

Banks on the Leading Edge

Assessing Your Compliance Resource Needs

by
James H. Wistman, MBA, CAMS
and
Aaron Kahler, CFE, CAMS
ICS Compliance



In the ever-changing regulatory environment of the banking industry, Audit Committees and Chief Auditors are increasingly asking: “How can we adequately assess whether internal budgeting and staffing are commensurate for the institutional compliance function?” This is in part due to the tightening focus on the ever-rising cost of compliance programs, especially in the wake of recent enforcement orders relating to regulatory deficiencies such as those concerning Anti-Money Laundering (AML), the Office of Foreign Assets Control (OFAC), and the Foreign Corrupt Practices Act (FCPA). This article provides an authoritative analysis, guiding the reader through the pertinent considerations, providing examples of “what

can go wrong,” and concluding with the theme that each bank should take a risk-based approach to assessing their compliance risks and to utilize the assessment in the appropriate allocation of compliance resources.

“How can we adequately assess whether internal budgeting and staffing are commensurate for the institutional compliance function?”

The short answer is, “It’s not easy to be precise” and that is primarily because the role of the compliance department (aka “compliance function”) differs markedly from bank to bank. Thus, while it may be appropriate to say something like, “A compliance department

may need to have one headcount for every 150 employees of the bank,” that generic rule of thumb is only the very beginning of the evaluation and budgeting process. To arrive at a reasonable overall budget for the compliance function, it is very helpful to deconstruct the compliance program into the very same components that are evaluated by the regulatory authorities:

- Training
- Policies and procedures (which guide employee conduct and firm-wide recordkeeping)
- Monitoring by compliance officers
- Compliance management

Compliance Training

In some institutions, the compliance function handles all aspects of training on regulatory requirements. In these firms, it is quite clear that the Compliance Officer must construct a budget, and this is often done on a department-by-department basis. That is to say, the Compliance Officer budgets a number of hours to meet annually, with each department, and provides required training. The Compliance Officer also sets aside time for preparation of training materials and recordkeeping (e.g. attendance lists).

However, in larger firms Human Resources often has a tight grasp on any and all training provided to staff (e.g. new product launch, sales practices, sexual harassment, etc.); therefore, it is Human Resources that has administrative staff to either, (1) schedule a Compliance Officer to appear now and then to deliver targeted content on banking regulations, or (2) retain an external compliance expert to come onsite and deliver the targeted content. It is very easy for executive management to underestimate the time it takes to adequately operate a robust compliance training program in a large firm, and there are several steps to getting this right: targeting the appropriate audiences, scheduling the training rooms and attendees, preparing the content, delivering the content, keeping track of attendance, and marking-up exams and notifying attendees of grades. “Chasing” each of the no-shows is in itself a major headache and time-consuming process. In parallel to classroom training, many firms also establish a budget for online, conference call, or video/DVD training.

For some institutions, operating the compliance training program is so complicated that it becomes a full-time position within compliance with supporting administrative staff and a separate annual budget. To cut through this uncertainty and complexity, it is often recommended that the annual compliance training needs be formally set forth as a training needs assessment. This approach helps

to forecast the burdens of annual compliance training (including board-level training) and can be structured with the “look and feel” of the Annual Audit Calendar, which often includes estimated auditor hours. A documented training needs assessment is an approach that appeals to many audit committees and helps prevent audit and compliance from scheduling an audit in the midst of scheduled training sessions.

Compliance Policies and Procedures

It is very difficult to predict the burdens associated with making appropriate revisions to compliance-related policies; plus, once policies are revised, it is almost always the case that several desktop procedures also will need to be revised, taking valuable time and expertise. The process of managing potential regulatory changes affecting your Institution within a calendar year can be one of great uncertainty, particularly the quantity of time and expertise that will be required to reach adequate compliance.

To cut through the complexity, it is recommended that a compliance policy calendar summarizing upcoming effective dates of announced regulatory changes is developed. By updating institutional regulatory objectives every month, compliance can use the calendar as an internal resource in editing and approving new policies and procedures. This forward-looking approach (as opposed to a reactive approach) greatly reduces the compliance burden allowing the institution to stay one step ahead of the deadlines. Executives can also coordinate with compliance officers and estimate how much work will be required over the coming quarter. If it is determined that in-house resources will be insufficient to stay ahead of the curve, then executives can decide to retain additional resources/consultants. This can then be documented with appropriate supporting rationality and be reported to the Audit Committee.

Compliance Monitoring

Surveillance performed by compliance officers is also an area where compliance functions vary widely in timeliness and sophistication. In all cases, the basic process is one in which compliance-related records that have been generated by employees, client-facing and operational divisions, are reviewed by independent compliance officers; this approach is necessary to evidence the bank’s ongoing operational compliance with applicable laws and regulations.

Whether such surveillance or “testing” is performed by compliance, internal audit, external consultants, or auditors, the key is to identify problematic areas early and fix the problems; it is not advisable to wait and rely on the findings of regulatory examiners. The regulatory authorities

Compliance

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increasingly expect that the bank itself will bear the costs of proactively evaluating its own compliance. Institutions should expect that examiners will eventually conduct an internal review of the organization and determine whether the institution has identified and appropriately addressed any deficiencies within the compliance environment.

Coordination between audit and compliance is therefore essential so that the budgets for these functions, when combined, are fully capable of absorbing the annual costs of comprehensively testing for ongoing compliance. If proper function coordination does not occur, the Audit Committee itself runs the risk of being criticized for not properly tasking the executive team in ensuring the budgets were sufficient. Since fines are growing, the risks of shareholder lawsuits for “regulatory surprises” are also growing.

Compliance Management

It is recommended that executives communicate with Compliance Officers to ensure that policies and procedures within the compliance function are up to date. All too often, compliance staff overly focuses its efforts on prepping their colleagues for upcoming examinations and does not allow adequate time for ensuring the compliance function

has adequate/up-to-date policies and procedures. The examiners historically have a focus on identifying these policy and procedure discrepancies and do not typically allow much flexibility for inadequacy. Therefore, the Audit Committee should ensure that executives have properly staffed and budgeted such that all procedures are current to reflect changes in product and regulations. It is suggested that the compliance function revise its procedures directly following any front office policy and procedure revisions in response to new regulatory impact, including sales practices and recordkeeping.

Failure to have adequate budget and staffing for the compliance function, can result in the sudden downgrade of the compliance component rating, and/or a full downgrade of the institution’s overall examination rating. For consumer compliance examinations, this can be an embarrassing public event with fines attached. For BSA and OFAC shortcomings identified by examiners, it is unfortunately rather common that fines are severe. This year, the registered holding company for one of the world’s largest banking and financial networks received a Cease and Desist Order from the Federal Reserve Board (FRB) and the Office of the Comptroller of the Currency (OCC) which clearly places adequate budget and staffing first and foremost among the tasks of the Board and Executives. They must submit a plan to strengthen the unit’s oversight

Enforcement Order

	Before	During	After
Risk Awareness (e.g., training) and Formal Assessment	300	1,500	700
Risk Identification & Control (e.g., policies)	500	2,000	750
Risk Monitoring & Containment (e.g., monitoring)	100	900	250
Risk Reporting (e.g., board meetings)	500	2,500	500
	<u>1,400</u>	<u>6,900</u>	<u>2,200</u>

The firm-wide impact of an enforcement order can be severe: it forces the firm into "rapid reaction" mode and a crisis management environment and can cripple new business development and seriously hamper ongoing client services. Some banks never fully recover and become take-over targets. This chart is merely illustrative, as each enforcement case is unique, but is grounded in extensive practical experience. The "During" phase as shown is per annum and assumes experienced professionals are brought into the compliance department to lead a turnaround, and the duration of that Intensive Care Unit period can be a matter of years. This chart focuses only on the impact on the compliance staff itself at a small bank. It EXCLUDES the billable hours of attorneys, auditors, investigators, and other consultants, which may rapidly equate to millions of dollars. It also excludes the impact on the directors and executives.

of business risk management. The operation was ordered to “employ a permanent full-time” regional compliance officer for risk management. They must also retain an outside consultant approved by the Fed to review the unit’s compliance program.

The table on page 20 displays a summary format of the impact resulting from an enforcement order on the compliance department’s work hours. Time is money, and each firm must decide whether to rotate talented managers into compliance for a period of time, and/or retain temporary experts who know how to turnaround the compliance program. The experts in this field, also known as “turnaround artists” or “gunslingers,” do not come cheap.

A word to the wise: as shown in the table, the one-time cost of remediating a compliance program that has fallen to a “3” rating is often five times the dollar amount of what it would have cost to run the program at a properly budgeted level all along; and that multiple can be much higher if there are fines. It is something like the timeless oil filter television commercials some of us will recall, “You can pay me now, or pay me later.”

In the current environment, which is characterized by a very high degree of legislative and regulatory uncertainty (aka risk), compliance consultants are often hired to assist Executives and Audit Committees with an independent evaluation of the “CCO’s TCO” (that is, the Chief Compliance Officer’s “total cost of operation” per annum).

In addition, Executives and Directors should know that the inflated annual cost structure for compliance tends to be disproportional for at least two, if not three, years (i.e., two full examination cycles) after the rating downgrade occurred. Only after a “clean” rating and upgrade of the compliance component can the budgets for Audit and Compliance be right-sized to an appropriately proportional level per annum.



James H. Wistman, MBA, CAMS, has more than 25 years of hands-on experience in implementing and enhancing compliance programs at all forms of financial institutions. Prior to joining ICS Compliance as Director, Jim developed a truly balanced approach to managing regulatory requirements through

his 10 years of experience at the Federal Reserve Bank of New York and 10 years of compliance risk management experience as a top-tier Compliance Officer. Jim has unparalleled experience in coping with enforcement orders, and at the Federal Reserve he served as a Supervising Examiner in the Bank Supervision Division and was often a leader on full scope examinations at high-profile institutions.



Aaron Kahler, CFE, CAMS, is an Anti-Money Laundering (AML) regulatory compliance expert who also specializes in fraud management/investigation and business intelligence/due diligence. He has more than eight years of experience in the commercial/retail, private banking, brokerage, and correspondent banking division sectors. Prior to joining ICS Compliance as Assistant Director, Aaron co-founded an AML and fraud investigation regulatory compliance consultancy, specializing in forensic investigations. Other previous roles include Senior Associate for the forensic and dispute services of a Big Four firm and AML Compliance Specialist for the BSA department of a major, global financial conglomerate. At the start of his career, Aaron worked with the New York State Office of the Attorney General as a Consumer Frauds Bureau Investigator.

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Morris James LLP
500 Delaware Avenue
Suite 1500
Wilmington, DE 19801
T 302.888.6800
F 302.571.1750
www.morrisjames.com