

# Compliance functions in banks-changing paradigms

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## *Need for compliance*

- To deal with legal, regulatory and supervisory issues which pervade all spheres of banking operations.
- Dedicated compliance units needed to address these issues.
- To ensure that deviations from prescribed rules/regulations/guidelines promptly addressed and redressed.
- RBI's guidance on "fit and proper" criteria for banks, emphasises appointment of a senior executive as the compliance head in banks
- Compliance is the face of the organization.

# Roots of compliance

- “Compliance Officer” in banks was introduced by Reserve Bank of India in August 1992
- Based on the recommendations of the Committee on Frauds and Malpractices in Banks (Ghosh Committee).
- 1995- association of compliance functions with the General Manager in charge of Audit and Inspection reporting directly to the CMD
  - with a system of periodic reporting or certification on compliance functions.
- Perennial need to deal with action paras from RBI ‘s AFI Reports-compliance as a dedicated function
- RBI’s only and most elaborate guidance( in 2007) on compliance based on Basel Committee on Banking Supervision (BCBS) prescriptions in April 2005
- New dimensions of compliance
  - Monitorable action plan
  - Risk Mitgation Plan

# *Changing Dimensions of Compliance*

- Group-wide perspective on compliance: Association of compliance risk with reputational and systemic risk
- Conglomerate model of functioning: Needs greater analysis of inter and intra-group transactions
- Integrated risk management or enterprise wide risk management framework are the need of the hour
- Targeted compliance;
  - Focus on specific areas and deficiencies
  - Time bound action and compliance-MAP,RMP
  - Compliance testing
  - Penalties for continued/deliberate/repetitive non-compliance.

# What constitutes an effective compliance process?

- **Identifying level of compliance risk**
  - in each business line, products and processes
  - Mitigation of such risks.
- **Circulation of**
  - instances of compliance failures among staff
  - preventive instructions
- **Active interaction of compliance Heads with Heads of Audit for remedying deficiencies**
- **Compliance should be part of “new products launches”.**
- **Compliance manuals –documenting and recording for posterity**
- **Well entrenched list of “dos” and “don’ts” in business operations.**
- **risk based compliance programme subject to oversight by the head of compliance**

# EXPECTATIONS FROM COMPLIANCE OFFICERS

- **Chief Compliance Officer has stellar role**
  - should submit reviews on quarterly/annual basis to Board/ ACB/ Board level Committee,
- **Focus on regulatory/ statutory compliance,**
  - compliance with fair practice codes and
  - other codes prescribed/ suggested by Self regulatory organization,
  - Govt. policies, bank's internal policies and prevention of money laundering/ funding of illegal activities.
- **Compliance with legal and regulatory requirements by overseas branches/ subsidiaries/ joint ventures in different jurisdictions**
- **observing proper standards of market conduct,**

## EXPECTATIONS FROM COMPLIANCE OFFICERS

- managing conflicts of interest
- treating customers fairly and ensuring the suitability of customer advice.
- Specific areas demanding increased attention:
  - prevention of money laundering and terrorist financing
  - various directions emanating from banking regulator and supervisor
  - tax laws and other statutes
  - KYC practices, frauds, fictitious offer of funds
  - Sharing of information under law

# *Compliance to adopt to changing times and demands*

- *alter compliance culture with respect to scale of operations, risk profiles and organizational structure.*
- *forward looking compliance*
- *deal with today's requirements with an eye on tomorrow*
- *top management to steer compliance-lead by example.*
- *compliance is a two-way process*
  - *top-down: board to employee*
  - *bottom-up: employee to top management(feedback)*



## **Changing facets of banking supervision-challenges to compliance**

- **Significant and gradual shift from AFI to RBS**
- **Compliance Risk Assessment**
  - **Key feature of RBS architecture used by the RBI (SPARC)**
  - **Not prevalent in other jurisdictions.**
- **Rule based regulation compliance assessment template or Tranche III**
  - **Tool for compliance assessment**
- **involves assessing the compliance culture and attendant risks.**

## Compliance Assessment Framework under RBS – Key features

- **Calibrating each guideline and mapping it to risk categories**
  - **Testing controls around each guideline**
  - **Transactions audit followed by verification by compliance officer**
  - **Compliance assessment template includes 158 regulatory guidelines that need testing and will be updated all the time.**
  - **Sampling methodology to be specified**
  - **Risk aligned approach to sampling and testing.**
    - **SSMs choose the two highest business risk given in the risk evaluation document for sample testing**
  - **Action template for serious violations, i.e., thematic study, targeted scrutiny and commissioned audit by external agencies**
  - **Compliance score serves as input for aggregate risk score.**
  - **Banks are also expected to articulate the controls put in place around each of the guidelines.**

## *Consequences of non-compliance*

- **compliance risk triggering other risks**
- **Compliance – tool for identifying, evaluating, and addressing legal and reputational risks.**
- **Penalties and sanctions by regulators and supervisors – name and shame**

## Compliance function's dilemma-compromising independence

- **Tweezer grip**
  - conflict between business mandate and rigors of regulation.
  - Profit maximisation vs abiding by law and rules.
- **independence of compliance –whether free from top management or compromised**
- **remuneration of compliance officers should be independent of the business lines they are responsible for (RBI Guidelines).**
  - To be aligned with the bank's overall financial performance.
- **Continuous system for testing of compliance to obviate influences from business lines**
- **segregation of audit and compliance functions is a must**
- **direct reporting of compliance aspects by Compliance Heads to Boards of banks.**
- **Proper Compliance testing preferred over mere certification of compliance.**

## Compliance function's dilemma-ways to address

- **Audit program that covers the adequacy and effectiveness of the bank's compliance function**
  - **Including testing of controls VIS-À-VIS perceived level of risk.**
- **Compliance functions should be able to initiate processes**
  - **right to conduct investigations**
- **Compliance to be regarded as a core risk management activity**
- **Overarching responsibility of Board of Directors and Senior Management for compliance**

## **Supervisory areas that require enhanced compliance**

- **integrity of regulatory/supervisory reporting**
- **irac norms/priority sector norms**
- **overseas regulatory requirements**
- **not to work around rules; but within rules**
- **foreign exchange business**
- **kyc/aml/fatf requirements**
- **customer grievances and communication**

- **Hoping for a more vibrant compliance culture in banks...**

**THANK YOU**