



## REGULATORY UPDATE 5/2009

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This is the first in a series of articles on the **Role of the Compliance Function and Compliance Officer**. This article appears in Newsletter 5/2009 (July 2009) at <http://www.complianceireland.com/Newsletter.html>. Other articles on this topic will be published in the future. You can subscribe free of charge to future Newsletters by sending an email to [news@complianceireland.com](mailto:news@complianceireland.com).

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**Compliance Ireland** runs full day courses on the Role of the Compliance Officer which covers all the essential elements of establishing the Compliance Function. See <http://www.complianceireland.com/ICONI&I.html> for more details.

### The Role of the Compliance Function and Compliance Officer in Ireland

- *“You are the eyes and ears of your firms when it comes to meeting corporate responsibilities. You need to be involved in strategic issues from the earliest stages and to be alert to new issues on the horizon. In a principles-led system the Financial Regulator cannot examine or vet every move and every file. We must rely on the infrastructure put in place in the firm to ensure compliance and on the independence and professionalism of the compliance officer in ensuring that this infrastructure is appropriate, robust and working effectively. That is the implied contract between the compliance officer and the Financial Regulator”.<sup>1</sup>*

Many Compliance Officers in Ireland are still digesting the meaning of the above words by the former Chief Executive of the Financial Regulator, Patrick Neary, in his speech to the Association of Compliance Officers in Ireland (ACOI) back in November 2007. Since that time the regulatory structures of many nations, including that of Ireland, are heading into

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<sup>1</sup> The Regulator’s focus for the Next Three Years - *The Contract between the Financial Regulator, the Compliance Officer and the Regulated Firm* - Address by Patrick Neary, Chief Executive, Financial Regulator to The Association of Compliance Officers in Ireland, November 2007 (see page 3)

unprecedented regulatory reform, the likes not seen since the fallout from the Great Depression. In the United States, President Obama unveiled his vision for US regulatory reform on 17 June 2009. The United Kingdom, although yet to announce a clear regulatory response to the global crisis, is planning major regulatory reforms such as those promoted by the Lord Turner, Chairman of the Financial Services Authority despite apparent strategic differences with Mervin King, Governor of the Bank of England.

In Ireland, the Minister of Finance (Brian Lenihan, TD) announced on 18 June 2009 the creation of a new Central Bank of Ireland Commission to be headed by a Governor. Two directorates, the Central Bank of Ireland directorate and Financial Supervision directorate will report into the Governor. This major structural change replaces the relatively short lived Central Bank & Financial Services Authority of Ireland (into which the Financial Regulator reports). Until such time as the Minister releases a Scheme or a Bill, the structure and workings of the Financial Supervision directorate - which replaces the role of the Financial Regulator - is largely unknown. What we do know is that at least three assistant director generals will head the following divisions with the Financial Supervision directorate: regulatory risk & enforcement division; prudential/solvency division; and a markets supervision division.

Minister Lenihan is confident that the new Irish structure will fit neatly into proposed plans by the European Union's to establish European wide financial supervisory bodies including an European Systemic Risk Council (comprised of central bankers and national regulators) to be chaired by the European Central Bank. One of the new EU bodies is to be charged with identifying and responding to systemic risks likely to threaten the stability of the European financial system. The other body is to oversee the regulatory standards applied on banks operating in the EU.

No sooner did regulatory professionals (at both the regulator and regulated entities) settle into a period of 'regulatory certainty' then we were hit by the global economic crisis (perpetuated by systemic and cultural flaws in industry and government) leading all of us to revisit the drawing board yet again.

Now, more than ever, the importance of an effective Compliance Function and those who work within it are the vital foundations for restoring domestic and international confidence in regulated institutions.

## [What is the role of a Compliance Function and Compliance Officer in Ireland today?](#)

In the press release accompanying the Annual Report issued 21 July 2009, Mr Jim Farrell, Chairman of the Financial Regulator stated:

*Our supervisory staff are now located on site and attend certain credit, treasury, audit, board and other meetings to monitor and assess the strength of corporate governance and management of risk. Banks now provide more detailed information on key risks to the Financial Regulator and chief executives are expected to reform how banks are managed. Boards of financial institutions must now completely overhaul their approach and probe, question and challenge management. In particular non executive directors must play a more active role and we are monitoring the effectiveness of bank boards in this regard."*

No-one disputes the fact that the Financial Regulator (and Central Bank & Financial Services Authority of Ireland) must change focus; so too must the industry. This change is due not only to macro failures - i.e. failures within the strategies and structures of the industry and the regulators - but equally due to micro failures - i.e. certain important practices were either not adopted or where adopted do not appear to have been open and transparent in a manner which allowed them to be independently and freely verified. This fatal combination of macro and micro errors has allowed numerous boards, senior executives and non-executive directors (NED) to thus far escape any semblance of accountability and responsibility<sup>2</sup>. Ireland has also been hit by a number of stinging criticisms in the International press, including criticism of its banks and regulators. Regardless of whether those articles can be legitimised by supporting facts, our international reputation as a well-regulated jurisdiction has suffered immensely from perceptions presented in the press. Two international journals which have lambasted Ireland include the *New York Times* and *Financial Times*. [Note: Any NED reading this article querying the appetite of regulators to pursue NEDs may be interested in the actions of the Australian Securities and Investments Commission which is currently pursuing banning orders and fines against a number of NEDs of James Hardie Industries Ltd for breaches of Australian company law relating to their acts and omissions.<sup>3</sup>].

Reading through the Financial Regulator's Annual Report I was struck by a lack of reference to the role of the Compliance Officer or the Compliance Function at regulated firms (although the word 'compliance' bobs up almost 50 times) given that much of the financial turmoil in Ireland was occasioned by poor corporate governance and macro-compliance standards. Compared to its international counterparts, the Financial Regulator does not appear to put into the public domain (which investors and other stakeholders can easily access) the same level of detailed information on the importance of the Compliance Function<sup>4</sup>. This situation can hamper the Compliance Function and the Compliance Officer unnecessarily. If the Financial Regulator has developed its thinking in this area (to the same standard as its international counterparts) but has not published it, then it must do so. How else will Compliance Officers gain important direction and insight from those who regulate the Compliance Function and Compliance Officers (via the approved person/fit & proper regime)?<sup>5</sup>

I last wrote an article on the specific topic of the Role of the Compliance Officer in the Autumn of 2006. At that time I mentioned that the Financial Regulator had twice stated in annual reports (2002 and 2004) that "*Compliance officers, in certain sectors, [are] falling short of the expected level of knowledge of our regulatory requirements*".

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<sup>2</sup> Note: the author is not advocating regulatory sanctions to simply appease disgruntled consumers and journalists. If a sanction is required, then this should only be taken after a careful yet expeditious examination of the facts of any particular case by criminal law enforcement bodies, the Financial Regulator and, where relevant, professional representative bodies with the power to discipline their members.

<sup>3</sup> See <http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/James%20Hardie>.

<sup>4</sup> Examples of two overseas financial regulators which publicise useful data on the Role of the Compliance Function/Officer: (i) Canada ([http://www.osfi-bsif.gc.ca/osfi/index\\_e.aspx?DetailID=294](http://www.osfi-bsif.gc.ca/osfi/index_e.aspx?DetailID=294)); (ii) United Kingdom (<http://fsahandbook.info/FSA/html/handbook/SYSC/6> and see also [http://www.fsa.gov.uk/pubs/ceo/compliance\\_risk.pdf](http://www.fsa.gov.uk/pubs/ceo/compliance_risk.pdf)). The author recommends searching the terms 'Compliance Officer' and 'Compliance Function' in the FSA's search engine to locate a wealth of information including speeches and enforcement actions dealing with this role and function of Compliance.

<sup>5</sup> On my unfounded speculation that an executive of the Canadian OFSI might be appointed as the Chief Executive of the Financial Regulator's successor, the author recommends that readers take due note of the OFSI's approach to overseeing the Compliance Function (see footnote 4 above).

Arguably the advancement of specific educational courses and representative bodies has helped address this concern. However little has been articulated by regulators, representative bodies, the compliance profession and consultants as to the exact nature and obligations for an effective Compliance Function across *all* business types. This is not meant as a negative criticism. Rather it is a by-product of the principles-based regulatory regime which Ireland and others have adopted. Indeed even in the UK and USA, which we in Ireland regard as rules-based driven regimes (although the FSA will disagree with such a simplistic description of its regime), there is no (and nor could there be a) complete 'Manual for the Compliance Function and Compliance Officer' but, as pointed out above, they do issue substantial information on the role of the Compliance Officer and Compliance Function. Given the criticism that many in Ireland levied at more regulatory prescriptive environments (and used these arguments to advertise the benefits of Ireland), it is interesting and ironic to read the Financial Regulator's statement in its Annual Report that "...our reliance on the boards and management of credit institutions, as part of our principles based regulation, to meet their corporate governance and risk management responsibilities was misplaced."<sup>6</sup>

Before we explore certain specific tasks of Compliance Officers, it is important to understand what we mean by the term 'Compliance Function'. It is a lot wider than one might first think and it is certainly not limited to the individuals working within a compliance department.

## Ten Principles for establishing a Compliance Function

Firstly, best international practice provides that there are 10 universal Principles for an effective Compliance Function<sup>7</sup>. If a regulated entity, in the author's view, does not embrace these Principles, it is at risk of failing to meet not only the requirements of the Financial Regulator but also jeopardising the strategic direction of its business.

- **Principle 1 - Responsibilities of the board of directors for compliance**
  - The board of directors is responsible for overseeing the management of the regulated firm's *compliance risk*<sup>8</sup>. It should approve the firm's *compliance policy*, including a *Charter / Terms of Reference* establishing a permanent compliance function. On at least an annual basis the board or a committee (e.g. Audit & Risk Committee) should review the *compliance policy* and its ongoing implementation to assess the extent to which the regulated entity is managing its compliance risk effectively.
  
- **Principle 2 - Responsibilities of senior management for compliance**

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<sup>6</sup> See Chairman's Statement in the Financial Regulator's Annual Report at page 4 ([http://www.complianceireland.com/documents/Financial\\_Regulator\\_2008\\_Annual\\_Report.pdf](http://www.complianceireland.com/documents/Financial_Regulator_2008_Annual_Report.pdf).)

<sup>7</sup> The 10 'best practice' principles identified herein are taken from the Bank of International Settlements (BIS), Basel Committee on Banking Supervision, April 2005 titled *Compliance and the Compliance Function in Banks*. The principles in BIS paper have been adapted for Compliance Functions generally regardless of the industry involved.

<sup>8</sup> Compliance risk is "the risk of legal or regulatory sanctions, financial loss, or loss to reputation a regulated firm may suffer as a result of its failure to comply with all applicable laws, regulations, codes of conduct and standards of good practice."

- Senior management is responsible for the effective management of the firm's compliance risk.
- **Principle 3 - Senior management responsibility**
  - Senior management is responsible for (i) establishing a *compliance policy*; (ii) ensuring that it is observed; (iii) reporting to the board on its ongoing implementation; and (iv) assessing whether the *compliance policy* remains appropriate.
- **Principle 4 - Senior management to establish a permanent and effective Compliance Function**
  - Senior management is responsible for establishing a permanent and effective Compliance Function as part of the regulated entity's *compliance policy*.
- **Principle 5 - Independence & Status**
  - The Compliance Function should be independent from the business activities of the firm. The Compliance Function should have a formal and documented status within the firm. This is achieved by a written *Charter / Terms of Reference* approved by the board setting out the Compliance Function's standing, authority and independence (see Principle 1 above).
  - The Compliance Function should identify, assess and monitor the compliance risks faced by the firm. It should advise, and report to, senior management and the board about these risks.
  - Those exercising compliance responsibilities should have the necessary qualifications, experience and professional and personal qualities to enable them to carry out their duties effectively.
- **Principle 6 - Resources**
  - The Compliance Function should have the resources to carry out its responsibilities effectively.
- **Principle 7 - Compliance Function responsibilities**
  - The Compliance Function should assist senior management in managing effectively the compliance risks faced by the firm. Where any of its responsibilities are carried out by staff in different departments, the allocation of responsibilities to each department should be clear.
- **Principle 8 - Relationship with internal audit**
  - The scope and breadth of the activities of the Compliance Function should be subject to periodic review by the internal audit function.
- **Principle 9 - Cross-border issues**
  - Where the firm carries on cross-border business, it should comply with applicable laws and regulations in all relevant jurisdictions. The organisation and structure of the Compliance Function and its responsibilities must be consistent with local legal and regulatory requirements.

- **Principle 10 - Outsourcing**
  - Specific tasks of the Compliance Function may be outsourced, subject to appropriate oversight by the head of compliance, who should remain an employee of the firm.

These 10 universal Principles set out the framework for establishing an effective Compliance Function. Readers will note that ultimate responsibility for managing compliance risk rests with the Board of Directors (both executive and non-executive directors) which delegates to senior management (executive directors and top line non-board management) responsibility for establishing an effective Compliance Function (Principles 1, 2 & 4). An integral part of such establishment is the development and dissemination of a *compliance policy*. In his speech to the ACOI in 2007, Mr Neary specifically noted that “*good compliance ... should have a direct link to senior management, be supported with resources, and be charged with the responsibility to implement and report on the compliance policy of the organisation.*” Mr Neary’s comments to the ACOI amplified the criteria established two years earlier by the BIS. Specifically the Financial Regulator endorsed the proposition that the Board of each regulated entity is required to have a ‘compliance policy’. (see Principles 1, 3 & 4 above)<sup>9</sup>.

Of all the Principles, I have decided to focus upon Principles 5 and 7 only to discuss the role of the Compliance Function. These two Principles embody the day-to-day activities of the Compliance Function.

## [The Role of the Compliance Officer - Principles 5 and 7](#)

Assuming that the Board or senior management has adopted a written *compliance policy*, put in place the structures to foster an effective Compliance Function and allocated adequate resources, what then is the role of the Compliance Function?

### *Independence & Status - Principle 5*

In order to demonstrate the independence and adequate status of the Compliance Function, four important criteria must be met.

Firstly, the Compliance Function should have a formal status within the firm. Secondly, a group Compliance Officer or head of compliance with overall responsibility for co-ordinating the management of the firm’s compliance risk must be appointed. Thirdly, Compliance Function staff, especially the head of compliance, should not be placed in a position whereby there is an unmanageable conflict of interest between their compliance responsibilities and any other responsibilities they may have. Fourthly, Compliance Function staff must have access to the information and personnel necessary to carry out their responsibilities. These four tenets should be accepted by all firms as being self-evident. However this does not mean the adoption of an ‘one-size fits all’ approach given the differing types and size of firms subject to regulatory oversight.

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<sup>9</sup> *Guidelines for Insurance Companies: Appointment of a Compliance Officer*, issued by the Insurance Financial Supervision Section, Department of Enterprise, Trade & Employment, July 2001 specifies the need for the boards of insurance undertakings to have a ‘compliance policy’.

## *(a) Formal Status:*

It is vital that the Compliance Function be well regarded and has a formal status within the firm to give it the appropriate standing, authority and independence needed to perform its duties. The most effective way to achieve this outcome is to record the status of the Compliance Function in the compliance policy or other formal document. The document should be communicated to all staff throughout the firm and address the following issues with respect to the Compliance Function:

- its role and responsibilities;
- measures to ensure its independence;
- its relationship with other risk management functions within the firm and with the internal audit function;
- in cases where compliance responsibilities are carried out by staff in different departments, how these responsibilities are to be allocated among the departments;
- its right to obtain access to information necessary to carry out its responsibilities and the corresponding duty of firm to co-operate in supplying this information;
- its right to conduct investigations of possible breaches of the compliance policy and its right to appoint outside experts to perform this task if appropriate;
- its right to be able freely to express and disclose its findings to senior management and if necessary, the board of directors or a committee of the board;
- its formal reporting obligations to senior management; and
- its right of direct access to the board of directors or a committee of the board.

[NB: During the course of the development of the Consumer Protection Code (CPC) an early draft (known as Consultation Paper 10) contemplated a definite compliance function structure with specific reference to the status of the Compliance Officer who was to be “*given the necessary expertise, resources, and authority and must have full access to all relevant information enabling them to perform their duties*” as well perform their monitoring duties independently of all persons and activities subject to their monitoring. A specific reference to the Compliance Officer, and thus his/her duties under the code, did not make the final cut of the legislative backed CPC (although a similar provision focusing on the Compliance Function, rather than focusing on Compliance Officer, did find its way into the CPC<sup>10</sup>).

## *(b) Appointment of group compliance officer/head of compliance:*

Every firm must have an executive or senior staff member with overall responsibility for co-ordinating the identification and management of the firm’s compliance risk and for supervising the activities of other Compliance Function staff. In Ireland we generally view this person as the designated ‘Compliance Officer’.

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<sup>10</sup> See Chapter 1, General Principle 4 and Chapter 2 Common Rules 57-60 of the *Consumer Protection Code* dated August 2006.

The Financial Regulator requires the appointment of Compliance Officers under various regulatory requirements and specifically identifies the role as one that must meet the 'fitness and probity' requirements. Generally speaking each designated Compliance Officer will complete an Individual Questionnaire, however depending upon the Compliance Officer's reporting line within the firm, there may be occasions where the Financial Regulator may not require each Compliance Officer to be an Approved Person (i.e. not compelling each Compliance Officer to complete an Individual Questionnaire Form).

The nature of the reporting line or other functional relationship between staff exercising compliance responsibilities and the head of compliance will depend on how the firm has chosen to organise its Compliance Function. Some Compliance Functions are structured under a centralised model and others are structured under a decentralised model. The latter model is where compliance staff reside in operating business units or in local subsidiaries. In such cases they may have a dual reporting line to both the operating business unit/local management and the head of the Compliance Function.

There is no specific requirement that the head of compliance be a member of senior management. However if this is not the case, then in the absence of a senior management team which pays adequate attention to governance and compliance, such a firm faces a real risk of engendering a systemic culture of non-compliance. But it should be equally noted that the same outcome will result where senior management appoint an ineffective, yet senior, person to the head of compliance.

Compliance Officers should also, with the encouragement of the board, foster a close professional relationship with the non-executive directors - either directly or via a committee of the board – to ensure that a 'safety valve' exists to counter any occasions of reports to senior management not being escalated to the board.

*(c) Conflicts of Interest:*

The Compliance Function must be independent from the business activities of the firm. This does not mean that those working within the Compliance Function cannot have a close working relationship with other staff and departments. Rather it means that any non-compliance task performed by the Compliance Function should not place compliance staff in a position of unmanageable conflicts of interest. For example, is it wise or appropriate for the Compliance Officer to be the Managing Director or head another significant operational function (e.g. Sales)? In such circumstances how can the Compliance Officer effectively monitor areas of significant importance (and therefore compliance risk) to a business when he/she wears both hats? This is not to say that in smaller firms the Compliance Officer cannot perform more than one role nor does it mean that one person cannot be the Compliance Officer for several group or related entities. However this is a judgment call for the board of such entities.

Smaller firms need to fully appreciate the nature, scale and complexity of their businesses when deciding to appoint the same person to the Compliance Function and another operational function. This issue arose in the matter of BISYS Fund Services Limited where the Investment Management Regulatory Organisation (a predecessor to the UK FSA) fined the firm £300,000 for, amongst other things, allocating to its

Compliance Officer significant operational tasks causing the firm to give insufficient time to carrying out an effective monitoring program<sup>11</sup>.

*(d) Access to information and personnel:*

Without doubt, the Compliance Function must have the right - on its own initiative - to communicate with any staff member and obtain access to any records or files necessary to enable it to carry out its responsibilities.

The Compliance Function should be able to carry out its responsibilities on its own initiative in all departments of the firm where compliance risk exists. Furthermore it must be given the right to conduct investigations of possible breaches of the compliance policy and to request assistance from specialists (e.g. legal, risk management or internal audit) whether these exist within or outside the firm. It therefore follows that the Compliance Function should be free to report to senior management on any irregularities or possible breaches disclosed by its investigations, without fear of retaliation or disfavour from management or other staff members. For this specific reason I note above the need for 'safety-valve' reporting lines which bypass normal reporting lines.

It is the author's personal experience that, when advising firms on how to structure Compliance Functions, this basic tenet (i.e. 'safety-valve reporting') is the most controversial. It is often met with objections such as, for example, '*Nobody here may see the remuneration methodology or salary of the CEO / Head of Sales / Distribution / Treasury / Trading / Structured Finance etc*'. Yet without access to such information, how can the Compliance Function adequately opine that remuneration policies are not leading the firm to provide inappropriate financial products/advice which offer higher levels of commission as opposed to other suitable alternatives with lower commission levels?

The author's view is, it appears, endorsed by the Financial Regulator. In his speech to the ACOI, Mr Neary stated that Compliance Officers "*must also have the necessary access to systems, records and to people at all levels with a duty to report to the Board or the Audit Committee of the organisation at all times.*" In its recent publication on corporate governance standards to be employed by reinsurance firms<sup>12</sup>, the regulator wrote that "*internal audit must have access to all activities and subsidiaries of a reinsurance undertaking*". Surely the same principle applies to all types of regulated entities?

## *Compliance Function responsibilities - Principle 7*

Principle 5 above deals with the demonstration of independence and sufficiency of status. To effectively discharge its responsibilities each Compliance Function should be governed and guided by a formal and documented *Charter or Terms of Reference*. This document specifies the key responsibilities of the function. To ensure that the *Charter / Terms of Reference* is communicated to all staff, it should be reproduced in the Compliance Manual or similar document. This is especially important for firms operating decentralised Compliance Functions to ensure responsibilities are properly allocated. It is imperative that the *Charter / Terms of Reference* be approved by the board. However it may be the case that the boards of large complex organisations delegate the approval to committee of the board, e.g. Audit &

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<sup>11</sup> See decision of enforcement action in the matter of BISYS Funds Services Limited at <http://www.fsa.gov.uk/pubs/additional/imro001-01.pdf>.

<sup>12</sup> *Corporate Governance for Reinsurance Undertakings* dated December 2007.

Risk Committee, or indeed the executive management of the firm (i.e. collective body of executive directors and top line management).

Regardless of how the *Charter/Terms of Reference* is established, the key responsibilities of a Compliance Function should include as a minimum:

- facilitation and development of a compliance culture within the firm;
- identification of the firm's regulatory obligations. [NB: A failure to do so may cause a firm to commit a prescribed contravention leading to an administrative sanction];
- provision of advisory services to the board and senior management on compliance laws, rules and standards, including upcoming regulatory developments and initiatives;
- drafting the an annual compliance plan;
- developing, implementing and carrying out an effective risk-based compliance monitoring programme;
- developing and implementing an effective and relevant Compliance Manual (or similar);
- liaising with regulators and other similar parties;
- facilitation and the provision of training of relevant personnel;
- (and perhaps) corporate and individual registrations/authorisations to be filed with the Financial Regulator.

It may be that some of the above areas are addressed by other functions within the firm, e.g. in-house legal, risk management or internal audit. In such cases, the *Charter / Terms of Reference* should clearly identify the involvement of other functions.

Equally it is important that the *Charter / Terms of Reference* is framed within identifiable boundaries. For example, is it appropriate that the Compliance Function be tasked with non-financial services regulatory compliance issues? Is it the correct function to advise and report to the board on matters of tax compliance, data protection compliance, occupational health and safety compliance, environmental compliance, employment compliance or corporate law/company secretarial compliance? If the boundaries of the Compliance Function are not clearly established then it will likely be held (erroneously) accountable for compliance with areas outside its expertise. These boundaries should be established by the board and/or senior management. After all, the board is ultimately responsible for the firm's governance and compliance obligations. This includes apportionment of responsibilities to the *appropriate* senior management functions.

## [Requirement to appoint a Compliance Officer](#)

Under this heading, I look at calls to embody the role of the Compliance Officer in statute and examine the requirements to appoint Compliance Officers within certain sectors of the regulated market.

### *Proposed statutory role*

Sometime ago, January 2003 in fact, Dr Liam O'Reilly (the first Chief Executive of the Financial Regulator) commented that he would give consideration to broadening the role of Compliance Officers within the industry, perhaps putting the role on a more formal footing. Dr O'Reilly drew attention to the statutory appointment of an actuary in the insurance sector and stated that "*consideration will be given to developing a similar role in future for compliance officers*". Little could Dr O'Reilly possibly know of the financial crisis tsunami to engulf the globe in 2008 and beyond when he made his comments 6 ½ years ago. Lax

corporate governance standards within some Irish financial and insurance firms, as well as those overseas, will no doubt lead to many politicians re-examining the comments of Dr O'Reilly as we develop a new robust framework of regulation aimed at identifying, at a far earlier stage, significant systemic risk to local and global economies.

Although no one single piece of law compels all regulated firms to appoint a Compliance Officer, numerous regulatory requirements either compel certain types of firms to: appoint a Compliance Officer; identify a person within the senior management team to be responsible for compliance; or restrict entry into the market unless such a person is appointed. We take a look at some of these industries below. *In a practical sense, it appears that Dr O'Reilly's comments have perhaps come to pass?*

## *Insurance sector*

In July 2001 the Department of Enterprise, Trade and Employment (the predecessor to the Financial Regulator on insurance regulation) issued a paper to insurers requiring that 'each authorised insurance undertaking nominate an individual office holder as Compliance Officer'.<sup>13</sup>

## *Reinsurance sector*

In December 2007, the Financial Regulator finalised a detailed note on the function of Compliance Officers within reinsurance firms. The paper has legislative basis under S.I 380 of 2006<sup>14</sup>. Chapter 8 of *Corporate Governance for Reinsurance Undertakings*<sup>15</sup> requires that boards of reinsurance undertakings "must identify a Compliance Officer whose function is to monitor compliance with all of the relevant legislation and required standards of business conduct and who reports to the Board of Directors at regular intervals to enable the Board of Directors to ensure compliance". The specific functions of a Compliance Officer at a reinsurer includes:

- ensuring that the reinsurance undertaking is kept up to date with the Financial Regulator's compliance standards;
- obtaining the approval of the Board for a policy statement on compliance with the regulations in S.I. 380, meeting the requirements of the Financial Regulator and with any other applicable legislation;
- monitoring the implementation of compliance and to report periodically to the senior management and to the Board thereon;
- reviewing products, procedures and systems on a planned basis from the viewpoint of effective compliance and to advise as to steps necessary to ensure compliance;
- monitoring anti-money laundering policies and procedures for effectiveness and ensure any suspicions are reported to the relevant authorities; and
- reviewing staff training processes so as to ensure appropriate compliance competencies.

Except for the task relating to anti-money laundering policies, the role of Compliance Officer at reinsurers is, for all intents and purposes, lifted from the Bank of International Settlements paper on *Compliance and the Compliance Function in Banks* referred to above.

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<sup>13</sup> See footnote 9 above.

<sup>14</sup> Regulation 20 of S.I 380 of 2006.

<sup>15</sup> Based upon Regulation 71(1) of S.I 380 of 2006.

Accordingly, the author submits that any Compliance Function struggling to understand exactly how to deal with, and manage compliance risk, should pay close attention to developing a compliance framework which oversees three specific areas of risk faced by a firm – (1) the risk of breaching prudential/solvency regulations; (2) the risk of breaching conduct of business rulebooks; and (3) the risk of breaching financial crime obligations. Not until a robust framework addressing these key areas is put in place should a Compliance Function undertake other activities.

## *MiFID sector*

The MiFID Regulations (S.I 60 of 2007) require such regulated firms to establish permanent and effective compliance, internal audit and risk functions depending upon the nature, size and complexity of the firm. Regulation 35(3)(b) of the MiFID Regulations requires the appointment of a Compliance Officer to be responsible for the Compliance Function. Separately, the Financial Regulator requires<sup>16</sup> MiFID firms to have in place a compliance officer who *“is the person responsible within the applicant’s organisation for ensuring the applicant complies with its obligations under the MiFID legislation and other relevant legislation”*.

## *Non retail Investment Intermediaries Act (IIA) firms*

Investment business firms authorised under Section 10 of the IIA are required<sup>17</sup> *“to identify an officer at management level, who shall be located in the State, with responsibility for compliance with all legal and regulatory requirements and for co-operation and liaison with the relevant regulatory authorities. Such person is to be designated the compliance officer and must have the necessary access to systems and records. The firm is required to ensure that the compliance officer has the freedom to report to the Board of the firm (or equivalent in the case of a partnership) at all times.”*

## *Banking sector*

From my research there does not appear to be one specific sectorial handbook which requires by force of law or regulation the appointment of a Compliance Officer at credit institutions. I queried my conclusion with the Financial Regulator which informed<sup>18</sup> that *“... there is no regulation which states that a credit institution is required to appoint a compliance officer. However, in respect of governance structures, the Financial Regulator is guided by Regulation 16 of SI 395/1992 [and] Article 22 of the Capital Requirements Directive (2006/48/EC). Article 22 states: “Home Member State competent authorities shall require that every credit institution have robust governance arrangements, which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, and adequate internal control mechanisms, including sound administrative and accounting procedures.” It is on this basis that we may require compliance or other officers”*.

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<sup>16</sup> See para 5.3 *Guidance Note on Completing and Submitting an Application for Authorisation under The European Communities (Markets in Financial Instruments) Regulations 2007 and Commission Regulation (EC) No 1287/2006 of 10 August 2006*

<sup>17</sup> Para 2.5 Prudential Handbook for Investment Firms, April 2008

<sup>18</sup> My thanks to the Financial Regulator’s Press Department for sourcing an official response to my query.

Furthermore, arguably some or a combination of the following would effectively compel a credit institution to appoint a Compliance Officer - 'fit and proper' code, the Consumer Protection Code and S.I 60 of 2007. In respect of an entity seeking a credit institution licence in Ireland, the identification of a Compliance Officer is a pre-requisite for authorisation.<sup>19</sup> Any argument supporting a notion that there is no legal requirement to appoint a Compliance Officer within a credit institution is purely academic.

## *Funds sector*

In respect of fund administrators, the UCITS Notices requires the firm *"to identify an officer at management level, who shall be located in the State, with responsibility for compliance with all legal and regulatory requirements and for co-operation and liaison with the relevant regulatory authorities. Such person is to be designated the compliance officer and must have the necessary access to systems and records. The administration company is required to ensure that the compliance officer reports to the board of the company at each such meeting, but at least quarterly."*

The above are just some examples of specific requirements to appoint a Compliance Officer within regulated entities.

## Personal responsibility and regulatory actions against Compliance Officers

*Why is it important for Compliance Officers to understand the requirements expected by regulators and legislators?* The Financial Regulator has, to date, concluded about 18 settlement agreements with financial and insurance institutions since commencing use of its administrative sanction powers. A number of these settlement agreements have involved sanctions against, or undertakings from, individuals where the person was either the regulated firm itself or a director of the firm. In fact at least three (3) directors of regulated firms have agreed to pay fines in their personal capacity. Clearly the Financial Regulator is prepared to use its sanction powers to achieve an outcome. Although none of the sanctions agreed by individuals are specifically due to the person failing in his role as a Compliance Officer, we must recognise that directors, senior management and controllers are ultimately responsible for their firm's compliance with all applicable laws, regulations and codes etc.

Accordingly Compliance Officers must be aware of not only their employer's corporate responsibilities but also their own personal responsibilities. A number of non-financial Irish laws, such as financial crime, company law, data protection, health and safety, environmental, tax and employment legislation contain provisions whereby directors, *officers* and management are guilty of the same offence as their company where the individual has consented to, been negligent or through connivance, caused the body corporate to breach the law. Individual(s) if found guilty face the same range of penalties as the company. If a person is registered / authorised as the 'Compliance Officer' by the Financial Regulator (and holds him/herself out as such a person) he/she arguably meets the term 'officer' under these laws. This is yet another important reason for a well documented *Charter / Terms of Reference* for the Compliance Function.

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<sup>19</sup> *Checklist for completing and submitting Bank Licence Applications* issued by the Financial Regulator

Similarly, financial industry laws covering areas such as insurance, reinsurance, banking, MiFID, other investment services, intermediaries, credit unions and the funds industry also provide for action against directors, officers and managers whose connivance, consent or neglect has caused the company to breach its obligations.

Further, the Central Bank and Financial Services Authority of Ireland Act 2004 provides that if the Financial Regulator suspects on reasonable grounds that a person concerned in the management of a regulated financial service provider is participating or has participated in the commission of a prescribed contravention by his/her employer, it may conduct an inquiry into the activities of the individual.

## *Accountability & Rewards*

The role of Compliance Officer is a fast moving and a continually developing one. In terms of responsibility it is no greater (or less) than that of any other senior operational role at a firm. The concerns of many Compliance Officers could be avoided by establishing a *Charter / Terms of Reference* (endorsed by the board) setting out the remit of the Compliance Function. Getting the Compliance Officer role right can lead to a very rewarding career. Despite the 'new economic reality' we face as firms cut costs, including salaries, I was pleasantly surprised to see an email in late June 2009 from a UK based headhunter seeking to recruit a head of compliance for (in the recruiter's words) 'a major insurance firm in Dublin'. The successful person will be an addition to the Compliance Function. The remuneration package on offer was €150,000 p.a, large percentage bonus plus other fringe benefits. Although very attractive, this is certainly not the largest package I know of offered to a Compliance Officer of an Irish financial institution. Also, a good number of years ago I saw one advertised position offering a base salary of £250,000 p.a. for a UK Compliance Officer.

## *Examples of sanctions against compliance professionals*

However, as I wrote in Autumn 2006, it is not always a bed of roses in the world of the Compliance Officer. Although still relatively rare, there have been occasions of Compliance Officers falling from grace and being sanctioned by regulators and courts.

*Example 1:* In January 2004 a senior executive in the legal and compliance department of Credit Suisse was sentenced to five years jail for passing on inside information to his friends. The sentencing judge described the action by the compliance professional as a "*flagrant, calculated and deliberate breach of trust*". The sentence was later reduced to four years on appeal.

*Example 2:* In the late 1990's, following an extensive investigation by IMRO (a predecessor to the UK FSA) into Morgan Grenfell, a compliance director was suspended for three years and permanently restricted from holding a compliance position. The deputy head of compliance was suspended for two years and undertook not to apply for a senior compliance position for an additional twelve months. A more junior 'compliance officer' at the firm was reprimanded over failures.

*Example 3:* In July 2008 the UK FSA withdrew from a person her authorisation to act as a Compliance Officer for "*lacking the competence and capability to ensure that her firm complied with FSA regulations aimed at ensuring customers are treated fairly*". The firm, PMSG Insurance Services Limited, was fined for €35,000 for the substantive failures and is no longer authorized by the FSA.

*Example 4:* In another case, October 2008, which caused many UK Compliance Officers and MLROs to think carefully about the adequacy of their firm's financial crime controls, the MLRO (who separately holds Compliance Oversight Controlled Function) was personally fined £17,500 for not having adequate anti-money laundering systems and controls in place for verifying and recording clients' identities. Ominously the FSA stated at the time that "*this is the first time the FSA has fined a money laundering reporting officer*" leading the author to think that the FSA has not ruled out doing it again! The firm, Syndicate Holdings Limited, was fined £49,000 for the substantive failures and is understood to have applied to have its authorisation cancelled.

## Conclusion

On a penultimate note, arguing a defense that one did not in fact appreciate his/her obligations as a Compliance Officer is not likely to be successful where the person is also a director of an Irish financial firm. Anyone completing Appendix 2 of a recent edition of the *Individual Questionnaire* should note that he/she signed the following declaration - (i) that he/she is fully aware of the obligations and the duties of a director of a company under the Companies Acts; and (ii) he/she confirms awareness of his/her responsibilities arising from "*legislation, regulations, codes of practice, guidance notes, guidelines and any other rules or directives, which are of relevance to the proposed position*" and he/she confirms their intention "*to ensure that the proposing entity of which I am to be a Director will be run in compliance with the same*".

Given the significant importance, as set out in this article, of effective Compliance Officers and Compliance Functions within Irish firms, perhaps it is fitting to end with the words of the Minister of Finance who, when announcing the establishment of the new regulatory structure, stated:

*"The reforms will be supported by a significant expansion of regulatory capacity within the new structure. Substantial additional staff with the skills, experience and market-based expertise needed to meet the objectives of the new structures will be appointed. Those recruited will also have the expertise to regulate the international financial services sector".*

The same words apply equally to those who direct and control significant operational functions (including the Compliance Function) within regulated firms.

END

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*This is the first in a series of articles on the **Role of the Compliance Function and Compliance Officer**. This article appears in Newsletter 5/2009 (July 2009) at <http://www.complianceireland.com/Newsletter.html>. Other articles on this topic will be published in the future. You can subscribe free of charge to future Newsletters by sending an email to [news@complianceireland.com](mailto:news@complianceireland.com). Compliance Ireland runs full day courses on the Role*

of the Compliance Officer which covers all the essential elements of establishing the Compliance Function. See <http://www.complianceireland.com/ICONI&I.html> for more details.

Compliance Ireland has advised many firms on how to structured and developed efficient and effective Compliance Functions and has independently reviewed Compliance Functions by firms upon their own initiative and when required by the Financial Regulator.

Peter Oakes is the Managing Director of Compliance Ireland Regulatory Services Limited ("Compliance Ireland). Peter is admitted as solicitor in Ireland, the UK and Australia. He has significant experience of acting as a compliance officer and lawyer in Ireland and the UK and being a non-executive director. Peter worked in the enforcement division of the UK Financial Services Authority and in the legal division of the Australian Securities (and Investments) Commission. Contact Peter Oakes at [peter@complianceireland.com](mailto:peter@complianceireland.com) (or [email@complianceireland.com](mailto:email@complianceireland.com)) should you have any comments on this article or require assistance with your Compliance Function. Peter Oakes' biography appears at <http://www.complianceireland.com/PBOprofile.html>.

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