2020

Cost of Compliance: New decade, new challenges.

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Contents

With thanks to Chloe Bloomfield and Helen Camfield

Executive summary

Financial-services firms were already facing an inflexion point in regulatory compliance for 2020, even before the COVID-19 pandemic disrupted the industry worldwide, according to the 11th annual cost of compliance survey by Thomson Reuters Regulatory Intelligence.

Tightening of risk and compliance budgets, regulatory and cultural change and the possibility of increasing personal liability all provided evidence of a cyclical turn from the post-financial crisis years. It is too early to tell how the novel coronavirus will influence that inflexion over the long term, but already regulators are issuing a flurry of revisions to rules, and firms are asking for the postponement of various regulatory initiatives so they can focus on managing events.

The cost of compliance survey annually focuses on the challenges financial services firms expect to face in the year ahead. This year's edition closed before the widespread impact of the COVID-19 pandemic had become apparent; thus, the report analyzes both the survey responses and, in an additional dedicated section, looks in more detail at what better risk and compliance practice will look like in the face of continuing uncertainty.

The survey generated responses from more than 750 risk and compliance practitioners worldwide, representing global systemically important financial institutions (G-SIFIs), banks (including challenger banks), insurers, asset and wealth managers, broker-dealers and payment services providers. The findings are intended to help financial services firms with planning and resourcing, while allowing them to benchmark their own approaches and practices to assess whether or not their expectations are in line with those of the wider industry. The experiences of the G-SIFIs are analyzed where these can provide a sense of the stance taken by the world's largest financial services firms.

The results show that as compliance functions have matured during the years after the 2008 financial crisis, an inflexion point has begun to appear. With the regulatory agenda moving through its post-crisis priorities, firms have enhanced their compliance capabilities to embrace the new range of disciplines and specialities required. Those specialities include culture and conduct risk, which show signs of being successfully embedded, as around a third of firms have discarded a potentially profitable business proposition because of culture and conduct risk concerns.

There are several positive risk and compliance trends for firms, but the survey results indicate firms are beginning to reprioritize their compliance needs. Last year will perhaps be seen as the start of a cyclical turning point for compliance functions. Even though the full effect of COVID-19 is yet to unfold, from the survey results, there are early signs of a shift in focus.

Emerging concerns were highlighted regarding resources, skills and a need to balance budgets and compliance costs. This is set against a background of continued uncertainty about conduct and cultural issues, regulators continuing to produce a raft of changes, and the growing spectre of greater personal liability. To meet these challenges, compliance functions are using other solutions such as regtech and outsourcing arrangements.

The findings include:

- **Board challenges** – The greatest compliance challenges boards expect to face in 2020 are balancing budgets in the face of increasing compliance costs, the volume of regulatory change, driving demonstrable cultural change, increasing personal accountability and the implementation and embedding of regulatory change. This contrasts with the 2019 board challenges which were keeping up with regulatory change, cyber resilience, personal accountability, culture and conduct risk and financial crime.
- **Compliance challenges** – The top three challenges for compliance teams for 2020 are keeping up with regulatory change, budget and resource allocation and data protection. In 2019 the top three challenges were the volume and pace of regulatory change, increasing regulatory burden and financial crime, AML and sanctions.
- **Culture and conduct risk concerns** – In the last year around a third of firms (34%) said they had discarded a potentially profitable business proposition due to culture-or conduct-risk concerns. This has ticked up from the 28% which reported discarding a potentially profitable business proposition in response to the same question in 2018. The biggest culture or conduct risk facing firms is seen as creating a unified compliance culture.

- **Regulatory developments** – TRRI in 2019 captured 56,624 regulatory alerts from more than 1,000 regulatory bodies, averaging 217 updates a day, a slight decrease from the year before. Regulatory change was reported as the top compliance challenge for 2020 with respondents anticipating that more information will be published by the regulator.
- **Budgets** – Overall budget expectations have eased slightly for the coming year with 49% expecting budgets to increase slightly and 31% expecting them to remain the same. Only 11% expect the total compliance team budget to increase significantly. The budget expectations sit alongside a softening in the expected cost of senior compliance staff with 48% expecting senior compliance staff to cost slightly more in the coming year, 13% significantly more. Since 2011 the expectation that senior compliance staff will cost significantly more has dropped by half (2011 – 27%; 2020 – 13%).
- **Compliance teams** – Mirroring the expectations on compliance team budgets, 34% expect their compliance team will grow (a gradual decline from 43% in 2018 and 38% in 2019). At the other end of the spectrum 7% expected compliance teams to shrink, up from 3% in 2019. In addition, 34% of respondents expect the turnover of senior compliance staff to increase in the next 12 months, 43% in the G-SIFI population. The top three skills required for an ideal compliance officer in 2020 were reported as being subject matter expertise, communication skills and integrity.
- **Personal liability** – Personal liability for compliance professionals is a constant concern. Some 17% of respondents reported that in the next 12 months personal liability will grow significantly and a further 41% expected it to be slightly more than today. This is in line with the prior year results where 60% expected the personal liability of compliance officers to increase. In addition, 73% of respondents think the regulatory focus on culture or conduct risk will increase the personal liability of senior managers.
- **Technology** – Respondents to the 2019 cost of compliance survey report[1] thought the biggest change for compliance in the next 10 years would be the automation of compliance activities. In Q1 2020, TRRI published its fourth annual report on fintech, regtech and the role of compliance[2]. The report concluded the financial services industry has much to gain from the effective implementation of fintech, regtech and insurtech but there are numerous challenges to overcome before the potential benefits can be realized.
- **Outsourcing** – More than a third (34%) of firms reported outsourcing some or all their compliance functionality (up from 28% in 2019). The reasons given included the need for additional assurance on compliance processes, cost and a lack of in-house compliance skills.

The questions posed in the 11th annual survey were refreshed to reflect the start of the second decade of the report. Some questions were maintained to enable year-on-year analysis while questions on topics such as culture and conduct risk have been added as, for many firms, these have become part of the "new normal". TRRI has used responses to the free-text questions and build word clouds. For the first time, TRRI asked respondents to list the three key skills required for an ideal compliance officer in 2020.

TRRI extends its thanks to all respondents along with a continued assurance the responses will remain confidential unless explicit permission to include an anonymized quote has been received.

"I hope – indeed expect – that the 2020s will be the decade when all firms and boards put conduct, culture and customers firmly at the top of the corporate agenda. [...] As compliance professionals, you have a vital role to play in being firm and decisive in the execution of your essential duties and reminding leadership teams that they are accountable for the behavior and culture of their firms."

Derville Rowland, director general, financial conduct, at the Central Bank of Ireland, January 2020

1 http://financial-risk-solutions.thomsonreuters.info/Cost-of-Compliance-2019

2 http://financial-risk-solutions.thomsonreuters.info/fintech-regtech-complinace-report-2020

Introduction

2020 marks 25 years since the collapse of Barings Bank and it would seem that everything and nothing has changed in financial services. There is still a huge amount of regulatory change seeking to ensure both financial stability and good customer outcomes. At the same time there have been numerous rogue traders, mis-selling scandals and a financial crisis which rocked the world economy and triggered another round of change, including a proliferation of personal accountability regimes with a view to driving better, risk-aware forms of behavior by senior managers.

The cycle for financial services firms is turning again. Firms are facing an extraordinary challenge posed by the novel coronavirus, and also climate risk and technology. Potential budget constraints threatens to make these challenges more difficult to handle.

Compliance functions had become accustomed to being appropriately resourced. Since the 2008 financial crisis, substantial resources have been allocated as firms have sought to ensure compliance and financial stability. That trend was borne out by the results of the annual TRRI cost of compliance survey reports over the last decade.

The broadly strong trend on resources was first called into question by polling for a series of three regional TRRI webinars in the autumn of 2019, when a global average of 14% cited budget constraints as the greatest challenge for financial services firms in the coming year. This rose to 26% for the poll in the UK and Europe webinar.

Budgets and the skilled resources available to compliance functions are inextricably intertwined. It is essential that risk and compliance functions have, and maintain, access to appropriate expert and skilled resources, preferably in-house, to enable the identification, management and mitigation of risks the execution of compliance monitoring and other activities.

Without an appropriate budget for the compliance function, firms will begin to lack the skill sets required for the future regarding the ramifications of COVID-19, climate risk, data science and technology. Budgets need to be sufficient for firms to invest in day-to-day compliance activities, to update essential skills and be able to deploy technology to improve compliance efficiency.

Insufficient compliance budgets could also lead to problems in terms of liability. Several jurisdictions including the UK, Australia, Ireland, Singapore and Hong Kong, have either implemented specific accountability regimes or are considering doing so, all seeking to eradicate misconduct from financial services firms. Without sufficient skilled resources underpinned by an appropriate compliance budget, senior individuals will be increasingly vulnerable as they are held to account, personally, for regulatory breaches.

The potential vulnerability of compliance officers themselves is likely to be exacerbated by any undue budget reductions. The compliance function itself may have to take the lead in determining how best to manage the rise in individual accountability. Compliance officers should first consider how best to manage their own personal regulatory risk. Once their own risk management infrastructure is in place, they will be better able to advise other senior managers on the best or better practices associated with managing personal regulatory risk. They will then be able to return their focus to the day job of firm compliance.

Compliance officers cannot, and should not, manage regulatory risks alone. They must be supported by their boards and other senior managers through the provision of an appropriate budget and other resources.

The need for skilled in-house compliance officers has already been discussed. The need for other senior managers to be equally skilled is also pertinent. Board members are not expected to be risk and compliance experts; however, they should have sufficient knowledge and awareness to understand the need for the compliance function to be resourced as well as the skills to set an appropriate risk appetite, drive a strong compliant culture, constructively challenge all risk and compliance reports and engage successfully with regulators.

It is overly simplistic to say that a squeezing of compliance budgets in the years running up to the financial crisis was a root cause. However, a lack of skilled in-house compliance resources cannot have helped firms which were facing extraordinary times. 2020 will be seen in the same light, this time because of the disruptions of COVID-19.

Under such circumstances, appropriate resourcing and allocation of budget to the compliance function cannot be allowed to dwindle. The "cost" of compliance may be considered high, but the costs of non-compliance are much higher both for firms and for individuals.

2020 will be another challenging year for financial services firms, we hope you find the 11th annual cost of compliance report useful in developing and benchmarking your firm's risk stance and compliance practices.

Susannah and Mike

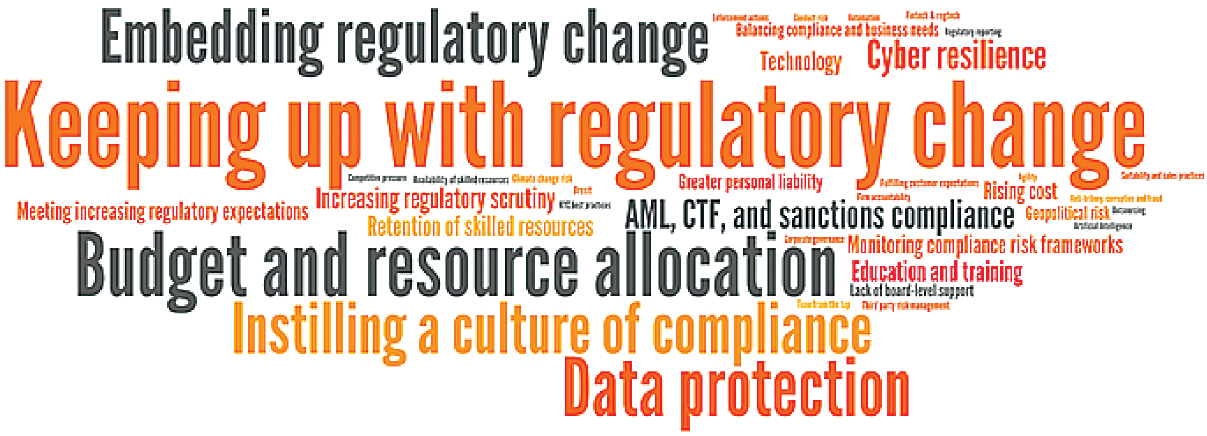
Challenges compliance officers foresee in 2020

This year's survey was completed prior to the COVID-19 outbreak. The challenges for 2020 raised in the survey may now have been superseded by the challenges that arise from the pandemic, but they remain underlying issues. The specific implications of COVID-19 and related challenges compliance teams will have to face are covered later in this report. It is worth reporting the results of the survey reflect industry opinion during a business-as-usual environment.

The top challenges in 2020 were:

1. Keeping up with regulatory change.
2. Budget and resource allocation.
3. Data protection (privacy, internal governance, GDPR).
4. Embedding regulatory change.
5. Instilling a culture of compliance.

The greatest compliance challenge(s) I expect to face in 2020 is/are…



Source: Thomson Reuters Regulatory Intelligence – Cost of Compliance: New decade, new challenges, by Susannah Hammond and Mike Cowan

As in 2019, regulatory change features heavily as a challenge for 2020. The survey reflects the continued changes in the regulatory landscape. Although many inititiatives have been introduced since the 2008 financial crisis, the focus in 2019 was one of monitoring and refinement which has generated its own regulatory output. The survey covers a range of challenges in this area from the increasing complexity to increasing volume to the changing international landscape to trying to embed regulatory change in financial services firms.

Embedding regulatory change is a challenge for firm cultures. The task is a subset of instilling a culture of compliance, which also featured as a challenge for 2020 and remains a constant problem for compliance teams. The question for firms is how to embed a compliance culture. The board and senior managers should lead this, backed with clear policies and procedures, training and development and monitoring processes. It must also be reinforced by suitable award, recognition and disciplinary procedures, and wrapped up with an adequate risk management framework and three-lines-of-defense model. These measures will help with the most diffcult aspect of cultural change: changing management mindsets. Replacing individual opinions with processes based on corporate values leads to true cultural change.

The survey also identified a concern that budgets and resources may be unavailable to meet these needs in terms of both employing and retaining appropriately skilled staff to deal with the volume of regulatory change.

This year's survey identifies data protection as a vital challenge. In Europe, the deadline for the introduction of the General Data Protection Regulation (GDPR) was 2018 but the survey suggests many firms may be having difficulty with the continuing requirements. GDPR has been the blueprint for other regulatory reforms, and in particular the 2020 introduction of the the California Consumer Privacy Act (CCPA), which has been described as the most comprehensive consumer protection law in the United States. The CCPA is extra-territorial in impact and applies to all qualifying organizations doing business in California that collect and sell the personal information of consumers or disclose personal data for a business purpose.

Among other things, the CCPA enables consumers in California to demand certain privacy rights from qualifying businesses. This includes the right to opt out of a sale of their personal information to a third party, the right to have their personal information deleted and, most notably, the right to request specific pieces of personal information that have been collected, sold or disclosed by a company.

The perceived compliance challenge may also reflect the greater number of firms dealing with customers online and the need for firms to keep pace with fast-moving technology for information security. Firms are on notice from regulators to fulfil their responsibilities, and fines will be issued for lost data and system downtime that has adversely affected customers. In addition, for some of the larger firms, data retention rules, especially when it comes to reviewing historic data, may cause operational difficulties.

The greatest compliance challenge(s) I expect to face in 2020 is/are...

Compliance culture at all staff levels – training alone is not an effective approach. Coping with increased, new regulatory requirements.

[Asia, G-SIFI bank]

The greatest compliance challenge(s) the board expect to face in 2020 is/are...

Source: Thomson Reuters Regulatory Intelligence – Cost of Compliance: New decade, new challenges, by Susannah Hammond and Mike Cowan

Top challenges for the board were:

1. Balancing budgets and increasing compliance costs.
2. Volume of regulatory change.
3. Driving demonstrable cultural change.
4. Increasing personal accountability.
5. Implementation and embedding of regulatory change.

The greatest compliance challenges faced by boards were balancing budgets and increasing compliance costs, respondents said. This suggests boards acknowledge the importance of providing compliance teams with the necessary resources but want to ensure they get the level of resource correct. Boards will be loath to overpay for compliance, especially if costs increase year on year, but equally will want to manage the firm's the regulatory risk.

The "champion vs challenger" conflict — whereby the head of compliance asks for more budget to deal with new regulation or specific projects, e.g., data protection, and boards question the value of increased spending — is a frustrating but healthy position.

Boards need to get this balance right because it may affect a director's personal liability. New accountability regimes have further convinced respondents of the increased personal liability of board members.

This places an extra burden on board members to comply with the rules and to demonstrate compliance. At a time when good corporate governance suggests boards should be more diverse, serving on the board of a financial services firm may hold little appeal given these extra responsibilities and regulatory scrutiny, making it harder to recruit directors.

Boards also anticipate challenges in terms of regulatory and cultural change. Boards should set the appropriate culture and management should put in place procedures to support that culture; failure to do so could lead to fines or censure of the firm, and of senior managers.

Board members are expected to have reporting structures in place to keep them informed of the risks run by all parts of the firm. This is difficult for large firms, and boards will be nervous that they are not receiving the information they need to be assured of regulatory change and cultural compliance.

Culture and conduct risk

> "The principles are the foundations of good conduct and should be an integral part of the operational process of planning or decision-making at all levels and as a way of overseeing and assessing whether the firm's conduct remains appropriate. If firms and their senior management approach a business activity from the outset using the principles as a foundational guide, as part of the organization of activities and as a way of monitoring execution of activities, I am sure we would see considerably less unintended harm caused by misconduct. In short, what we need is less hindsight and more foresight."

Mark Steward, executive director of enforcement and market oversight at the UK FCA, February 2020

The consideration of culture and conduct risk has become the new normal. The detail of culture and conduct risk expectations are not set out in a rulebook but have been articulated in speeches and are inherent in the approach to senior manager accountability regimes. Firms must continually demonstrate the qualitative culture and conduct-risk measures in place. One of the most powerful means of measurement is in the ramifications, particularly when it means a firm has chosen not to do something.

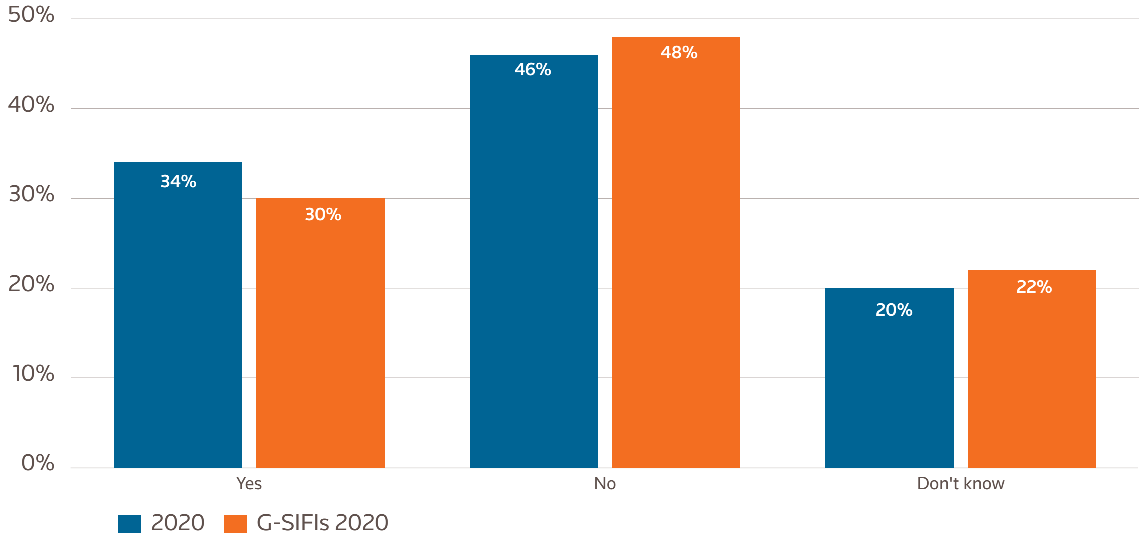
The question about whether firms had discarded potentially profitable business propositions due to culture and conduct risk concerns was originally asked in five annual surveys and associated reports on culture and conduct risk which concluded in 2018. For 2020, the question was once again asked for the cost of compliance report.

A third (34%) of respondents said they had turned down a potentially profitable business opportunity in the previous year because of culture and or conduct risk concerns. This was a slight rise on the 28% which reported discarding a potentially profitable business opportunity in the fifth annual culture and conduct risk report in 2018.

A firm choosing to avoid a potentially profitable activity is a powerful demonstration of culture and conduct risk policies working. Firms should document the reasoning behind all such decisions and aim to learn lessons, whether they were connected with the use of third parties, product design, undue complexity or other aspects of business activity.

There are distinct regional variations, with 46% of firms based in continental Europe and 41% of firms based in the Middle East reporting they had turned down potentially profitable business opportunities, compared with 19% in Canada and 24% in Australasia.

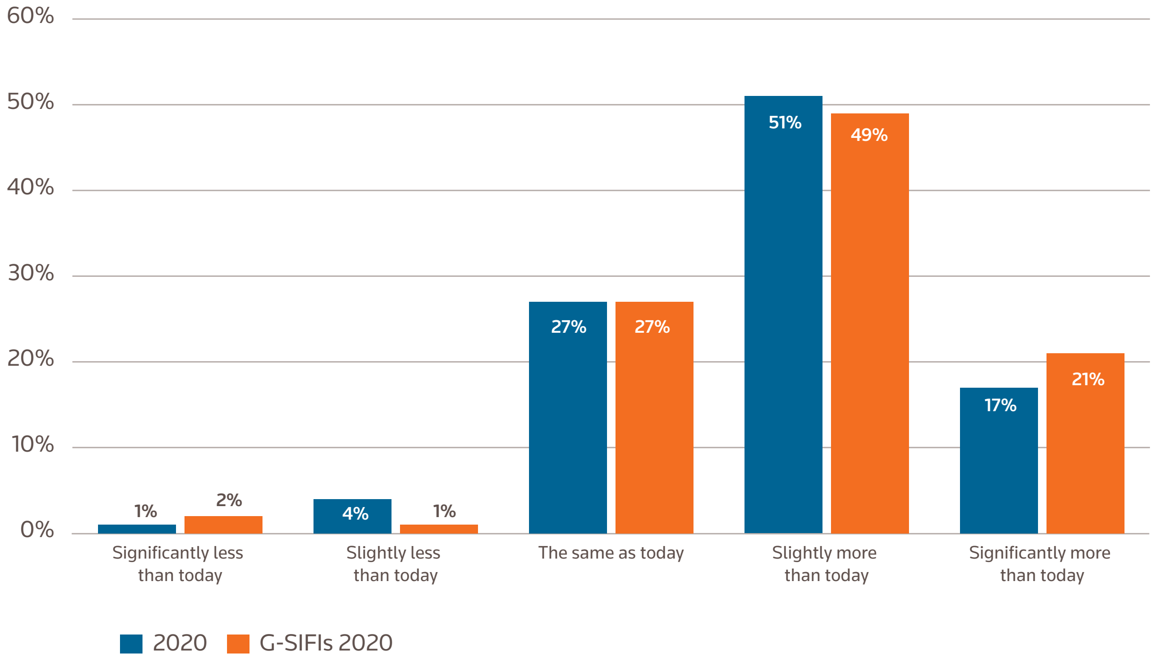
Have you in the last 12 months discarded a potentially profitable business proposition due to culture and/or conduct risk concerns?



Source: Thomson Reuters Regulatory Intelligence – Cost of Compliance: New decade, new challenges, by Susannah Hammond and Mike Cowan

The influence of culture and conduct risk on business decisions is also reflected in the resources devoted to considering such difficulties. The majority of respondents expect the cost of time and resource devoted to conduct risk issues either to stay the same or to increase in the coming year. Specifically, a fifth (17% of firms, 21% of G-SIFIs) expected a significant increase in the cost of time and resource devoted to conduct risk issues in the next 12 months — a result, perhaps, of the proliferation of accountability regimes and their link back into conduct.

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: New decade, new challenges, by Susannah Hammond and Mike Cowan

From a regional perspective, more than two-thirds (69%) of firms in the UK expect cost of time and resource devoted to conduct risk to increase in the next 12 months, of which 25% expect this to increase significantly. This is in comparison to 61% of practitioners based in Continental Europe and the Middle East expecting cost of time and resource to increase for conduct risk.

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

Lack of accountability in business areas, they do not exercise a prevention of culture

[South America, Asset Management]

The challenges posed by culture and conduct risk are illustrated by the range of responses to the question about the single biggest culture or conduct risk faced by firms. The top two risks cited were the need to create a unified compliance culture and balancing competitive and compliance pressures. This suggests many firms are still finding it a challenge to implement and embed such risks.

Culture, specifically being able to evidence change within the firm, is a theme which will loom large among board challenges during the year ahead.

Practitioners said the single biggest culture or conduct risk facing their firm this year will be:

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 culture or conduct risk your firm is facing?

Source: Thomson Reuters Regulatory Intelligence – Cost of Compliance: New decade, new challenges, by Susannah Hammond and Mike Cowan

The creation of a unified compliance culture across a firm, particularly one with several business lines and geographies, is a large task. The impetus must come from the board and be continuously championed by all senior managers. Equally, the firm must have policies and procedures which are tailor-made for the business. The board will need regular reports on the efficacy of those policies and procedures. The firm's stance on culture needs to be supported by a control infrastructure covering a comprehensive suite of preventive and detective controls, the three lines of defence and an appropriate risk-aware approach to reward, recognition and, where needed, discipline.

> "While the bank's leadership plays a significant role in changing culture by setting the 'tone from the top', I believe that you would agree with me that board-level oversight alone would be insufficient if banks want all their staff to understand and live up to the desired culture. Therefore, it is equally important that the banks' leadership cascade the 'tone from the top' down to ensure that the bank's desired culture, values and behavioral standards are understood and shared by different levels of staff, through effective and continual communications and training."
>
> **Alan Au,** executive director (banking conduct) at Hong Kong Monetary Authority, January 2020

Regulatory developments and reporting

In 2019, TRRI captured 56,624 regulatory alerts from more than 1,000 regulatory bodies, averaging 217 updates a day. This was a slight decrease on the previous year, which is perhaps unsurprising as the regulatory agenda for 2019 did not include large regulatory developments such as the Markets in Financial Instruments Directive II (MIFID II), GDPR and Capital Requirements Directive IV (CRD IV).

The regulatory agenda for 2019 dealt more with progressing, monitoring and reviewing changes that had been initiated in previous years. The Financial Stability Board (FSB) set an agenda that included:

- **Addressing new and emerging vulnerabilities in the financial system –** for example, work on fintech (crypto-assets, decentralized financial technologies), cyber resilience, non-bank financial intermediation and accounting and auditing.
- **Finalizing and operationalizing post-crisis reforms –** such as ending too-big-to-fail, making the derivatives market safer and promoting resilient non-bank financial intermediation.
- **Implementation of reforms –** this included the fifth annual report on implementation and effects of the G20 financial regulatory reform, monitoring implementation of Basel III, implementation of the over-the-counter derivatives market reforms, peer reviews (thematic peer review report on bank resolution planning, thematic peer review report on implementation of the legal entity identifier (LEI) and country peer reviews of Mexico and South Africa).
- **Evaluating the effects of reforms –** this included continuing evaluation work and cross-border consistency.
- **Reinforcing outreach to stakeholders –** this included regional consultative groups and communication and engagement with external stakeholders.

The European Banking Authority has undertaken work on Basel III, cyber security, operational resilience, data strategy and improving capital and liquidity requirements. The UK Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) have undertaken work on improving capital and liquidity regulations, moving away from Libor, progressing the quality of regulatory data and conduct risk issues in retail banking.

In Australia, APRA's four main priorities for 2019 were to maintain system resilience, improve outcomes for superannuation members, transform governance, culture, remuneration and accountability and improve cyber resilience across the financial system. APRA reported that 2019 was a "year of reviews" with the Royal Commission report on Misconduct in the Banking, Superannuation and Financial Services Industry, released in February, and the APRA Capability Review, released in July.

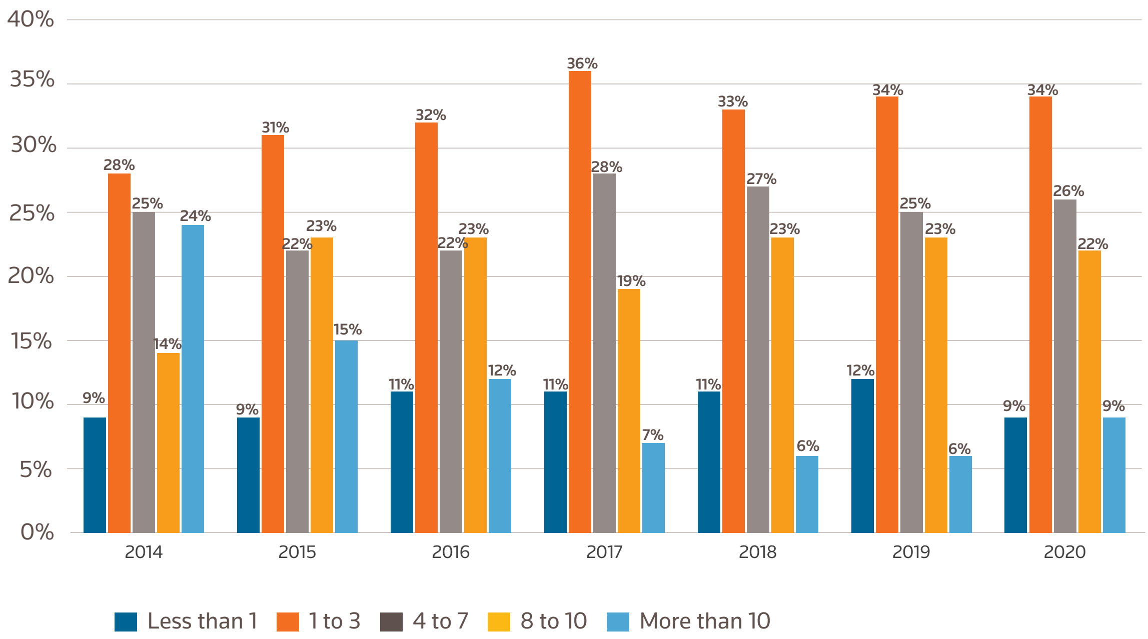
The survey showed that the amount of time compliance teams spend tracking and analysing regulatory developments has remained consistent on average in the last few years. The average compliance team spends one to three hours a week tracking and analysing regulatory developments.

The share of teams spending more than 10 hours tracking and analysing regulatory developments in an average week has fallen sharply from 2014 (24%), to 9% in 2020. Those spending eight to 10 hours rose from 14% to 22% during the same period, while the four to seven-hour category has remained relatively stable (2020: 26%).

Between one and three hours a week seems too short a time for a compliance department to identify and agree actions with the business, given the volumes of regulations being progressed. There is evidence elsewhere in this survey that regtech solutions are increasingly being used, and this could make it easier to identify and communicate new regulations.

The figures may also indicate that senior managers in the first line are undertaking more of the analysis, with compliance teams identifying changes and passing them on to the first line to analyze before monitoring actions that are required for the firm to become compliant. This would also fit in to the evolution of the various regimes to make senior managers more accountable for the parts of the business for which they have responsibility, including risks and regulations.

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: New decade, new challenges, by Susannah Hammond and Mike Cowan

Regulatory reporting

The most common form of regulatory reporting is through regulatory returns. The completion and submission of regulatory returns has been the subject of some scrutiny in recent years. For example, in 2018, a UK FCA "Dear CEO" letter on the quality of prudential returns urged CEOs of investment firms to review their regulatory reporting practices to ensure they were fit-for-purpose, complied with the relevant reporting provisions and produced materially accurate data.

The appropriateness of regulatory returns was highlighted in the independent review of the prudential supervision of the Co-operative Bank Plc. In 2019 the PRA imposed a combined financial penalty of £44 million on Citigroup Global Markets Ltd, Citibank N.A.'s London branch and Citibank Europe Plc's UK branch for failings in relation to their internal controls and governance arrangements underpinning compliance with PRA regulatory reporting requirements. This was the first time the PRA had imposed such a fine.

At the end of October 2019 the PRA issued a "Dear CEO" letter confirming that it " … expects firms to submit complete, timely and accurate regulatory returns. These expectations have not changed; the integrity of regulatory reporting is the foundation of effective supervision."

The PRA said it would commission reports on financial institutions to look primarily at those returns required under the common reporting framework. In March 2020, however, the PRA said, due to COVID-19, it was reprioritising these reviews until later in the year.

Elsewhere, the Central Bank of Ireland (CBI) fined Wells Fargo Bank International 5.88 million euros for serious failings in its regulatory reporting capability and compliance. The CBI also fined the Bank of Montreal Ireland Plc 1.25 million euros for breaching a condition of its banking license. The CBI found the bank had failed to submit three operational risk returns, or to establish and maintain effective processes and internal controls to ensure compliance with the regulatory reporting condition.

The Monetary Authority of Singapore's new reporting standards under the notices on submission of statistics and returns for commercial banks and merchant banks, known as Notices 610 and 1003 respectively, raise the bar substantially for regulatory reporting.

Governance and controls for regulatory returns

Firms should consider the following when deciding on measures to offset risks regarding regulatory returns:

Clear and accountable ownership – Under the UK Senior Managers and Certification Regime (SMCR) the production and integrity of a firm's financial information and its regulatory reporting is a prescribed responsibility. This means that the responsibility for the accuracy, coverage and timely submission of regulatory returns should be allocated to an appropriate senior manager. This does not mean that this individual should complete all returns. There may be scope for delegating completion to another department or individual, but someone with accountability for the process should be established. In jurisdictions where regulatory reporting is not a prescribed responsibility it could still be good practice to have a named senior manager with designated oversight.

Control framework – The owner of regulatory returns needs a control framework that ensures returns are completed on time and are accurate. The compliance department should provide assurance that all regulatory requirements have been allocated. This could be achieved by a mapping exercise that matches regulatory rules, returns and deadlines against internal processes, people and dates. The individual areas of the business that create the data must provide assurance that it is accurate and correct. The control here could be regular testing of the systems used to establish that outputs are correct, or independent checking of the statistics used and self-attestation that figures were accurate. The owner also needs assurance that deadlines have been met adequately (perhaps by a diary system that flags deadlines but also allows those responsible for acknowledging completion of returns).

Monitoring by quality assurance (QA), risk and compliance or internal audit – A QA function should review each return before submission to provide assurance that the data are accurate and meaningful. Firms should also regularly review the processes that support completion of regulatory returns. This would include any formulae used to generate statistics.

Consistency – There may be timing differences between the completion of regulatory returns and other pieces of internal management information. As far as possible iIt is important that, the data used are the same and tell the same story.

Reporting – A report on submission, issues and conclusions from regulatory returns should be submitted on a regular basis to the committee responsible for operational risk and any other relevant committees. Regulatory returns should be a valuable source of information that can be used to begin investigations, not just seen as a chore that has been imposed on firms.

Training and competency – Ensure individuals producing the data have the necessary training and understand their jobs and the reasons for them.

Contingency arrangements – Procedures should also be put in place to cater for any problems that prevent the completion of returns; for example, system back-ups or alternative ways of gathering the required information.

Communication lines – Documented lines of communication need to be put in place both internally for approval and awareness, and if required with the regulator to inform them of late submission.

Liaison with regulators

"National authorities need to be able to do what is right in their jurisdiction rather than rigidly applying identical requirements country-by-country. [.....] However, these local solutions can cause higher compliance costs for firms operating internationally. The need for a local element shouldn't be used as a blanket justification for local implementation that leads to inconsistent outcomes or increased costs for firms or their clients."

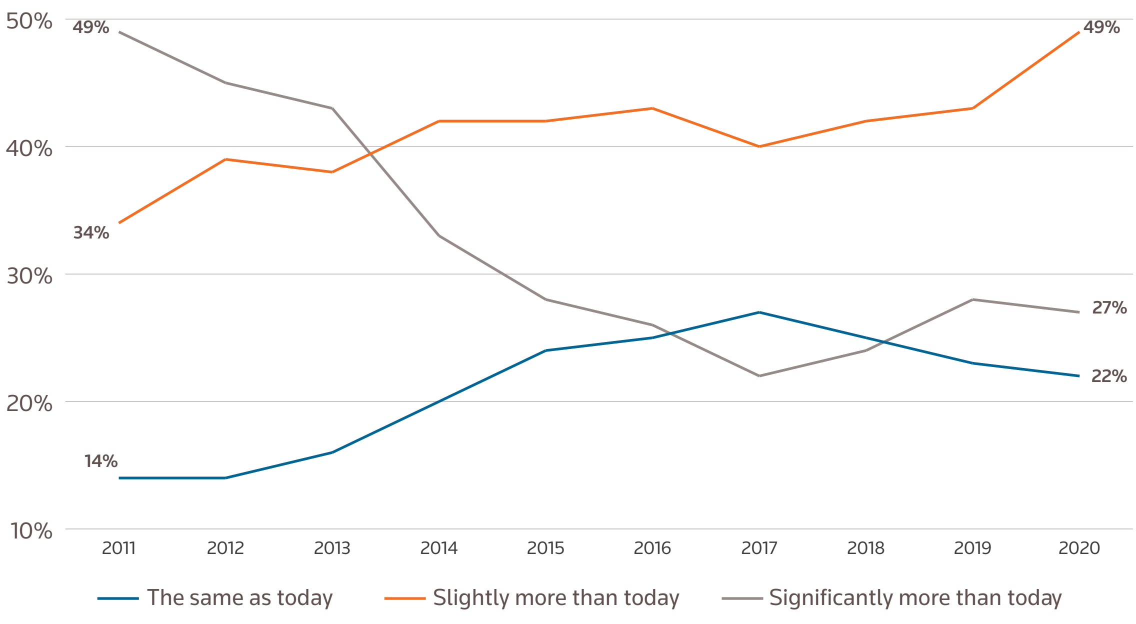
Nausicaa Delfas, executive director of international at the UK Financial Conduct Authority, January 2020

Firms have contact with regulators for many reasons, including the tracking and analysis of new regulatory initiatives and rule changes through consultation papers and decision notices. There are the extensive regulatory returns that firms must complete and senior management applications that need approval.

Most firms will have some form of relationship-management meeting, visit or call on a monthly, quarterly or annual basis. Firms may also become involved in thematic reviews looking at a sector theme or may have firm-specific reviews looking at aspects of the firm's business. Where a firm has been found to be non-compliant, the UK regulators, for instance, may invoke a "Section 166" review whereby an accountancy firm is tasked to review the firm's handling of a problem, subject or incident (which can lead to enforcement action).

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....



Source: Thomson Reuters Regulatory Intelligence – Cost of Compliance: New decade, new challenges, by Susannah Hammond and Mike Cowan

The survey results anticipate more information will be published by the regulator in 2020. In the 10 years up to 2018, the cost of compliance report saw year-on-year increases in the total number of alerts, although in recent years there has been evidence of the number of alerts starting to decrease.

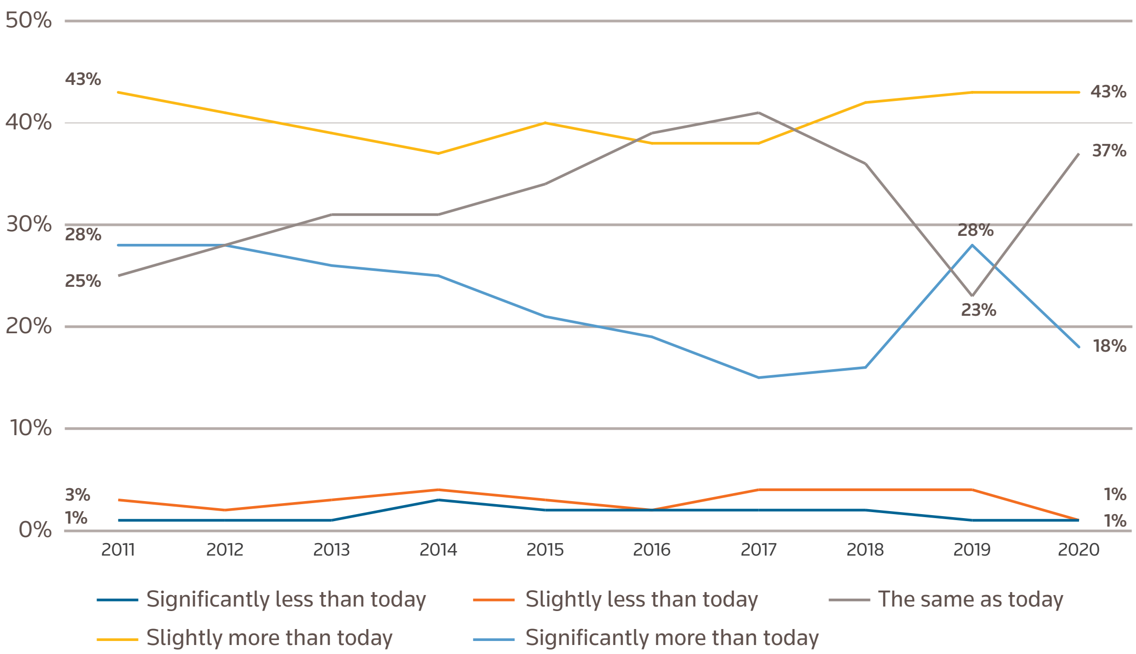
The survey suggests firms anticipate an increase in regulatory information. In 2020, 76% of firms expect the amount of regulatory information published by regulators and exchanges to increase in the next 12 months (49% slightly more, 27% significantly more). In 2019, 69% of G-SIFIs expected the amount of regulatory information published by regulators and exchanges to increase (39% slightly more, 30% significantly more). This has jumped to 83% in 2020 (59% slightly more, 24% significantly more).

Regionally, in Australasia 90% expect that regulatory information published by regulators and exchanges to increase in the next 12 months (39% slightly more, 51% significantly more). This could be attributed to the continued need to respond to a Royal Commission inquiry into financial-services misconduct, and a growing spotlight on climate risk.

Almost half of firms in the UK (48%) and 46% of firms in Continental Europe expect a slight increase in regulatory information published by regulators and exchanges in the next 12 months. This may be because the transition phase of the UK's exit from the European Union is expected to generate considerable regulatory activity.

Liaising and communicating

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: New decade, new challenges, by Susannah Hammond and Mike Cowan

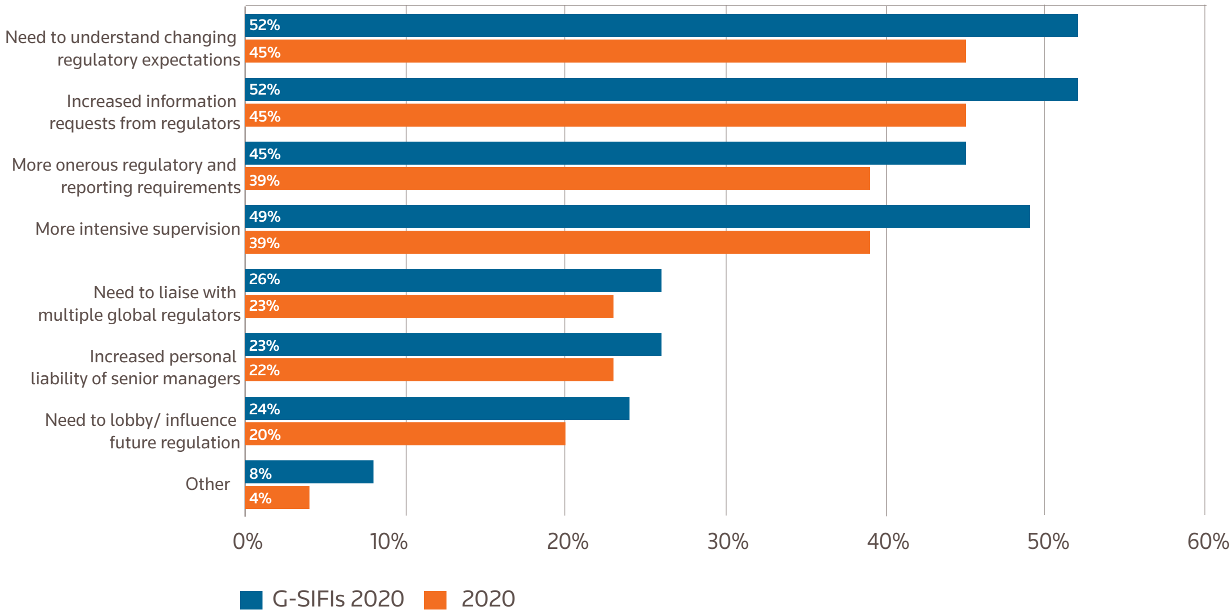
The percentage of firms expecting the time spent liaising and communicating with regulators and exchanges to increase has fallen, after a slight peak in 2019. In 2020, 61% of firms expect to spend more time communicating with regulators and exchanges in the next 12 months (43% slightly more, 18% significantly more), compared with 71% in 2019 (43% slightly more, 28% significantly more).

In 2020, a higher proportion of G-SIFIs, overall, than in 2019 expect to spend more time liaising and communicating with regulators and exchanges in the next 12 months, with almost a quarter of G-SIFIs (23%) expecting to spend significantly more.

The top three reasons for communications have remained the same in recent years. These are:

1. Need to understand changing regulatory expectations (45%).
2. Increased information requests from regulators (45%).
3. More onerous regulatory and reporting requirements (39%).

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



Source: Thomson Reuters Regulatory Intelligence – Cost of Compliance: New decade, new challenges, by Susannah Hammond and Mike Cowan

The greatest compliance challenge(s) the board expects to face in 2020 is/are…

Regulatory changes, balancing demand from the business in terms of where to deploy resources given increased regulatory risk and pressure to grow.

[United States, G-SIFI bank]

Regionally, more than half (52%) of firms based in Asia identified the need to understand changing regulatory expectations as the main reason for regular liaison with regulators and exchanges. Of firms based in Australasia, 58% cited more onerous regulatory and reporting requirements as the main reason for greater liaison. For firms based in the UK and the Middle East, an increase in the number of information requests from regulators was the primary reason.

Firms are expecting most of their communication with regulators to involve clarifying regulatory requirements and dealing with information requests. This might entail replying to consultation and discussion papers or perhaps lobbying the regulators. At a time when regulatory data is a priority for many regulators, it is perhaps unsurprising that managing regulatory returns features heavily. 2020 may see not only the continued reporting of existing returns but also changes in systems and reporting requirements to which firms need to adapt.

It is unsurprising G-SIFIs have highlighted "more intensive supervision" as a main reason for liaising with the regulators. G-SIFIs attract more regulatory scrutiny and this will include more frequent relationship management visits and firm-specific reviews. G-SIFIs may also be involved in more thematic reviews, depending on the criteria the regulators use to select their sample.

In summary, firms are expecting to spend about the same or slightly less time liaising with regulators in 2020 with regard to regulatory changes, even though they are expecting the regulators to publish more information. Two significant events that may generate regulatory change are the UK's withdrawal from the EU and, in Australia, the continued response to the Royal Commission.

Budget and skilled resources

"One of the most important lessons I've learned as a CEO is that there's no fixed endpoint when it comes to shaping an organization's culture. You can never take a step back and say, "We've finished the culture project. Well done! Now it's time to focus our efforts elsewhere."

John C Williams, president and chief executive of the Federal Reserve Bank of New York, January 2020

All regulators advocate a culture that includes proper compliance disciplines. The development of effective compliance disciplines requires appropriate skills and resource in compliance teams. Regulators have put in place principles, rules and guidance to make sure firms establish such compliance functions.

For example, the Basel Committee on Banking Supervision has said: "The bank's senior management is responsible for establishing a permanent and effective compliance function within the bank as part of the bank's compliance policy. [...] The bank's compliance function should have the resources to carry out its responsibilities effectively."

The Financial Stability Board (FSB) and the U.S. Federal Reserve have both referenced this.

In the UK, the FCA has ruled that firms need a compliance function that has "the necessary authority, resources, expertise and access to all relevant information".

Compliance teams have grown in both size and competency, in response to the changes introduced following the 2008 financial crisis. Many regulatory initiatives have now been completed or are on their way to completion: for example, in Europe MiFID II, the GDPR, the Mortgage Credit Directive (MCD) and CRD IV. Firms may well have heaved a collective sigh of relief in 2019, thinking that the worst was over, and their compliance departments could move into a "business-as-usual" phase. The early signs of this are perhaps being seen in this year's survey results.

There are indications firms are beginning to think about reducing the size of their compliance teams. Many respondents predicted only slight increases to budgets or said they would remain the same. The cost of senior compliance staff is predicted to reduce, and staff turnover to remain the same. Combined, for 2020, this picture shows a levelling of expectations regarding budgets and resources.

Times are hard for financial services firms although the full impact of COVID-19 on the financial system has yet to unfold. Compliance departments are far from immune from financial disruption and must contribute to a firm's profits, which usually means cutting cost.

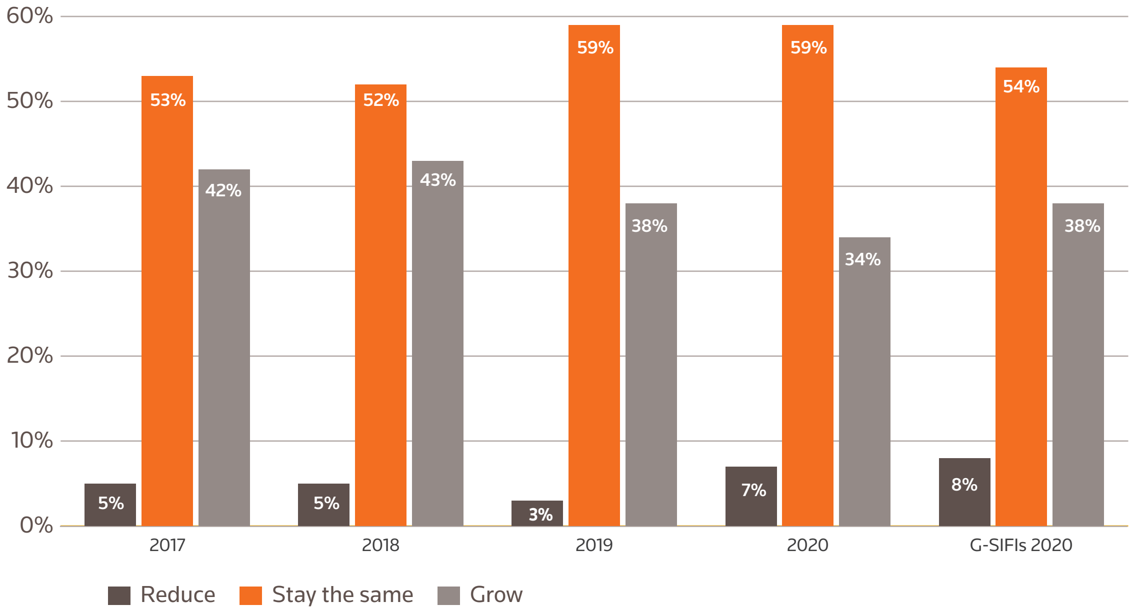
Firms must find the balance between the pursuit of profit and the requirement to ensure business is conducted in an ethical, compliant, customer-focused way. Like culture, though, the pursuit of regulatory compliance has no fixed endpoint.

The greatest compliance challenge(s) I expect to face in 2020 is/are ...

Reduced headcount and cost consciousness, coupled with an active external market leading to turnover of what resources remain. This will result in loss of capability and corporate memory, and significant challenges in maintaining the current 'positive' trajectory within the organization.

[Australasia, undisclosed sector]

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

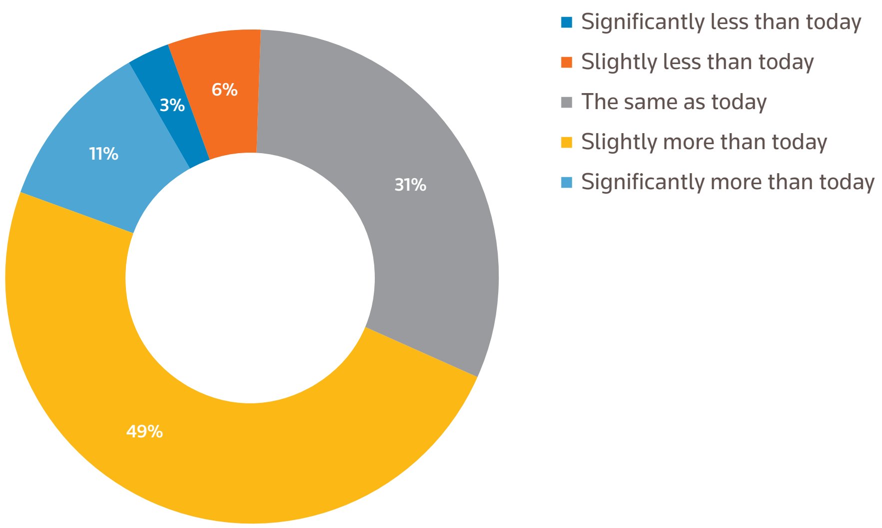


Source: Thomson Reuters Regulatory Intelligence – Cost of Compliance: New decade, new challenges, by Susannah Hammond and Mike Cowan

A total of 7% of firms (8% of G-SIFIs) said they were expecting their compliance teams to be reduced in size. This is the largest percentage since 2017, up from 3% the previous year. The expectation that compliance teams will grow has fallen year-on-year since 2018. In 2020, just more than a third (34%) of firms expect compliance teams to grow, the lowest TRRI has seen since 2017.

On the face of it, this could be a response to cost-cutting by firms but, alternatively, it could be that firms are finding more efficient ways to meet their compliance needs. For example, they could be making greater use of regtech for compliance work. Horizon-scanning, identity checking and mandatory training are all areas in which technological solutions can now perform functions which would previously have manual tasks. It could also be that firms are outsourcing more to third parties.

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



Source: Thomson Reuters Regulatory Intelligence – Cost of Compliance: New decade, new challenges, by Susannah Hammond and Mike Cowan

Respondents did not expect to see significant change to their budgets in the year to come: 49% of respondents expected slightly more, with 31% anticipating that budgets would remain the same (11% significantly more). These figures have remained relatively consistent in recent years.

Regionally, 82% of firms based in Australasia expect the total compliance team budget to remain the same, or increase slightly, in the next 12 months. Almost half (44%) of firms based in Canada and 41% of firms based in the United States expect budgets to remain the same, or increase only slightly in the year ahead, with reasons given including the need to drive efficiencies and overall business cost reduction.

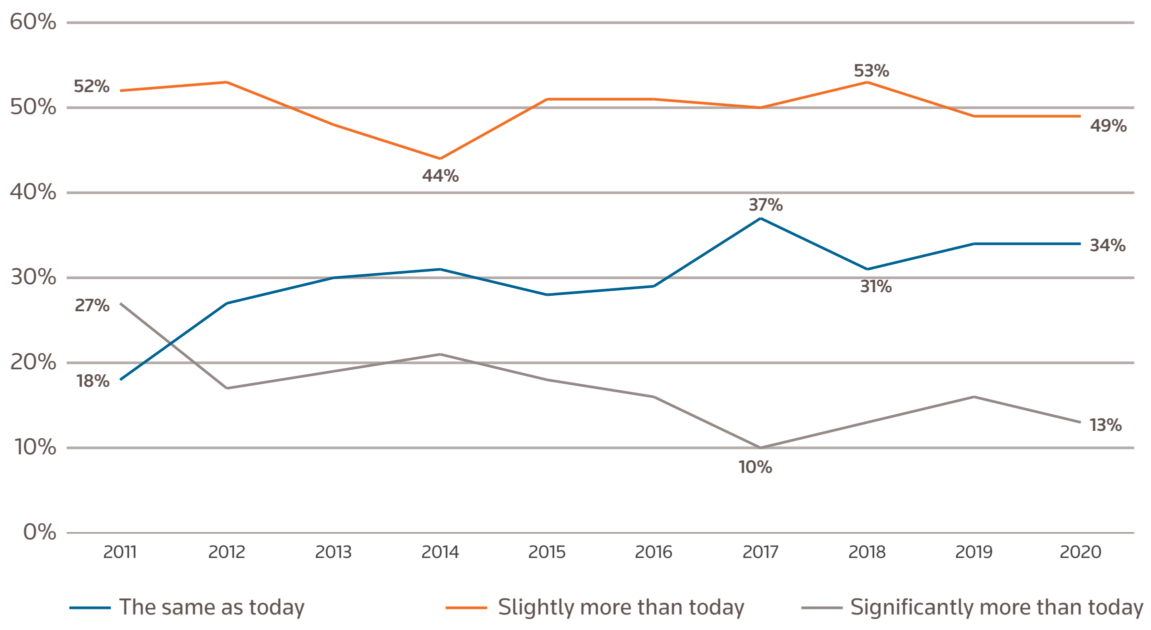
The expectation that budgets will increase slightly but that compliance teams may reduce in size suggests that money which might previously have been spent on compliance staff is now being spent on other things.

The greatest compliance challenge(s) I expect to face in 2020 is/are ...

Preparing senior management with updates on regulatory changes to enable them to provide the required attestation to the regulators

[Middle East, broker-dealer]

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



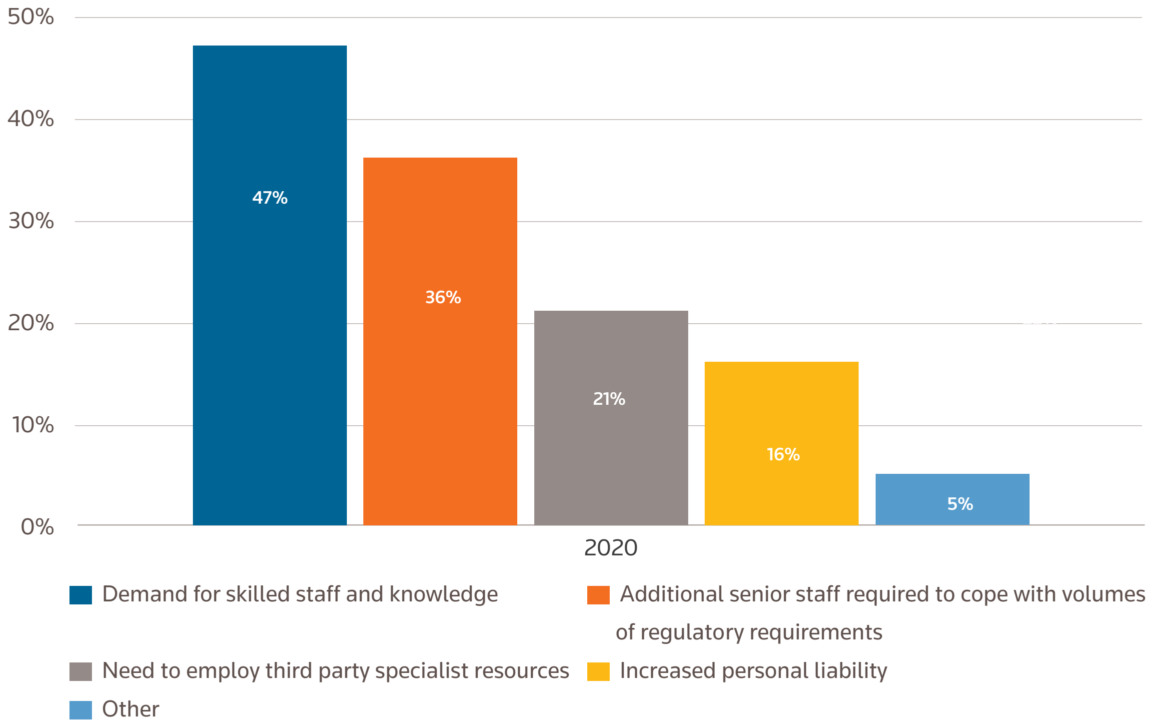
Source: Thomson Reuters Regulatory Intelligence – Cost of Compliance: New decade, new challenges, by Susannah Hammond and Mike Cowan

The survey indicates that the cost of senior compliance staff is reducing. Some 34% of respondents believe costs will remain the same, an increase from 18% in 2011. The majority still expect a slight increase (48%), although the underlying trend is down from 2011 (from 52%). The most significant move has been that those who expect cost of senior compliance staff to be significantly more has dropped to 13%, from a high of 27% in 2011. Contrary to the mainstream results, in 2019 G-SIFIs expected cost to be slightly/ significantly more (57%) and this has risen to 65% in 2020.

An expectation of reduced staff cost could be down to several reasons. Firms in this category may be seeing low staff turnover, with savings on recruitment costs. The survey results below support this, in that 60% of respondents thought staff turnover would remain the same. Firms may have developed internal training and development processes that have nurtured more junior staff into senior roles, or it may be that succession plans have become more effective in determining internal succession. Firms may have spent time making their regular compliance processes such as monitoring, more routine and may therefore not require the same degree of expertise to operate them.

The G-SIFI results are interesting in that the emphasis of their responses suggests an increase in staff costs. In larger firms such as G-SIFIs compliance becomes more complex due to the wider range of products, services, jurisdictions, technology and accounting practices that are involved. G-SIFIs may have to pay a premium to recruit specialists in such areas.

I expect the cost of senior compliance staff to increase because of...



Source: Thomson Reuters Regulatory Intelligence – Cost of Compliance: New decade, new challenges, by Susannah Hammond and Mike Cowan

Where responses suggested that the cost of senior compliance staff would increase this is largely down to demand for skilled staff and knowledge, and to the need for additional senior staff to cope with volumes of regulatory requirements.

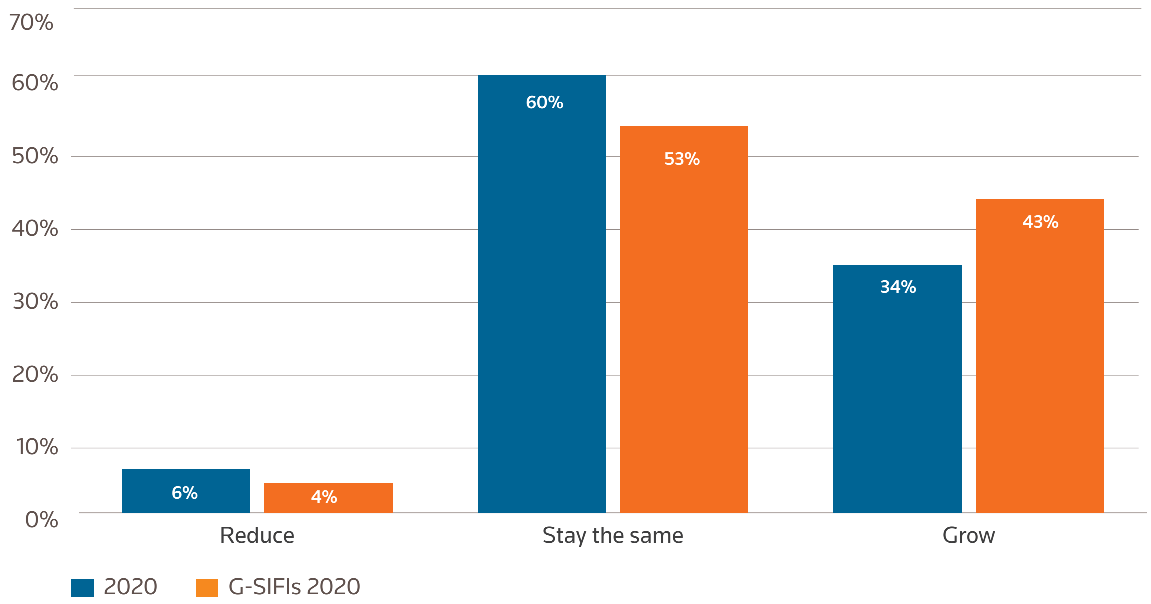
Regionally, 72% of firms in Australasia expect the cost of senior compliance staff to increase in the next year (55% slightly more, 16% significantly more), compared with 56% for firms in Canada (41% slightly more, 15% significantly more) and in the United States (47% slightly more, 10% significantly more).

Of those who say the cost of senior compliance staff will increase in the coming 12 months, 47% said that would be because of demand for skilled staff and knowledge. This was closely followed by the need for additional senior staff required to cope with the volume of regulatory requirements (36%).

The primary reason for firms based in Australasia expecting the cost of senior compliance staff to increase is demand for skilled staff and knowledge (64%). In Canada, it is the need for additional senior staff to cope with volumes of regulatory requirements, which relates to the greatest compliance challenges firms expect to face in the next 12 months — keeping up with regulatory change.

Other reasons (5%) for an expected increase in the cost of senior compliance staff include the greater complexity of the regulatory and commercial environment; regulatory scrutiny, inception of advanced technology, and more board-level risk.

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



Source: Thomson Reuters Regulatory Intelligence – Cost of Compliance: New decade, new challenges, by Susannah Hammond and Mike Cowan

This year's survey introduced a series of new questions focusing on senior compliance staff — one looked at staff turnover. In 2020, 60% of respondents expect the turnover of senior compliance staff to remain the same. More than a third (34%) of all firms, and 43% of G-SIFIs, expect turnover of senior compliance staff to grow.

The report has already touched on some of the reasons for respondents believing staff turnover will remain the same. The introduction of the Senior Managers and Certification Regime in the UK, and equivalents elsewhere, may have an impact. On the one hand, once managers have been through the process and been approved by the regulator, they may be less inclined to go through the same process in a new role and will therefore stay with the firm. Roles that carry a senior manager designation make individuals more marketable and prone to moving jobs, however. Senior manager regimes may also increase the personal risk for role holders, prompting them to leave to pursue opportunities which carry less risk.

There also is growing focus on the need for the composition of firms' management teams to be more diverse. In February 2020, the European Banking Authority (EBA) issued a new benchmarking report on diversity practices in credit institutions and investment firms, which found that, of 834 institutions surveyed, 41.61% had not adopted diversity policies. In addition, the UK Financial Reporting Council (FRC) published its findings from new research looking at firms' approach to boardroom ethnicity. It may be harder to recruit the right candidate when drawing from a more diverse recruitment pool. This could mean roles remain unoccupied for longer but, once filled, that role holders may be less inclined to move.

The survey results this year suggest that compliance teams could be reduced, and budgets may only increase slightly. This could mean that compliance teams are developing more effective and efficient ways of operating, perhaps by using regtech solutions or outsourcing arrangements. The outsourcing section, later in the report, suggests firms are using third-party suppliers more. If these third parties are competitively priced, this might explain why the cost of senior compliance staff is declining and may contribute to expectations that staff turnover will remain the same. If, however, these cuts are a sign of firms shifting resources away from compliance then firms should be aware of the risk that such a strategy runs.

Personal liability

" ... illicit and unethical behavior is rarely the result of an isolated 'bad apple'. It's more often the symptom of a rotten culture. And rotten cultures don't appear overnight — nor for that matter do positive, inclusive ones, where people feel empowered and accountable to upholding the values of the organization."

John C Williams, president and chief executive of the Federal Reserve Bank of New York, January 2020

Personal accountability regimes have proliferated as regulators seek to drive better, risk-aware standards of behavior. In late 2019 TRRI published a special report entitled "Accountability gets personal: Are you prepared for the rise in accountability regimes in 2019?"[3] which considered both the regulatory changes and what firms should, in practice, do about the changing supervisory approach.

Compliance officers, as well as all senior individuals in financial services firms, are on notice that regulatory regimes are making it simpler for supervisors to hold people to account. All the possible causes of misconduct, from incentives to culture, have come under policymakers' spotlight. Regulators have also focused on making it harder for "rolling bad apples" to keep changing firms or jurisdictions to stay ahead of supervisory attention.

Senior individuals would be well-advised to consider three principles for managing their personal liability:

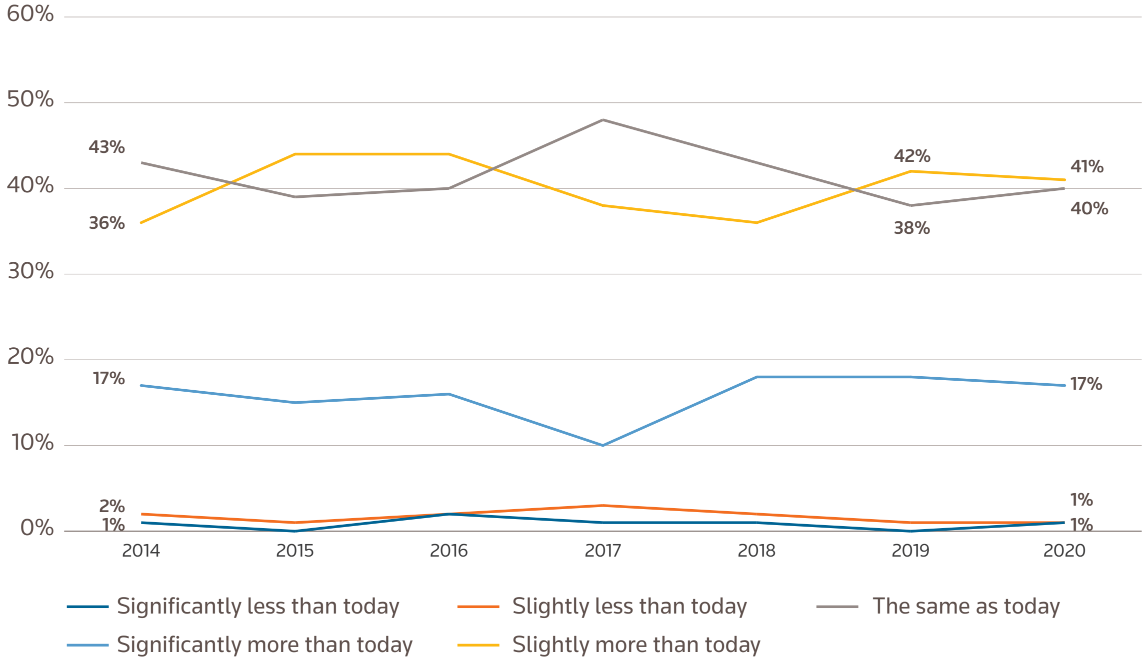
1. **Be aware -** build the capability to keep abreast of all changes to relevant rules, requirements, obligations and expectations, bearing in mind some applicable rules may arise outside an individual's home jurisdiction.
2. **Compliance by design –** know exactly what they are responsible for at any point in time and how compliant activities in their areas of responsibility are structured, and tested as operating effectively.
3. **Evidence –** invest in comprehensive recordkeeping so, after the event, compliant activities, and hence the discharge of relevant obligations, can be demonstrated.

Senior individuals who breach of their obligations will increasingly find themselves subject to regulatory enforcement action and will be unlikely to hold a senior position in financial services again.

Against that background, compliance officers' expectations about their personal liability reflect their perennial concern. Consistent with previous years more than half (58%) of respondents expect the personal liability of compliance professionals to increase in the coming year (41% slightly more and 17% significantly more). Just 2% thought that the personal liability of compliance professionals would decrease either slightly or significantly.

3 http://financial-risk-solutions.thomsonreuters.info/personal-accountability-report-2019

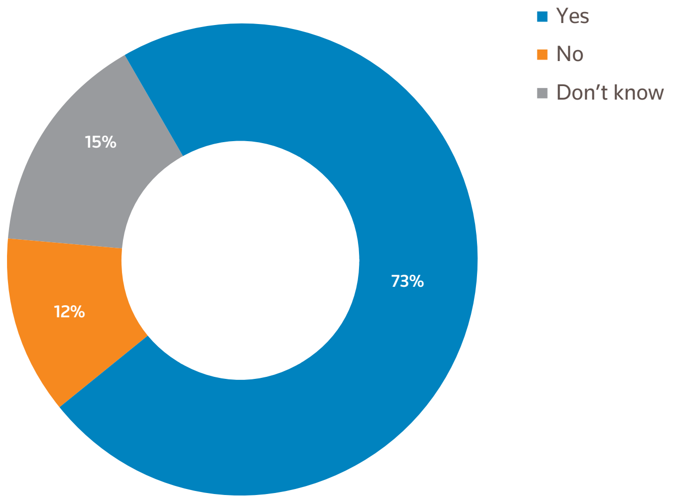
Over the next 12 months, I expect the personal liability of compliance professionals to be...



Source: Thomson Reuters Regulatory Intelligence – Cost of Compliance: New decade, new challenges, by Susannah Hammond and Mike Cowan

It is not only the spread of accountability regimes which have the potential to raise the personal liability of senior individuals in financial services firms, but also the regulatory focus on culture and conduct risk issues.

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

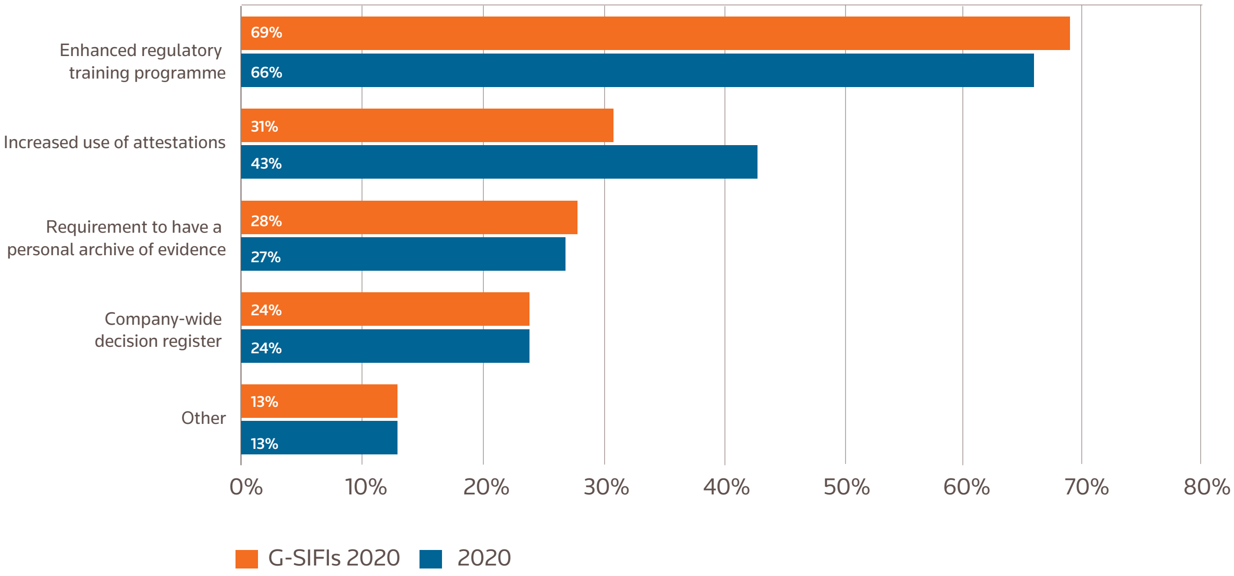


Source: Thomson Reuters Regulatory Intelligence – Cost of Compliance: New decade, new challenges, by Susannah Hammond and Mike Cowan

In 2020, almost three-quarters (73%) of practitioners believe the regulatory focus on culture and conduct risk will increase the personal liability of senior managers. This increases to 77% among G-SIFIs. Regionally, 94% of firms in the Middle East and 91% of firms in the UK expect the regulatory focus on culture and conduct risk will increase the personal liability of senior managers. At the other end of the spectrum just more than one-fifth (21%) of firms in the United States do not expect the regulatory focus on culture and conduct risk to increase the personal liability of senior managers.

Respondents reported that firms are taking a range of actions and practical steps to offset the risk of potential personal laiblity. The most prevalent investment is in an enhanced regulatory training programme, with two-thirds (66%) of firms choosing to build or refresh skills. Other measures include the greater use of attestations, though here the disparity between all firms and G-SIFIs is apparent, with one-third (31%) of G-SIFIs reporting increased attestations as opposed to almost half (43%) of the wider population of firms. Firms have also implemented a company-wide decision register together with requirements to have a personal archive of evidence.

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: New decade, new challenges, by Susannah Hammond and Mike Cowan

The practical mitigants being deployed to help manage personal regulatory risk are highlighted in the three key skills now seen as essential for an ideal compliance officer. Paramount is the need for subject matter expertise. In a fast-moving regulatory environment this is no small undertaking for compliance officers. It is not just a question of knowing that the rules, requirements and expectations have changed; compliance officers must also know what those changes mean in practice for the firm, its senior managers, its business activities and its customers.

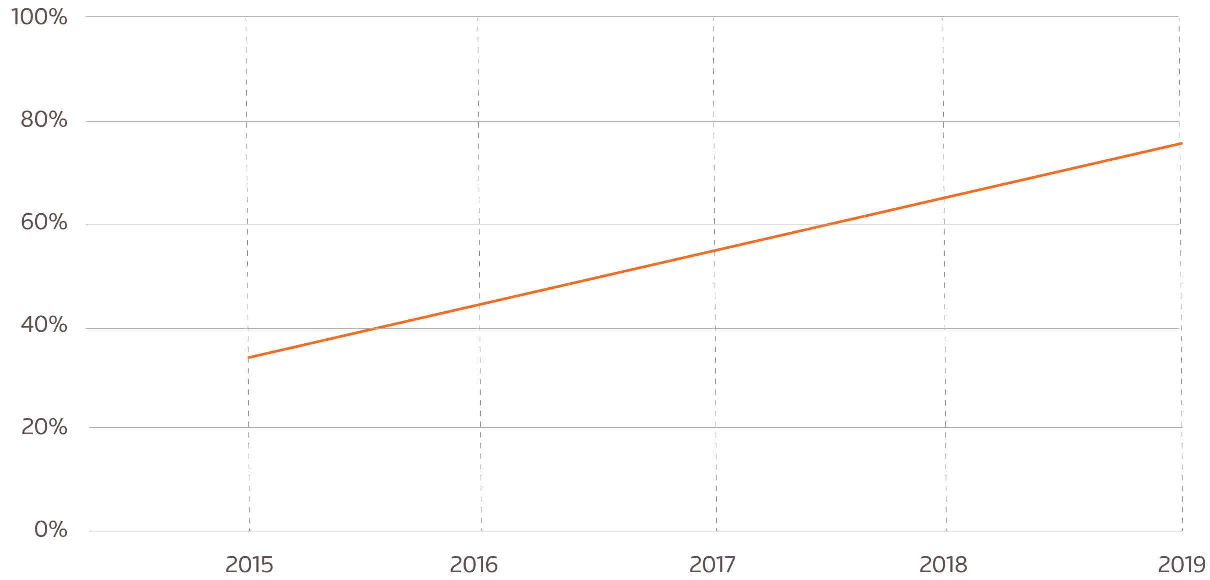
Another critical element of the polymath requirement for compliance officers is the ability to communicate and influence, combined with the required integrity. The extra skills of experienced talented compliance officers will become even more valuable as the more rote compliance tasks begin to be undertaken by regtech solutions. Equally, when it comes to the approach needed to handle culture, conduct risk and personal liability, a skilled compliance officer is an essential part of a firm's regulatory-risk management.

What are the three key skills required for an ideal compliance officer in 2020?

Source: Thomson Reuters Regulatory Intelligence – Cost of Compliance: New decade, new challenges, by Susannah Hammond and Mike Cowan

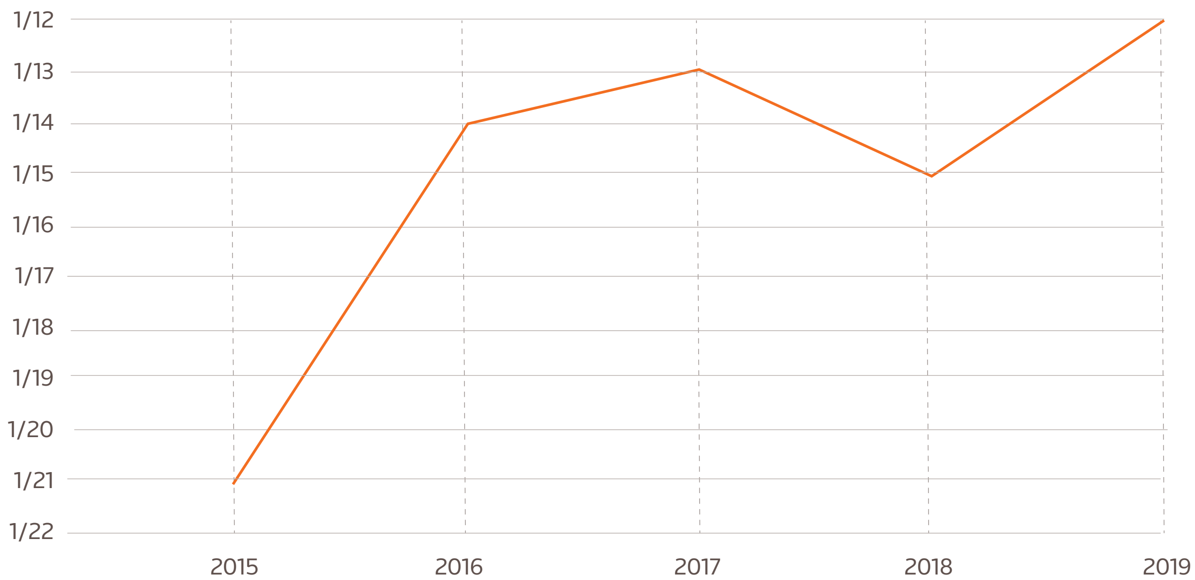
The findings of the 2020 cost of compliance report are backed up by the empirical evidence provided by Corlytics Ltd., a regulatory risk intelligence firm. Corlytics works with global regulators, financial institutions and their advisors to provide data and analytics to inform future risk management.

Individual Liability: % of enforcement cases against individuals



Source: © Corlytics 2020 (Based on Corlytics data tracked from the FCA, ASIC, FINRA and MAS)

Control failures: Frequency of enforcement where training identified as a control failure



Source: © Corlytics 2020 (based on FCA, NYDFS, ASIC & HKSFC cases where controls are cited)

Technology and cyber risk

"It is the responsibility of the board and senior management to ensure that cyber security is embedded in their firm; this should be achieved through a combination of raising awareness, building resilience and enhancing capabilities."

Central Bank of Ireland, thematic inspection of cyber-security risk management in asset management firms, March 2020.

In Q1 2020, TRRI published its fourth annual report on fintech, regtech and the role of compliance[4]. The report concluded that the financial services industry has much to gain from the effective implementation of fintech, regtech and insurtech, but numerous challenges must be overcome before the potential benefits can be realized. Investment continues to be needed in skills, systems upgrades and cyber resilience before firms can deliver technological innovation without endangering good customer outcomes. An added complication is the business need to innovate. while looking over one shoulder at the competitive threat posed by big technology firms.

The last year has seen many technology start-ups going into liquidation and far fewer new start-ups getting off the ground. Solutions need to be practical; providers need to be careful not to over-promise and under-deliver and, above all, developments should be aimed at genuine problems and not be solutions looking for a problem.

There are nevertheless considerable benefits to be gained from implementing such solutions. For risk and compliance functions, much of the benefit may come from the ability to automate rote processes with increasing accuracy and speed. Indeed, when 900 respondents to the 10th annual cost of compliance survey report were asked to predict the biggest change for compliance in the next 10 years, the most popular response was automation.

Technology and its failure, or misuse, is increasingly being linked to the personal liability and accountability of senior managers. Chief executives, board members and other senior individuals will be held accountable for failures in technology and should therefore ensure their skills are up to date. Regulators and politicians alike have shown themselves to be increasingly intolerant of senior managers who fail to take the expected reasonable steps with regards to any lack of resilience in their firm's technology.

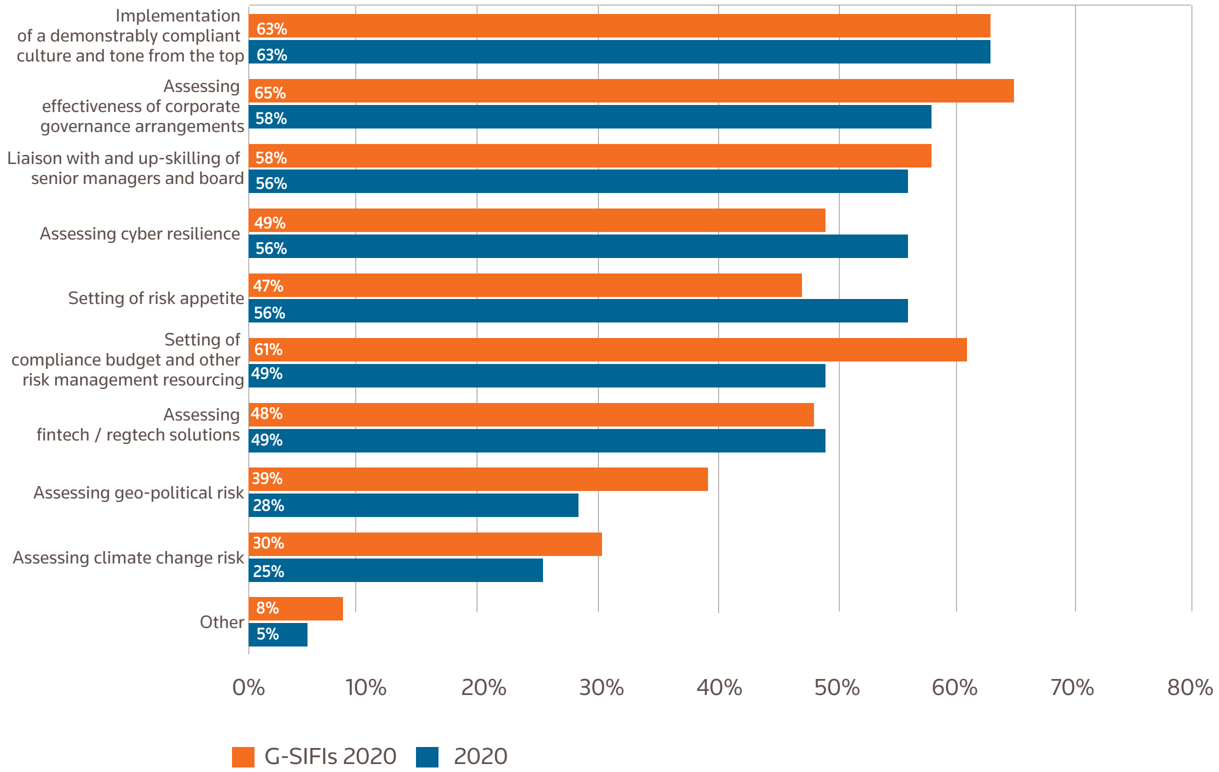
One specific concern is cyber risk. Not only is compliance involvement expected to continue to grow (up from 48% in 2016 to 56% in 2020) but the potential costs vary widely. In February 2020, the European Systemic Risk Board published a report which estimated that the total cost of cyber incidents for the world economy in 2018 ranged between $45 and $654 billion.

"Coming to cyber and [operations] in particular, I am not aware and I do not think we have rejected anyone on those grounds alone. However, we have made a point to a number of boards that we think they need to build up their expertise in this area, as indeed many other institutions and we ourselves are building it up. That is a concern about the degree of experience at the top of these institutions in that particular field."

Sam Woods, deputy governor, prudential regulation and chief executive of the UK Prudential Regulation Authority, during oral evidence in January 2019 to Treasury Select Committee on the work of the PRA

4 http://financial-risk-solutions.thomsonreuters.info/fintech-regtech-complinace-report-2020

Over the next 12 months I expect more compliance involvement in...



Source: Thomson Reuters Regulatory Intelligence – Cost of Compliance: New decade, new challenges, by Susannah Hammond and Mike Cowan

Respondents are also expecting more compliance involvement in assessing fintech and regtech solutions, but the deployment of any solution is dependent on the firm's IT infrastructure. Many financial services firms' legacy IT systems still need to be updated.

In October 2019, the UK Treasury committee published a second report on IT failures in the financial services sector.

"Firms are not doing enough to mitigate the operational risks that they face from their own legacy technology, which can often lead to IT incidents. Regulators must ensure that firms cannot use the cost or difficulty of upgrades as excuses to not make vital upgrades to legacy systems. Given the potential for short-sightedness by management teams, if improvements in firms' management of legacy systems are not forthcoming, the regulators must intervene to ensure that firms are not exposing customers to risks due to legacy IT systems. When firms do embrace new technology, poor management of such change is one of the primary causes of IT failures. As time and cost pressures may cause firms to cut corners when implementing change programmes, the regulators must adopt a proactive approach to ensure that customers are protected," the report said.

The requested "proactive approach" is expected to involve personal accountability for senior individuals. Given the proliferation of personal accountability regimes it is unlikely that the UK will be the only jurisdiction seeking to hold senior managers liable for IT failures.

"National authorities need to be able to do what is right in their jurisdiction rather than rigidly applying identical requirements country-by-country. [.....] However, these local solutions can cause higher compliance costs for firms operating internationally. The need for a local element shouldn't be used as a blanket justification for local implementation that leads to inconsistent outcomes or increased costs for firms or their clients."

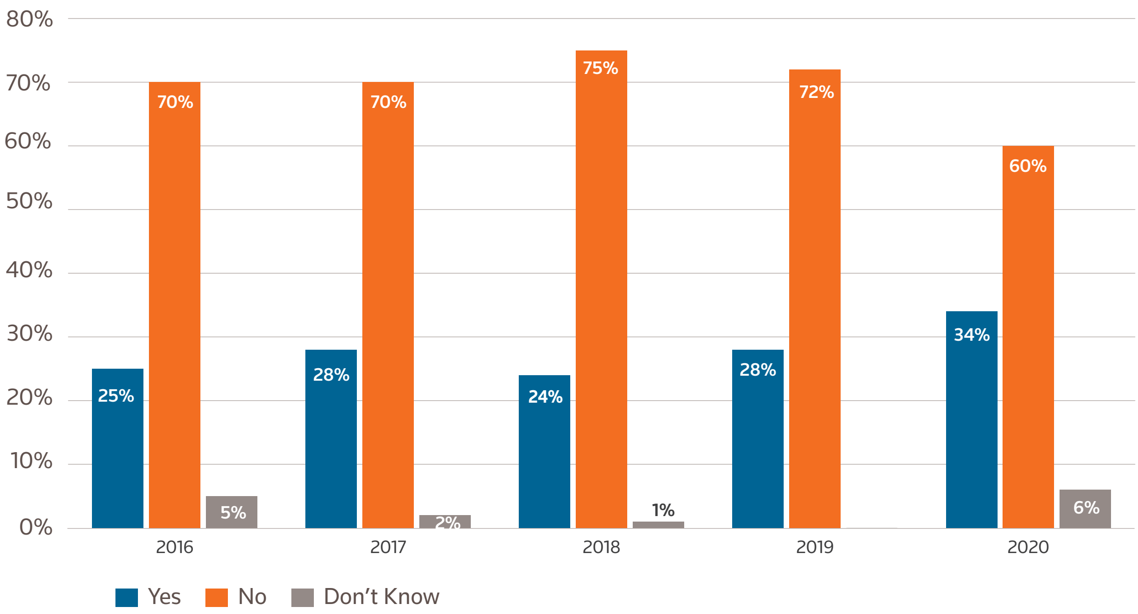
Nausicaa Delfas, executive director of international at the UK Financial Conduct Authority, January 2020

Outsourcing

This year's survey showed a marked increase in the number of firms which have outsourced some of their compliance functionality. The overall percentage of firms which outsource all or part of the compliance function has increased to 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.

Reasons for outsourcing include the need for additional assurance on compliance processes (54%), cost (43%) and lack of in-house compliance skills (34%). Despite a slight change in priority, these have remained the top three drivers for outsourcing since the question was introduced. Those who selected "other" reasons for outsourcing cited auditing; third-party due diligence, enhanced due diligence, anti-money laundering (AML) monitoring; KYC processes and client on-boarding.

Do you outsource any or all of your compliance functionality?



Source: Thomson Reuters Regulatory Intelligence – Cost of Compliance: New decade, new challenges, by Susannah Hammond and Mike Cowan

With the development of technology and refined working practices, financial services firms have outsourced tasks more often in recent years. Compliance functions could use outsourcing for a range of activities:

- **Compliance monitoring –** This aligns itself to the "auditing" services that accountancy firms offer. Smaller firms, instead of employing compliance monitoring expertise directly, will outsource this function to get both cost and skills benefits. The practice can also protect the independence of the compliance monitoring function.
- **ID and sanctions checking –** More firms are using credit reference agencies or dedicated credit data firms to vet new and existing customers. The credit reference agency generally has a wider range of data sources to be able to identify and verify a customer. Many such firms will also couple this ability with access to international sanctions lists.
- **Mandatory training –** All firms will have some form of mandatory training programme that takes staff through the basic elements of legal and regulatory subjects such as AML requirements, health and safety legislation, data protection legislation and company policy on ethics and conduct. In the past, firms may have had internal training departments to develop these packages. In recent years, however, independent training providers have developed generic packages which cover the main points in a range of subjects and are suitable for many firms.
- **Financial promotions –** It may be that compliance functions have outsourced the approval of financial promotions to external legal practices. Where time or expertise is unavailable to do this, it may be more cost-efficient to employ external legal resource rather than recruit that expertise. Many firms will already have access to some form of legal counsel and where this is an external legal practice it may be that approving financial promotions is included as part of wider contract.

- **Horizon-scanning –** The identification of upcoming regulatory changes is another area where firms may have outsourced some or all of the internal process. The quantity of regulatory material produced in the last few years has made this a costly exercise for compliance departments, and more external organizations are providing regulatory information to firms. This still leaves the analysis, circulation and agreement and tracking of actions for internal teams, but even some of these disciplines can be made easier with external technology.

Outsourcing is seen as a risk by many regulators, and guidance is in place in most jurisdictions. For example, in the United States the Federal Reserve has its own guidelines on outsourcing. The Monetary Authority of Singapore has issued guidelines on outsourcing setting out its expectations. The Australian Prudential Regulation Authority requires that "all outsourcing arrangements involving material business activities entered into by an APRA-regulated institution and a head of a group be subject to appropriate due diligence, approval and ongoing monitoring". In the UK the FCA has a series of rules (SYSC 8) in its systems and controls sourcebook.

Outsourcing technology is seen as a particular risk, with the use of the cloud as a focus for regulatory guidance. The EBA issued recommendations on cloud outsourcing in 2017 and APRA has updated its guidance in recent years.

This level of regulation increases the risk of censure should firms get it wrong. In 2019, the UK FCA and PRA fined R. Raphael & Sons Plc £1.89m for failing to manage its outsourcing properly between April 2014 and December 2016, and the Central Bank of Ireland fined JPMorgan Administration Services (Ireland) Ltd 1.6m euros in respect of regulatory breaches relating to the outsourcing of fund administration activities.

For compliance functions, outsourcing is a good way of leveraging expertise from already stretched budgets, but care should be taken to ensure that outsourced contracts enable compliance with all relevant rules.

COVID-19 – What good or better practice looks like for managing the continuing uncertainty

"... for part of the responsibilities of macroprudential policy is to protect the economy from the madness of people".

Mark Carney, former governor of the Bank of England, March 2020

The novel coronavirus is having a profound impact on financial services firms, their employees and customers and the wider world. Firms need to be prepared for all eventualities. The minutiae of a firm's exposure to the virus or other preparations will be firm-specific but there are some common considerations.

The particular ramifications of geopolitical and other uncertainties cannot be planned for, but many can be mitigated by training and awareness, together with an effective suite of tested policies and procedures. The point gains even sharper focus with the proliferation of accountability regimes.

Firms and their compliance officers must acknowledge uncertainty, and their ability to foresee or offset events may be limited. That should not stop them from developing policies which enable them to respond with agility.

Firms may wish to consider creating stand-alone policies, or they may decide to align their approach to the one in place for handling dawn raids or other surprise events. As with all policies it should be documented, and all members of staff should be familiar with its contents. The board and all senior managers should be briefed in detail on the policy and asked to confirm their understanding of the agreed approach. In addition:

- **Disaster recovery and business continuity -** Plans should be kept under review, and firms should test their efficacy. Any dependencies should be assessed carefully to consider whether the back-ups (whether IT, physical location or otherwise) could themselves be affected by government COVID-19 response measures. Some firms are required to build and maintain "living wills", for which the same criteria would apply.
- **Data -** Many firms process data in certain locations and in a range of jurisdictions. Firms should have a central record of exactly what data is held, where, and on what basis. This will help ensure compliance with data protection requirements and will improve accessibility and retrieval. Should a swift and comprehensive repatriation of data be required, firms must know exactly what is held, where, and under what terms.
- **Outsourcing -** Firms should keep all outsourcing agreements under review. They should also keep all entities (even those in the same group structure) to which processes or other activities are outsourced under review to ensure that — with shifting measures to deal with COVID-19 and evolving geopolitical realities — the outsourcing remains strategically viable. As the previous section has shown 34% of firms outsource some or all of their compliance functionality in 2020. Compliance officers must therefore ensure they have line of sight to all outsourced compliance functionality and a back-up plan if that functionality needs to be reallocated, potentially at speed.
- **Staffing concerns -** The shifting political approaches to managing the virus risk have put a spotlight on both where employees work and the increasing likelihood that they 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 officer will need to be in the loop, for example, to keep regulatory registrations up-to-date and to ensure the firm is not left with any undue long-term gaps in key roles and skill sets.
- **Organization charts -** All firms will have an organization chart setting our who reports to whom. Many firms also capture, explicitly, who is responsible for what in the business. Those firms which do not already document this may wish to begin to build the next level of detail into their organization charts. It is much simpler for firms to respond to events if there is immediate clarity as to who is in a position to take the required actions.
- **Cyber-attacks -** There has already been an increase in cyber risk, with phishing in particular growing alongside the need to work remotely. Firms can bolster their defenses by seeking to ensure company-confidential, sensitive client or other important files are securely and regularly backed up in a remote, un-connected back-up or storage facility. If the firm has been a victim of, say, a ransomware attack it should use all possible means to swiftly regain access to IT systems and client files. This may mean paying any ransom demanded as a matter of urgency. The

follow-up action is then to learn all possible lessons to prevent a recurrence of the attack.

- **Communication -** A firm's communication policy should clearly state who should be contacted, and in what order. While the local compliance officer should be one of the first people contacted, senior managers up to the top of the firm should be included in the communication ladder. The firm's press office should also be high on the contact list, with an agreed holding statement as a minimum. Handling the PR of any potentially significant adverse event is a critical part of the process.
- **Communication with regulators -** Communication with regulators can take a couple of forms – in a single jurisdiction firms should consider the need to inform their financial services regulator of any substantive adverse event. Firms which operate in multiple jurisdictions should consider reporting any adverse event to the firm's lead financial services regulator.
- **Post-event review -** Detailed jurisdiction-specific policies may look great on paper but until they have been tested in an unexpected adverse event then there is no way to know whether they were fit-for-purpose. A post-event review should be used to refine the policy and to initiate a new round of training and awareness for the entire firm.

The response to the pandemic, and to the resulting geopolitical uncertainty, will be difficult for firms and their senior managers to handle but clearly documented and communicated policies should allow difficult situations to be managed as smoothly as possible.

There has been a chorus of responses from regulators on COVID-19 which can be summed up as hitting the "pause" button to enable embattled firms to focus on protecting good customer outcomes.

Bank and PRA supervisors will review their work plans so that non-critical data requests, on-site visits and deadlines can be postponed, where appropriate. This includes pausing the skilled persons Section 166 reviews relating to the reliability of banks' regulatory returns that were announced in October 2019. In doing so the PRA will have regard to the flexibility provided under the relevant regulatory regimes, for example in the Capital Requirements Regulation and Solvency II.

This will allow supervisory engagement to focus on the most important matters relating to financial stability, the safety and soundness of firms, and protection of policyholders, including the impact of Covid-19. In doing so, we will continue closely to coordinate our supervisory work on Covid-19, wherever possible, with the FCA and other authorities.

Statement from the Bank of England on COVID-19, March 2020

We are reviewing our work plans so that we can delay or postpone activity which is not critical to protecting consumers and market integrity in the short-term. This will allow firms to focus on supporting their customers during this difficult period.

Statement from the UK FCA on COVID-19, March 2020

...in the short term, EIOPA will limit its requests of information and the consultations to the industry to essential elements needed to assess and monitor the impact of the current situation in the market.

Statement from EIOPA on actions to mitigate the impact of COVID-19, March 2020

Our regulatory approach will continue to be risk-based and we will attempt to avoid any unnecessary regulatory burdens. In times like these, timely communication and cooperation between regulators and the regulated community is critical and cannot be stressed enough. The DFSA encourages all Authorised Firms to maintain active and regular contact with the DFSA and to approach the DFSA if they have specific queries or issues. Moreover, the DFSA expects all Authorised Firms to provide prompt notifications of any significant developments, events, or other matters reasonably expected to be reported to the DFSA.

Statement from the Dubai Financial Services Authority on COVID-19, March 2020

ASIC has immediately suspended a number of near-term activities which are not time-critical. These include consultation, regulatory reports and reviews, such as the ASIC report on executive remuneration, updated internal dispute resolution guidance and a consultation paper on managed discretionary accounts [...] By taking these actions, industry participants will be better placed to focus on their immediate priorities and the needs of their customers at this difficult time.

Statement from the Australian Securities and Investments Commission on COVID-19 challenges, March 2020

The CFTC has issued a series of temporary, targeted relief to designated market participants in response to the COVID-19 pandemic. These efforts are designed to help facilitate orderly trading and liquidity in the U.S. derivatives markets.

Statement from the US Commodity Futures and Trading Commission on COVID-19 related relief, March 2020

"...The Office of the Superintendent of Financial Institutions (OSFI) announced a series of regulatory adjustments to support the financial and operational resilience of federally regulated banks, insurers and private pension plans. This includes adjusting a number of regulatory capital, liquidity and reporting requirements.

These measures, along with the delays of previously planned regulatory changes, are designed to help reduce some of the operational stress on institutions. They also ensure that OSFI's guidance is appropriate for these extraordinary circumstances while remaining risk-focused and forward-looking."

Statement from the Office of the Superintendent of Financial Institutions (Canada) on regulatory flexibility to support COVID-19 efforts, March 2020.

Closing thoughts

"One of the key risks remains the lack of a consumer-focused culture within the financial services sector. So it won't come as a surprise to hear we will continue to hold boards and leaders to account for embedding effective behavior and cultures."

Derville Rowland, director general, financial conduct at the Central Bank of Ireland, January 2020

2020 has already been unprecedented in terms of the chaos and disruption caused by the COVID-19 pandemic. The aftermath of the 2008 financial crisis saw regulators and firms put in place strong frameworks for managing capital and liquidity. It saw a push from the regulators to strengthen operational resilience plans and move away from too-big-to-fail. Alongside these prudential measures there was a focus on culture and conduct. This has proved to be more difficult, because it is less tangible than a balance sheet, but many firms have worked diligently to put in place appropriate cultural and conduct arrangements.

This crisis will test adherence to those arrangements just as it has been testing firms' operational and prudential resilience plans.

Those firms which previously took a simple tick-box approach to culture and conduct risk are likely to be vulnerable to risky behavior and the associated poor customer outcomes as the ramifications of the virus play out. Indeed, even the strongest of firms will feel the impact of COVID-19, but those who have built a firm-wide risk-aware approach to culture and conduct risk will emerge ahead of those who simply paid lip service.

This year's survey results pose some challenges to firms' ability to demonstrate a risk-aware approach to culture and conduct. The impact of tightening of risk and compliance budgets, regulatory and cultural change and the possibility of increasing personal liability were all evident this year.

Taken as a whole, the results of the 2020 survey indicate an inflexion point for financial services firms, with all the hallmarks of the cycle being seen to turn again. It is too early to tell the how the virus will influence that inflexion but already firms are asking for the postponement of various regulatory initiatives so they can focus on managing events.

Firms need to appreciate that in 2020 it would be a potentially very unwise time to reduce the budget available for risk and compliance. There will be competing priorities, but in troubled times firms need a well-resourced, highly skilled compliance function more than ever. If possible, firms should consider investing in skills at all levels, in operational resilience (particularly in terms of IT infrastructure) and in embedding their approach to culture and conduct risk.

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