



Compliance function in Banks.  
Regulator's perspective.



# Introduction

- Regulation is increasingly becoming a complex business.
- There are fast paced technological developments and financial innovations.
- Market players are always a step ahead of the regulators who struggle hard to catch up.
- So far evolution of regulation has been reactive.
- Regulation needs to move to proactive role and outguess and outrun the regulatee.
- Regulator and regulatee are not in an adversarial role.
- A stable banking system is in the interest of all.
- In an unstable scenario everyone suffers.



# Introduction... contd.

- The cost of resolving a banking crisis can be very steep.
- It is therefore important that everybody plays by the rule.
- We however do not live in an ideal world.
- Organisations are driven by human beings ultimately with all their strengths and weaknesses.
- Hence the need for someone to be present with a red flag.



## Why is regulation so important for banking?

- Banks are special.....?
- Because banks hold un-collateralised deposits of the public.
- Banks are highly leveraged institutions.
- Banks create credit and are the source of liquidity in the system.
- Banks drive real economy.
- Entry norms for the banks are highly restrictive.
- Various safety features are sought to be built in the banking through the law and prudential regulations.

# Compliance Universe in Banking



- The primary source of regulation for banks is the Banking Regulation Act 1949 which stipulates RBI as the banking regulator.
- Besides there are other acts mainly RBI Act, FEMA, PMLA which impact business of banking.
- Then there are regulatory guidelines/directives etc. issued by RBI.
- Standards and codes set by BCSBI, FIMMDA, FEDAI and IBA.
- Listing agreements with SEs.

# Compliance Universe .....contd



- Policy guidelines framed by the Board of Directors
- Internal codes of conduct & governance applicable to the staff and managerial personnel
- Codes for management of conflict and interests.
- Codes for fair treatment of customers.
- Embracing broader standards of integrity and ethical conduct



# Compliance Risk

BCBS Paper of 2005 has given a definition of Compliance Risk:

*“Risk of legal or regulatory sanctions, material financial loss or loss of reputation a bank may suffer as a result of its failure to comply with laws, regulations, rules, related self regulatory organisation standards and codes of conduct applicable to banking activities”*

Stripping the definition of legalese it only means that if you don't comply you would face regulatory sanction, legal action, penalties and loss of reputation



# Evolution of compliance function

- Ghosh Committee on Frauds and Malpractices in Banks-1992.
- Further guidelines on the role of Compliance officer issued in 1995.
- GM in charge of Audit & Insp to be designated as Compliance officer reporting to CMD and qtlly cert on compliance-1997 (withdrawn in 2000).
- BCBS 'Committee on Compliance & the Compliance function in banks' 2005.
- WG setup by RBI in 2005.
- Final guidelines issued by DBS on 20.4.2007



# The Guidelines

- Compliance starts at the top.
- Compliance should be part of the culture of the bank.
- Organisation of compliance function can be different in diff organisations:
  - ✓ Large-located within operating business lines
  - ✓ Smaller - Located in one unit.
- Organisation of Compliance function should be aligned with risk management strategy & structure
  - ✓ Part of Operational risk mgt.
  - ✓ Separate but with coop on compliance function.



# The Guidelines .....contd

- It should be independent & sufficiently resourced.
  - ✓ Clear responsibilities
  - ✓ Activities subject to periodic review by IA.
- Responsibility of BOD for overseeing the Compliance risk:
  - ✓ Approve Compliance policy.
  - ✓ Formally document establishment of Comp function.
- Sr. Mgt. to be responsible for implementation of policy:
  - ✓ Communication
  - ✓ Dissemination



# The Guidelines .....contd

- Prepare a document embodying the policy framed by BOD containing principles & processes for identification and management of compliance risk
- At least once a year assess main compliance risk facing the bank and plans to manage them
- Such assessment should address any shortfall of policy, procedure, implementation or execution
- Reporting to BOD of failures and working of the function
- Taking measures against any breach of policy.



# Compliance Function Principles

- Independence: Formal Status:

Compliance document should address the following:

- ✓ The role and responsibility.
- ✓ Measures to ensure independence
- ✓ Relationship with RM and Audit functions
- ✓ In case of distributed responsibility, allocation among depts.
- ✓ Right to obtain and obligation to supply information
- ✓ Right to conduct investigation for breaches
- ✓ Right to express freely & disclose findings to sr. mgt.
- ✓ Formal reporting obligation to senior management
- ✓ Right of direct access & communication to BOD

# Compliance Function Principles ...contd



## Head of Compliance

- ✓ An executive or senior staff member as HOC with overall responsibility to coordinate, identify & manage compliance risk & supervise activities of compliance staff
- ✓ Nature of reporting line to HOC by staff
- ✓ HOC not to have direct business line responsibility
- ✓ Head of Bank & BOD should be informed when HOC leaves with reasons

# Compliance Function Principles ...contd



- Conflict of interest:
  - ✓ HOC should undertake only compliance activities & nothing else as far as possible
  - ✓ Remuneration of compliance staff should not be related to performance of business line
- Access to information and personnel:
  - ✓ Right to communicate with any staff & access to records
  - ✓ Free to carryout its functions and conduct investigation for breaches
  - ✓ Free to report to sr. mgt. on any irregularity or breaches
  - ✓ Report annually or more frequently to BOD

# Compliance Function Principles ...contd



- Resources:
  - ✓ It should have sufficient resources to carry out its functions
  - ✓ It should have adequate and skilled staff
  - ✓ Should have provision for regular education and training
- Responsibilities:
  - ✓ Should assist sr. mgt. in managing effectively the compliance risk faced by the bank either centrally or distributed across different depts.

# Compliance Function Principles ...contd



- Advice senior management on compliance rules, laws and developments
- Guidance and Education of staff on compliance issues and contact point for queries
- Preparation of documents such as manuals, codes of conduct etc
- Identification, measurement and assessment of compliance risk
- Monitoring testing and reporting
- Statutory responsibility and liaising
- Compliance program

# Compliance Function Principles ...contd



- Relationship with internal Audit:

The scope and breadth of the activities of the compliance function should be subject to periodic review by IA function.

- Cross border issues:

Banks should comply with the applicable laws and regulations in all jurisdictions of their business consistent with local legal and regulatory requirements.

# Some (in)famous instances of Compliance failure

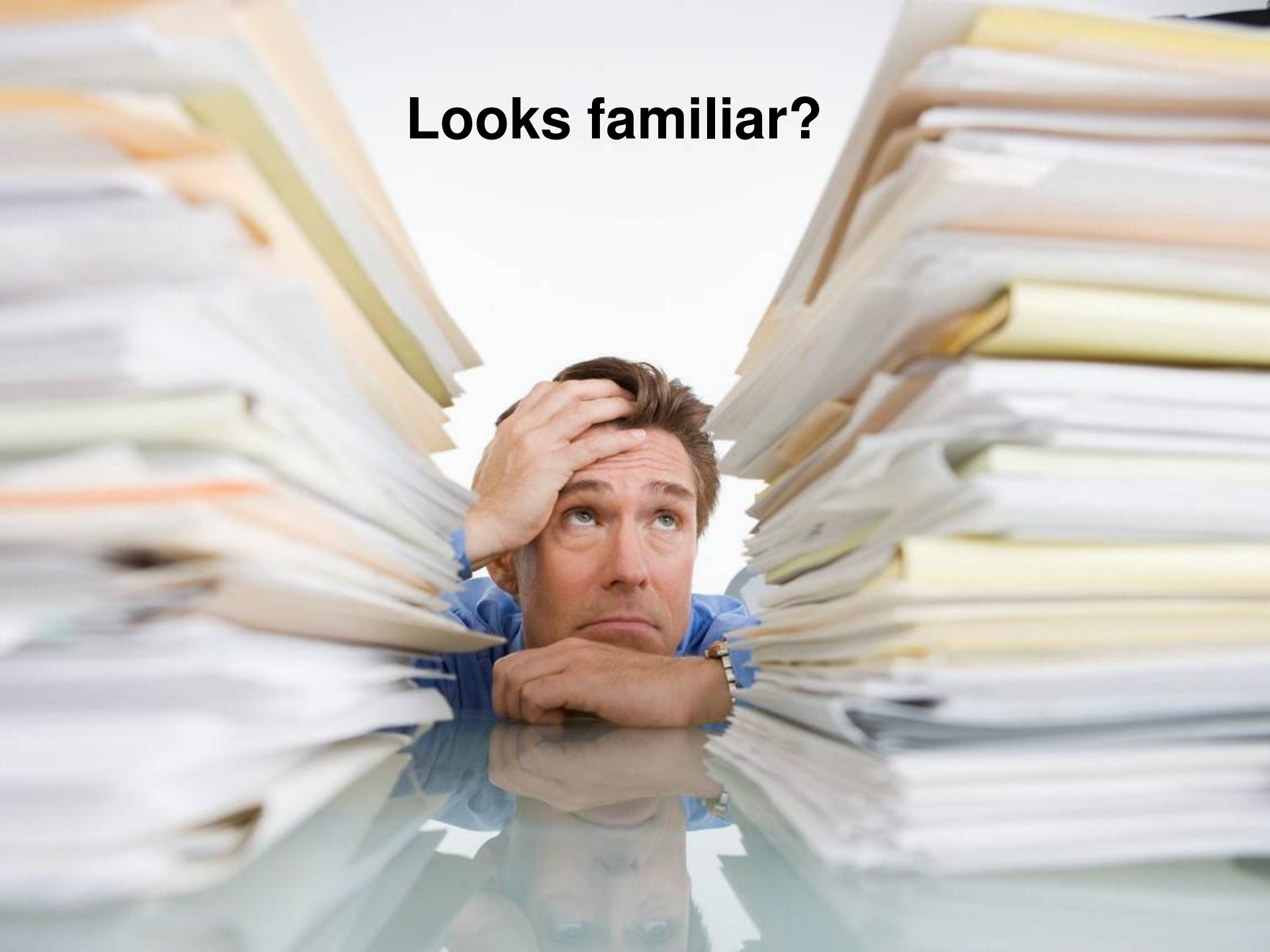


- Security scam of 1992 total cost to the system Rs 5000 cr.
- Mexican Cartel's money laundering proceedings against HSBC in US. Cost to the bank \$ 1.92 billion.
- Standard Chartered Iranian money laundering case in US. Cost to the bank \$327 million

Challenges going forward:

- Dodd Frank Wall Street Reform Act
- FATCA

**Looks familiar?**





Thank you

Questions?