality of greater personal liability for compliance officers has begun to create its own issues with heightened demand for skills, rising salaries and experienced compliance officers being seen to choose firms with a strong compliance track record rather than go to, or stay at, firms with a weak approach to risk management. There also appear to be concerns that compliance officers perceive themselves as being 'targeted' by regulators.

"However, we need to be constantly reminded of the importance of being measured and thoughtful in exercising our enforcement authority. For example, throughout my tenure I have repeatedly called on the Commission to tread carefully when bringing enforcement actions against compliance personnel, who are often the only line of defense we have in detecting and preventing violations of the federal securities laws. Recent enforcement actions holding compliance officers to a standard of strict liability will only serve to chill talented professionals from playing this vital role."

*Dodd-Frank at five: A capital markets swan song, speech given by Daniel M. Gallagher, commissioner, U.S. Securities and Exchange Commission (August 2015)*

The U.S. SEC has taken the potential backlash from compliance (and indeed from some commissioners within the regulator itself) particularly seriously and has gone out of its way to point out that it has brought relatively few cases targeting chief compliance officers relating solely to their compliance-related activities.

In general, the U.S. SEC's enforcement actions against CCOs ebb and flow with the number of cases brought against investment advisers and investment companies. Estimates show the following number of enforcement cases brought against these CCOs, compared with the number of enforcement cases brought against investment advisers and investment companies, between 2009 and 2014:



Source: Based on US SEC data

The vast majority of these cases involved CCOs who "wore more than one hat", and many of their activities went outside the traditional work of CCOs, such as CCOs that were also founders, sole owners, chief executives, chief financial officers, general counsels, chief investment officers, company presidents, partners, directors, majority owners, minority owners and portfolio managers. Many of these cases also involved compliance personnel who affirmatively participated in the misconduct, misled regulators or failed entirely to carry out their compliance responsibilities.

There is, however, a growing recognition from regulators that the apparent focus on compliance officers may be counterproductive, both sending the wrong message to the industry and deterring talented individuals from working in the profession.

"While I respect the views of my fellow commissioners, based on what I'm hearing from the CCO community, the dissent, and the resulting publicity, has left the impression that the SEC is taking too harsh of an enforcement stance against CCOs, and that CCOs are needlessly under siege from the SEC. Thus, I am concerned that the recent public dialogue may have unnecessarily created an environment of unwarranted fear in the CCO community. Such an environment is unhelpful, sends the wrong message, and can discourage honest and competent CCOs from doing their work."

*The role of chief compliance officers must be supported, speech by Luis A. Aguilar, commissioner, U.S. Securities and Exchange Commission (June 2015)*



REUTERS | Nacho Doce



REUTERS | Jumana El Heloueh

## WHAT IS THE LIKELY IMPACT ON THE INDUSTRY?

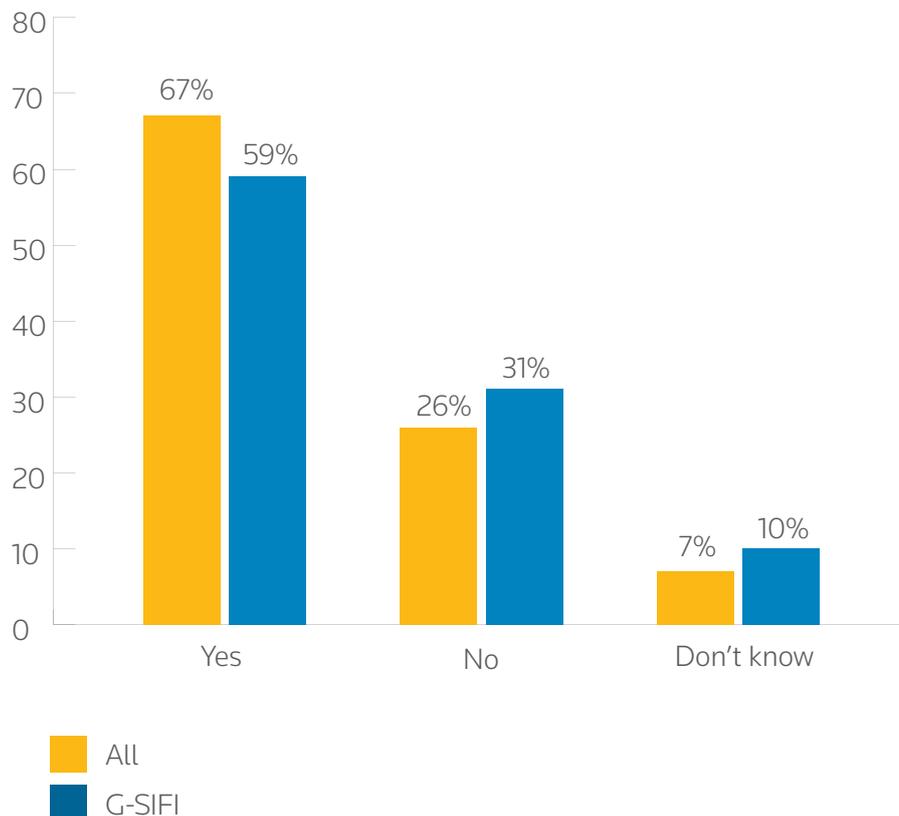
The external environment for financial services firms has shifted as governments, supranational policymakers and regulators have acted to try to repair and rebuild economies and balance sheets. Blame for the crisis and for the subsequent Libor and FX scandals has led to “banker bashing” becoming a national pastime in many jurisdictions.

As a result, financial services firms face a complicated raft of changes to the rulebook and supervisory expectations, with the stated intention of holding more individuals personally accountable for regulatory failings, particularly those which result in customer detriment.

“Even the most intrusive supervision can only go so far in promoting a culture of ethics. The industry must itself take collective responsibility to promote higher ethical standards. It is better that industry develops codes of good conduct that take into account operational realities that they know best and that holds firms accountable to their peers, than wait for the regulator to set rules that may be impractical or too onerous.”

*Building a culture of trust in the financial industry, speech by Ravi Menon, managing director, Monetary Authority of Singapore (January 2015)*

### DO YOU THINK THE FOCUS ON ACCOUNTABILITY WILL HAVE AN IMPACT ON THE ABILITY TO RECRUIT AND RETAIN SKILLED SENIOR STAFF?



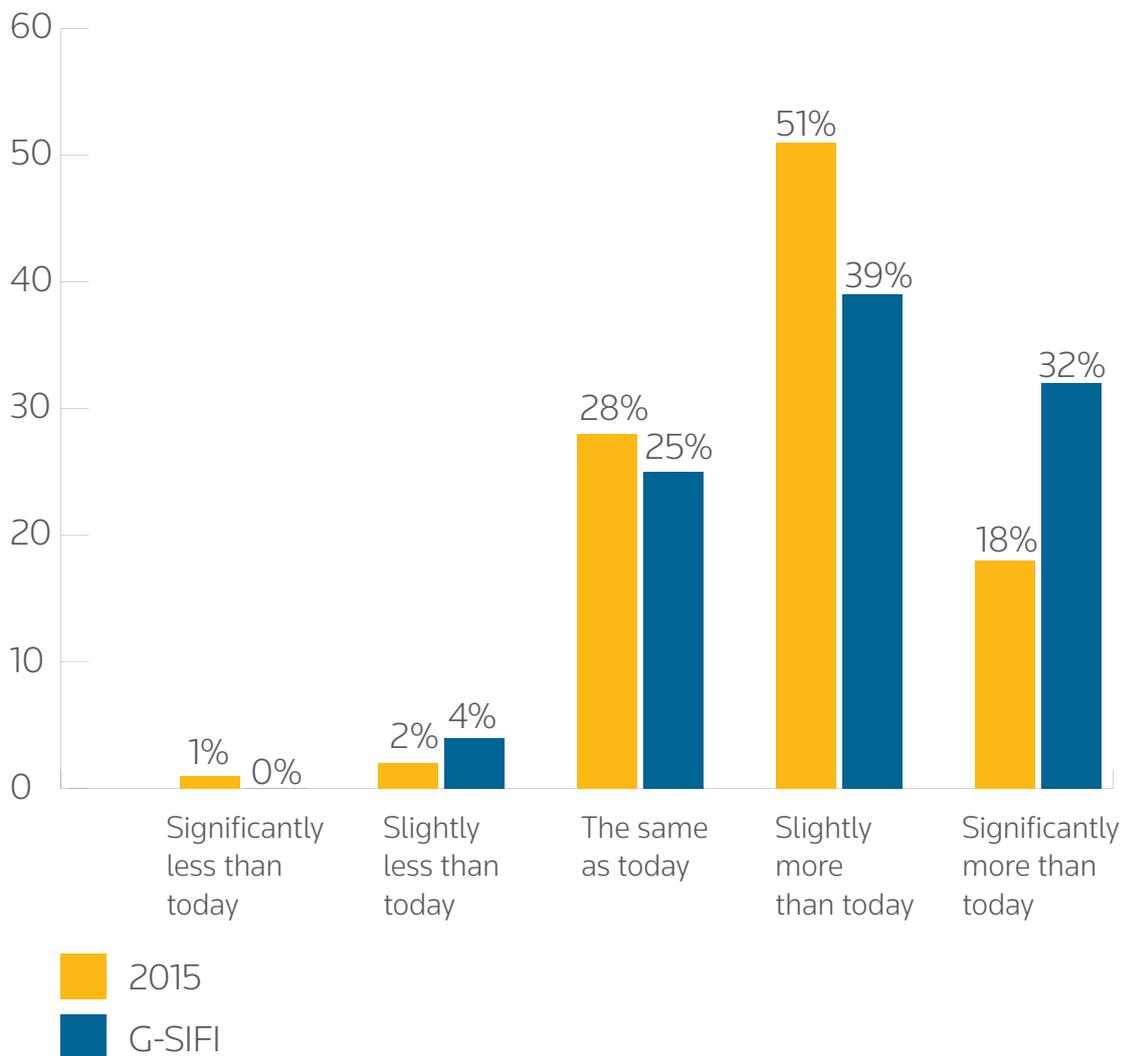
Source: Personal Liability poll 2015

There is, for example, a danger that highly skilled senior individuals with a full understanding of the new UK SMR will either choose to leave the industry or not to take on important roles such as non-executive directors. Equally, firms and regulators are all seeking to draw from the same pool of skilled compliance officers, leading to higher cost expectations. Good financial services knowledge and experience, whether in trading, governance, risk or compliance, are likely to be at a premium for some time to come.

Two-thirds of survey respondents say that the focus on accountability will have an impact on the ability to recruit and retain skilled senior staff, although the G-SIFI results show that the biggest firms seem to have fewer concerns.

It may be that, given the intense regulatory focus which has already been brought to bear on G-SIFIs, these firms have already changed substantially, and also have more faith in the efficacy of their rebuilt systems and controls. It is also possible that the G-SIFIs are more confident that they will have the resources to pay the escalating costs associated with skilled senior individuals. Whatever the reasons for the differential between the G-SIFIs and the others, the findings need to be considered alongside the fact that 65 percent of G-SIFIs said the personal liability of compliance professionals would increase in the coming year (21 percent reported a significant increase) compared with all firms reporting 59 percent expecting an increase (15 percent significantly).

**OVER THE NEXT 12 MONTHS, I EXPECT THE COST OF SENIOR COMPLIANCE STAFF TO BE**



Source: Cost of Compliance 2015

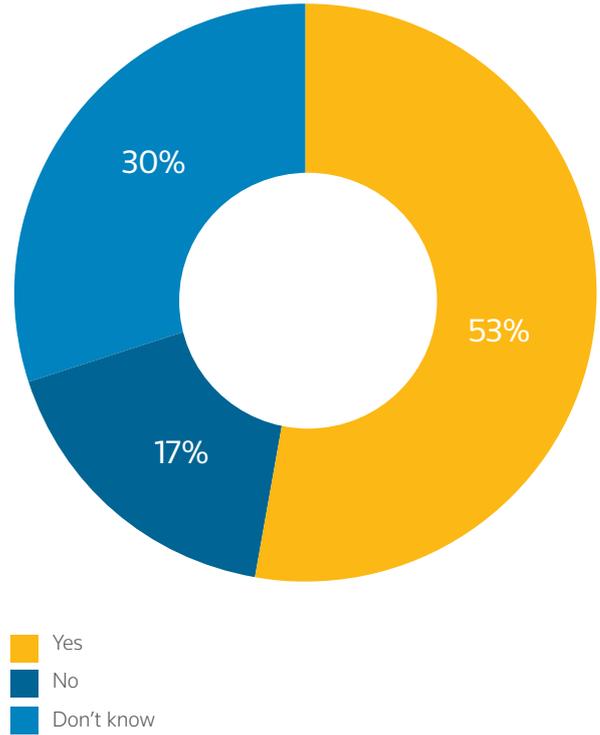
Greater personal liability, more demand for high-quality risk and compliance knowledge and the potential difficulties in recruiting and retaining skilled senior staff have led to widespread expectations that the cost of senior compliance staff will continue to increase in the coming year.

“Frankly, until individuals have a meaningful sense of responsibility for their actions — particularly in a high-reward environment — governance issues are unlikely to be reduced.”

*Confidence to crisis and back, speech by Martin Wheatley, CEO, UK Financial Conduct Authority (June 2015)*

Anecdotally, firms and individuals are investing substantial amounts of time and money in building the infrastructure required to comply with new regulatory regimes and expectations. Despite the investment, only 53 percent of survey respondents believe that new legislation focused on increasing individual accountability such as the UK Senior Managers and Certified Persons Regimes will change behavior for the better. The behavior of some senior individuals needs to change, and change radically, but there appears to be distinct skepticism that the revised approach to accountability will be effective in acting as a credible deterrent.

**WILL NEW LEGISLATION FOCUSED ON INCREASING INDIVIDUAL ACCOUNTABILITY SUCH AS THE UK SENIOR MANAGERS AND CERTIFIED PERSONS REGIMES CHANGE BEHAVIOR FOR THE BETTER?**



Source: Personal Liability poll 2015



REUTERS | Max Rossi



REUTERS | Shannon Stapleton

## WHAT CAN COMPLIANCE OFFICERS DO?

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There are a number of aspects to the consideration of personal regulatory risk management. The extent to which each area or issue is considered will depend on the individual's role within the firm. The chief executive is not expected to be an expert on the granular detail of risk and compliance but he or she must be aware of the issues, able to set an appropriate risk appetite, drive a strong compliant culture, understand and challenge all risk and compliance reports and engage appropriately with regulators. Equally, the head of compliance not only needs to be able to support the firm and other senior managers in the identification, mitigation and management of regulatory risks but must also be the acknowledged expert on all regulatory matters. In the increasingly harsh spotlight focused on senior individuals there needs to be a greater appreciation of the impact of the changes to both the rulebook and the more qualitative regulatory expectations. There are a number of practical points for firms and senior individuals to consider:

- **Awareness of the external regulatory environment:** The need to raise internal awareness of the external regulatory environment may mean changes to reporting and the inclusion of a standing update item on relevant meeting agendas. Firms need to be aware that it is not just mainstream financial services regulatory changes which may affect the business. As just one

example, in February 2015 it was announced that not only would the UK Information Commissioner's Office have wider fining powers with regard to direct marketing breaches but also that the UK government would look at introducing measures to hold "board-level executives responsible for nuisance calls and texts".

- **Considering and learning the lessons from regulatory announcements:** All relevant regulatory information needs to be, and to be seen to be, considered. This includes supranational or cross-border regulatory changes, the lessons to be learned from enforcement actions against firms undertaking similar business activities and any messages from speeches and other regulatory publications.
- **Maintaining communications with regulators:** Senior individuals need to be able to discuss all relevant regulatory changes with the supervisor, and to understand the likely impact they will have on the firm and its customers. Anyone meeting with or speaking to the regulator should be expected to make and maintain comprehensive notes of the discussion and to keep a record of any documents or other information exchanged. In particular, any requests or expectations stated by the regulator should be noted and as a matter of best practice confirmed in writing to ensure

clarity of understanding. All information provided to the regulator must be accurate and able to be substantiated, and all actions and timescales agreed must be met and reported on both internally and externally.

- **Signing attestations:** The increasing use of attestations is a distinct regulatory strategy and as such firms, and particularly the compliance function, should ensure complete clarity as to the exact scope of any attestation required. This will enable any additional work required to confirm the state of compliance to be undertaken and will also allow the firm and the senior individual charged with signing the attestation to build a suite of comprehensive evidence to demonstrate the basis for the confirmation.
- **Lobbying:** If a firm does not already have a lobbying program in place it may want to consider investing in its ability to influence the external regulatory environment. While lobbying is a medium- to long-term investment, the current mismatch and divergence of rules between jurisdictions (the issues in the derivatives marketplace between the EU and the United States are a particular case in point) are proving to be expensive and distracting for firms. The over- and under-lap of the current international patchwork of rules may lead some firms to choose to breach some conflicting rules which could in turn raise further supervisory questions for senior managers. Senior managers and compliance officers will also want to influence proposals that can directly affect personal accountability and liability, such as those arising from the Parliamentary Commission on Banking Standards, which led to the UK SMR.

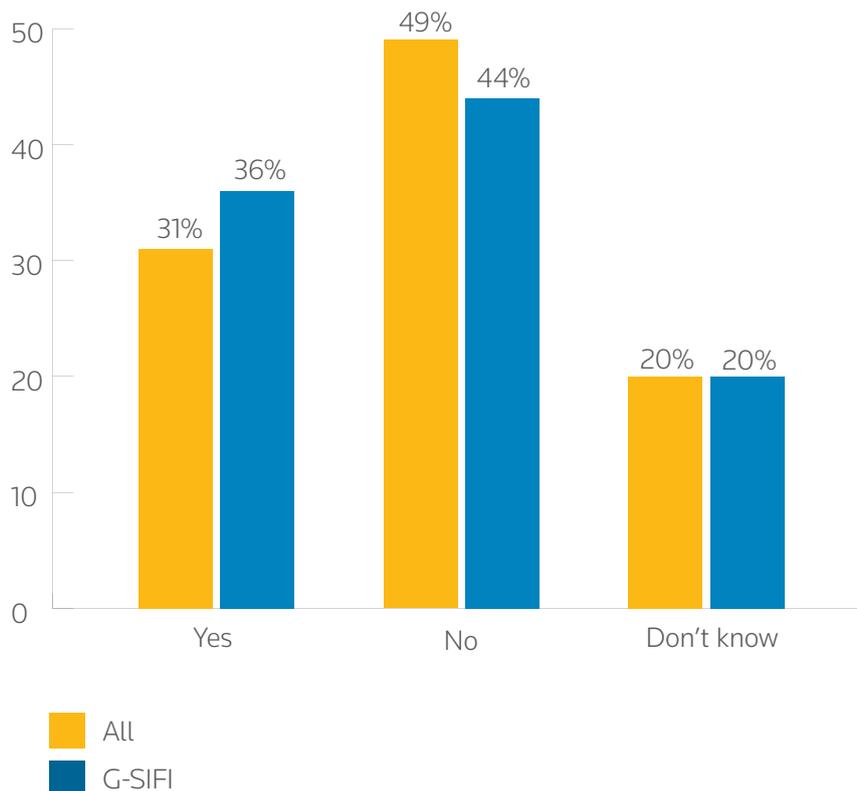
“We are reliant on compliance officers and internal audit to act as a first line of defense, to support effective regulation at firms and to show backbone even when challenged by their colleagues.”

*Georgina Philippou, acting director of enforcement and market oversight, UK Financial Conduct Authority, in a press release regarding the Bank of Beirut enforcement action (March 2015)*

In theory, senior individuals should have much more control over the internal environment of their firm than they do over the external. The levels of line of sight and control can, however, be illusory in a large, complex firm. Senior managers need to be realistic about the implications of their accountability and their ability to discharge their role and responsibilities. There are a number of practical points for firms and senior individuals to consider:

- **Culture and conduct:** The regulatory buzz words are culture and conduct risk with a focus on the "how" business is conducted as well as the "what". Firms need to ensure that the discussions on culture, risk appetite and setting the tone from the top have happened at a suitably senior level and that consensus has been reached. It is not necessarily a given that all senior individuals will agree on what "good" looks like for the firm. Indeed, anecdotally some widely differing opinions and views have been aired at board meetings where the subject was raised. Any discussion, challenge and constructive criticism should be documented and the final agreed position must be given, and

### DO YOU THINK SENIOR MANAGERS REALLY KNOW WHAT IS GOING ON IN THE BUSINESS?



Source: Personal Liability poll 2015

be seen to be given, support from all senior managers. Given the survey results highlighting the expected link between conduct risk and personal liability, it will be worthwhile investment for many firms to ensure comprehensive and consistent documentation on all aspects of the development, implementation, embedding and testing of conduct risk.

- **Understanding the business:** All senior managers, and compliance officers in particular, need to understand the business being conducted. Although firms should always have a thorough, in-depth understanding of all their products, activities and processes, all too often enforcement actions show that as people and businesses change, knowledge levels become severely depleted, with the inevitable regulatory consequences. Particular care needs to be taken with any new areas of business or products whether the change is by acquisition or internal development. It is concerning that only 31 percent of respondents thought senior managers really knew what is going on in their business. Almost half (49 percent) said 'no', while 20 percent said 'don't know'.

"You must take responsibility for understanding and managing the risks in your business, you cannot delegate and forget, and you cannot hide in labyrinthine structures where it is all too easy for everyone to say it was not me."

*Wholesale markets and risk: FEMR and beyond, speech by Tracey McDermott, acting CEO, UK Financial Conduct Authority, at the British Bankers' Association Conference (July 2015)*

- **Regulatory approvals and registrations:** Regulatory approvals and registrations need constant maintenance and in a large international firm need visibly adequate resourcing. It is imperative that the employee structure chart is kept up-to-date. Most international regulatory bodies have the concept of authorized or registered persons, so it is essential that there is an accurate central record for all employees in all firms. This is particularly true of international groups where employees may hold a number of directorships and/or registrations in a number of different legal entities in a number of different jurisdictions. Firms may wish to ask certain regulators for a full list of all registered persons to check that the records at the firm and the regulator can be reconciled – it is not, for instance, unheard of for a regulator to fail to update its own records despite having been informed of changes. It is far better for both the individual and the firm to be active in undertaking such checks rather than discrepancies coming to light as part of, say, an intrusive supervisory visit and there being, a mismatch of understanding as to which senior manager is registered where and responsible for what.

- **Job descriptions:** Job descriptions are often only considered in detail when someone is new in their role, and even then they tend to be high-level, general documents. Almost nowhere is the interlinking between roles, job descriptions and accountabilities routinely considered. All senior managers should review and document exactly what their role covers and how those obligations are discharged. This activity needs to be done on a firm-wide basis to ensure that the resulting aggregation of all the (much) more detailed job descriptions come together into a seamless whole. For the whole process to be effective it then needs to be kept up-to-date.
- **Management information:** Good management information is the lifeblood of any firm, and in the current regulatory environment management information could be seen as the need for evidence, evidence and more evidence that a firm and the senior managers running it have done all of the right things in all of the right ways. Part of high-quality management information is the need to challenge constructively the assumptions, scope and limitations on all reporting and to ensure elements such as whistle-blowing are routinely captured and analyzed, and that action is taken as necessary. In today's world the challenge needs to extend to all areas of the business and not just those that are overtly or directly regulated. A case in point is the Nationwide Life Assurance Company which in May 2015 was fined \$8 million by the U.S. SEC for breaches regarding the processing and pricing of subsequent purchase payments and redemption orders for variable insurance contracts and underlying mutual funds. The issue at the heart of the enforcement action was something as apparently mundane as the procedures for the collection of mail. Although this area is not directly covered by the rule books, in this instance procedures had not changed for almost six years and led to Nationwide Life being in breach of its regulatory obligations.

Senior managers must not only contribute to their firm being compliant but must also be able to demonstrate the discharge of their personal regulatory obligations and accountabilities. As part of the required core competency of senior persons being able to manage their own personal regulatory risk there are a number of practical elements to consider:

- **Evidence of responsibilities:** In a somewhat different angle from the use of job descriptions as part of the internal environment it is clear that the job description of the future will be significantly more detailed, and for the protection of both the individual and the firm it is critical that all regulatory criteria and expectations are included. As part of the daily management of the firm senior individuals will need to collect and maintain the evidence routinely to show how they have discharged their obligations and responsibilities. Consideration

may in particular be given to the need for a "decision register" to help senior managers' evidence both the decision taken and the evidence on which that decision was taken. Similarly when roles change, detailed documented handovers need to become the norm to ensure that all concerned can manage their personal regulatory risk. It could easily be seen as a cottage industry but the greater level of documentation regarding job descriptions is an essential part of enabling senior managers to demonstrate the appropriate discharge of their responsibilities.

"Only when board directors understand that they are accountable not only to shareholders but also to customers and society more broadly through the regulatory agency can we be confident that effective governance and internal controls will be put in place."

*How can the banking industry regain the moral and ethical high-ground it once enjoyed before the global financial crisis, speech by Norman Chan, chief executive, Hong Kong Monetary Authority (April 2015)*

- **Training:** Firms should also invest in building knowledge and awareness of the implications of the changing regulatory environment. Engaging in a rolling regulatory training program is one option; apart from anything else there is a much greater likelihood of enforcement action for any unprepared or unaware individual. Senior individuals should take responsibility for maintaining the evidence of their continuing training and education activities, and for challenging the scope of the learning to ensure that it covers all relevant areas.
- **Evidence of decisions:** Senior managers need to build and maintain their own personal archive of evidence to demonstrate the full discharge of their regulatory obligations. For some quantitative elements that is likely to be a relatively simple process but there are often challenges when culture is added into the mix. Akin to the potential for a "decision register", one quick win could be to gather all board and other meeting minutes which evidence the challenge and engagement by the individual.
- **Intellectual property:** When a senior manager changes firms it is reasonable that he or she should be able to maintain the suite of documents which support their compliance behavior. Given that at least some of the documents could be business-sensitive and the intellectual property of the firm, however, sensible arrangements will need to be made to enable the senior manager to access the documents under certain circumstances even when they are no longer employed by the firm.

## CLOSING THOUGHTS

Personal liability is here to stay. Compliance officers appear to be feeling unduly vulnerable, but the reality is that firms will look to their compliance function to determine what good looks like in the management of their own regulatory risk, which can then, in turn, become the blueprint for everyone else.

There are several benefits for compliance officers thinking through how best to manage their own personal regulatory risk. Most obviously, they themselves must stay out of regulatory trouble. Other benefits include being able to advise other senior managers on the best practices associated with managing personal regulatory risk, and once their own risk is appropriately managed they will be able to devote more attention back to the day job of firm compliance.

"Expectations have now been raised, and people have to adjust their behavior accordingly. We should not underestimate how difficult this is going to be to do. We are asking people to re-examine the behaviors that in many cases made them successful, and led to reward and promotion. This can't be anything but a challenge, but it must be done, and firms need to support these people to do it."

*Wholesale markets and risk: FEMR and beyond, speech by Tracey McDermott, acting CEO, UK Financial Conduct Authority, at the British Bankers' Association Conference (July 2015)*

Regulators need to handle with great care the imposition of more realistic personal liability for wrongdoing. Credible deterrence driving better risk-aware behavior is one thing but it must be applied even-handedly. In the United States, the backlash against the perceived targeting of compliance officers has done no one any favors and risks driving talented individuals out of the industry. In the UK, the implementation of the UK SMR is going to be watched closely and the first enforcement actions scrutinized in detail. It is clear that the regulatory focus on personal liability and accountability will continue. The impact on the industry and behavior remains to be seen.

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