

Doing More With Less: The New Compliance Paradigm

BY ALAN K. HALFENGER

Recently, I had dinner with a good friend, who is the Chief Compliance Officer (CCO) and General Counsel of a mid-size financial services firm. As we waited for our table, he told me how frustrated he was over an internal meeting in which the discussion focused on the fact that market downturn would force his firm to look for opportunities to reduce headcount and optimize and reallocate costs. Specifically, the two new compliance positions that had been budgeted for 2016 (one a replacement and one for an additional person to cover AML and international issues) were on the chopping block.

However, what really bothered the CCO was not the headcount reduction, but the commentary on his firm's legal and compliance functions. During the meeting, it was said several times that compliance was critical to the firm and that the firm wanted to take on no regulatory risk. However, the necessity of the additional compliance positions was doubted because they appeared to be redundant. The conversation concluded with a "rah-rah" speech about "doing more with less." Although I have frequently heard stories like this, it is just as common (if not more common) to sit with COOs and Managing Partners, and hear them complain about the ever-upward spiral of compliance costs.

The purpose of this article is to suggest a new paradigm for thinking about compliance costs which, if implemented wisely, will drive how firms spend money protecting themselves on regulatory matters and, more importantly, will stop many of the budget battles being waged.

In order to make these real changes, CCOs will need to implement three key steps in order to adopt this paradigm:

1. Change your approach to staffing and costs;
2. Work harder on educating management about the true cost of compliance and, more importantly, non-compliance; and
3. Act as a true steward of the firm's balance sheet by implementing cost-saving strategies.

Step 1: Change how you approach your budget

The first step is to change the process around the almost constant increases in headcount and firm compliance costs. Despite all of our lobbying and industry-to-regulator conversations, new regulations are issued and the demands on compliance continue to grow. All too often this triggers an immediate knee-jerk reaction that results in adding staff, even though the full impact of the new rule is not yet fully understood. These requests are often off budget cycle and ad hoc in nature. While it is important to meet these regulations, the solution cannot always be to add headcount, and CCOs must find creative ways to comply.

CCOs should slow down, wait and see if and when the rule is implemented, see what consulting and law firms are saying about the rule and, most importantly, see what everyone else is doing. All too often CCOs run up large professional services bills trying to identify the impact of a pending regulatory change and immediately hire an expert in that particular subject area, just as the market is hitting its peak for that skill set. CCOs often come to realize that after the initial impact of the rule change, they do not need a full-time dedicated resource. Then they are forced to deal with a highly compensated professional who is not really needed. The CCO is often forced to use this resource for other tasks and projects that could be performed by a less expensive resource. When you consider this scenario, it is no surprise that management often feels compliance staffing is reactionary and not well thought out.

Whether or not it is required by senior management, you should have a budget and a compliance plan, neither of which are difficult to implement. For example, consider establishing an annual first quarter process that begins with the completion of the firm's annual compliance program review. At the conclusion of the annual review, update your risk and conflicts matrix to include all major new business initiatives (conduct meetings with key firm personnel and review the new product committees' forward docket) and regulatory changes (sift through industry newsletters on what to expect in the coming year). Weigh and prioritize the issues, and categorize the various projects into "new projects" or "business as usual." Then, determine the expected budget for each project. In particular, technology spending should have a detailed proposal, and task and volume budgets should be developed for day-to-day tasks.

For example, say a firm knows that it wants to review approximately 1% of the emails in its system, and that task currently requires two analysts. However, growing the firm's overall headcount by 20% will increase email volume. If the compliance team models the capacity of a surveillance analyst, using this budgeting approach will help firms predict when they need to add staff, and where someone has slack and can absorb the incremental work. All of this is built into an overall budget that is then presented to management and the oversight committee. Barring a crisis, headcount should never need to be added off-cycle.

As a result of this process and the ongoing dialog with management, compliance managers develop a supportive relationship with management and encounter fewer headcount battles. CCOs of

About the Author

Alan K. Halfenger is a Partner at ACA Compliance Group. www.acacompliancegroup.com. He can be reached at ahalfenger@acacompliancegroup.com.

This article was originally published in the April 2016 issue of NSCP *Currents*, a professional journal published by the National Society of Compliance Professionals. It is reprinted here with permission from the National Society of Compliance Professionals. This article may not be further re-published without permission from the National Society of Compliance Professionals.

small firms may not be able to complete this detailed process, but there is no reason that a simplified model cannot be implemented with the help of the firm's corporate finance staff. Adding headcount is not always the silver bullet, and decisions based on solid planning are always easier to defend.

Step 2: Educate senior management

When you eliminate the ad hoc headcount requests and develop a budget and a plan, you now have to support and explain it to management. If you have sought their input throughout the budgeting process, this step is easy. You need to "sell" or educate management on the risks, costs and need for mitigation. One of the key roles of a CCO is to advise senior management on the risks of their business and the key regulatory expectations. The most successful CCOs always present extensive benchmarking information as part of their presentations. This benchmarking may be done on narrow issues, such as when CCOs are urging senior management to implement a more restrictive personal trading policy (it always helps when you can say your peers have already migrated to the more restrictive rule you are proposing.) More importantly, it is critical for management to understand where the industry is on broader issues, such as the size and budget of other compliance programs in not only peer firms, but firms larger and smaller.

Step 3: Be the steward

The next step in this process is for management to fully understand the costs and risks related to non-compliance. As part of their compliance training, many firms talk about what enforcement actions have incurred. The CCO must present this to management as part of the planning and education process. But it should not stop at the headlines, because the costs of negative regulatory actions have a deeper and broader impact. As a CCO, one of my biggest allies in this area was our head of sales and marketing. His concerns were always straightforward, as in, "How do I explain this issue and crisis to clients and investors?"

When these reputational risks are combined with out-of-pocket legal expenses and management time is often dedicated to enforcement actions, the case for proactive compliance spending and testing gets easier. It is critical to remember that the selling of fear almost always backfires in the long term because the scary event does not always occur, and therefore not only can headcounts be reduced, but your credibility as a trusted advisor protecting the firm suffers.

CCOs not only have to think like a regulator (or, as I have been described, a cop), but they must start thinking like a business partner. As mentioned above, the credibility of the CCO as a trusted advisor is critical to the overall success of the program. No place is this more clearly demonstrated than when a new issue rule or expectation is raised and the CCO can say, "We have thought about this and we can absorb this into our existing program," or, "We have identified several ways to address this issue and we have found an efficient (cheaper) way to get it done."

Tools of the trade

I have talked to dozens of CCOs in the last couple of months, and I have heard one consistent message: "I need more resources." Since this solution is often not possible, the conversation quickly turns to, "How do I get it done?" I have found that there are three primary drivers that we can focus on:

1. Implement technology to support day-to-day operations

Deploy technology solutions in key processing areas. Examples of this include personal trading, regulatory reporting, marketing materials tracking, and trade surveillance. These solutions, when integrated into a holistic compliance solution, allow a CCO to track risks, publish compliance rules, and automate testing and issue tracking. This can have a game-changing impact on the development of a compliance program. While the process of selecting and implementing these technology solutions can actually add stress and increase workloads in the short term, the long-term impact is huge. It should be noted that technology solutions have often been packaged and decreased in cost in recent years, allowing smaller firms to take advantage of the benefits.

2. Find a third-party partner to help

The second major trend is outsourcing and partnering with consulting firms and other service providers to reduce the costs of certain processes. There are a large number of compliance tasks that are operational in nature or small enough that they can be done more cheaply, and often better by a third-party provider. Many CCOs are looking for help in a number of areas, such as: reviewing emails; monitoring data security and data loss prevention programs; processing OFAC and KYC information; social media monitoring; personal trading and the review of advertising. While these are all critical to the success of the firm and its compliance program, many CCOs are stretched too thin to sweat the small stuff. There are many new solutions for this to be accomplished in a high-quality, cost-effective manner. Anywhere a CCO can get additional help, support, and leverage is a good thing for the compliance program.

3. Invest in highly-trained compliance professionals

The final trend is in the area of staffing. The market for experienced compliance officers and staff has gone through the roof. Although this relentless upward spiral has benefited many of us personally, not to mention many recruiters, it has not always served our firms and their clients well. Many compliance programs have been forced to look to alternative sources for smart, well-trained staff. In recent years, there have been a number of universities and law schools that have developed certificates and programs in regulatory compliance. Larger firms have joined with these programs to invest in the training program to create pipelines of new and junior compliance staff.

Many of the programs I have managed have benefited from close partnerships with finance and operations. Not only was I able to shift some testing and control work to them, but these departments often have larger staffs and are a good source of smart, hard-working analysts. We have also identified other alternative sources for high-quality staff, but it is critical that money is reinvested into training and development for these newly minted compliance officers.

Like high-quality health insurance, a world-class compliance program does not come cheap, but it does not have to be bloated and inefficient. CCOs must continue to mitigate regulatory risk in addition to identifying opportunities to spend money wisely and develop the business and budgeting skills necessary to fulfill their duties as officers of their firms. Many of the processes identified in this article can be tailored to any size firm and can significantly improve its performance. CCOs should realize they are not alone in this struggle and start the conversations needed to develop efficient and cost-effective compliance programs at their firms. ★