AlixPartners

MAY 2020

WHY FINANCIAL INSTITUTIONS MUST EMBRACE NEW WORLD COMPLIANCE

To weather an increasingly disruptive world, financial institutions must revolutionise their compliance and risk approaches

Even before COVID-19 ripped the rug out from under the world's economies, financial institutions (FIs) were facing increasing pressure to get their houses in order.

Growing concern over a host of modern-day dilemmas, including slavery, cyber security and climate change, has seen scrutiny mount over FIs' activities. Customer, investor and societal focus on institutions' environmental, social and governance (ESG) performance has gone mainstream. This translates to a deepening reputational, regulatory, and financial risk for organisations who fall short.

To survive and prosper long-term, FIs need to be on the right side of this complex, changing agenda. But it won't simply be a case of adding more boxes to their compliance and risk checklists. It will involve a wholesale transformation of FIs' compliance and risk management function – a 'New World Compliance' – to avoid the mistakes of the past and move forward into the future.

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WHY HAS FI COMPLIANCE FAILED?

Several issues persist at the heart of FI compliance and risk management approaches. Despite record levels of investment, the tackling of financial misconduct by FIs continues to underperform.

Since the 2007-8 financial crisis, misconduct has seen FIs hit with punitive costs amounting to more than US $350 billion, or 15% of total bank equity. While charges relating to sub-prime lending dominated over the decade, there was also a more recent uplift in misconduct costs connected with sanctions violations, money laundering and tax evasion. Without these misconduct pay-outs, Euro area banks' net income could have been a third higher over this period, according to the European Central Bank.

Why then do FI compliance systems continue to fail? Time and again, it comes down to fault lines within an organisation's culture.

BLINKERED FOCUS

A narrow approach to compliance and risk management leads to siloes, lazy reliance on box-ticking, and a linear and short-sighted view of risk. As a result of passive process rather than proactive compliance, transactions are released that would otherwise trigger concern against AML obligations, or just plain common sense.

The response of many FIs to burgeoning compliance obligations has been too piecemeal, with new technologies and capabilities layered on top of existing systems, without addressing the performance of the whole. Instead of working smarter, the result is a misshapen compliance monster of parallel processes, contradictory information and insufficient governance, that no FI would design from scratch.

FIs' reluctance to intelligently adopt new technologies also curtails the ability to minimise integrity risks. Institutions need to leverage relevant data to work effectively, and this is something only advanced technological competencies can deliver.

But the main failure of FIs, is the inability to see compliance and risk management as a business-wide responsibility. To quote Warren Buffett: "Everyone must be [their] own compliance officer".

DRIVING CHANGE

The compliance agenda is changing, as society expects more from institutions, forcing FIs, as enablers, to review their involvement in global issues.

Even before COVID-19, the scope of financial compliance was already expanding in relation to the illegal wildlife trade – valued at US $23 bn per year. Speculation over the trade's role in COVID-19 has accelerated this particular compliance movement, with the Financial Action Task Force working on recommendations to support FIs in identifying illicit related activity.

Modern slavery – with annual profits totalling US $150 bn – has similarly attracted the public's attention, with the knowledge that 40 million people worldwide are thought to be in forced labour. With moves already underway to regulate corporations relying on these supply chains, and the UN's ambition to eradicate modern slavery by 2030, there are serious reputational and financial implications for FIs processing transactions that underpin it.

Data security is also a priority, thanks to new legislation and enforcement such as the General Data Protection Regulation (GDPR), and media scrutiny.

And the reputational and financial risk of non-compliance could not be clearer. Several major corporations have faced eyewatering financial penalties as a result of sensitive data breaches, incurring multi-million-dollar pay-outs, legal fees, and damage to brand image.

In addition, climate change remains high on the FI compliance and risk agenda. Having once been viewed as a 'soft' law issue, in 2019, twenty new climate laws or amendments were introduced, and 1,000+ climate-related cases brought. Recently, investment groups – including BNP Paribas Asset Management, DWS and Comgest Asset Management – reiterated calls for companies to uphold climate commitments, as has BlackRock, the world's largest asset manager.

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NEW WORLD COMPLIANCE REQUIRES STRONG LEADERSHIP

It is within the power of financial institutions to manage their control environments proactively, and make them smarter, leaner and more cost-effective. However, it will take strong leadership to effect the kind of deep cultural changes FIs need to enter the new world of compliance.

Firstly, leaders must get risk and compliance management working together to add real value: integrating the horizon-scanning, risk-minimising mindset with the need to meet regulations. Regulators want FIs to evidence both, showing they understand risks and are diligently and sincerely striving to reduce them.

Secondly, leaders will have a pivotal role to play in driving the effective adoption of new technologies within their organisation. Regulators are pro-emerging tech, many offering sandboxes where FIs can safely test new capabilities. Successful leaders will recognise that leveraging new, user-friendly technological and data competencies that work intelligently across departments is key to meeting future compliance needs.

Last, but by no means least, if those at the top are truly to address integrity risk, they must champion an end-to-end, compliance-positive culture internally. This is where we see banks becoming more effective – by dissolving organisational boundaries, integrating risk management, compliance, privacy and financial crime, and encouraging everyone to see risk and compliance as their business.

In the New World of Compliance, banks need to embrace change, get ahead of the agenda and transform their operations at speed, before the court of public opinion – rather than regulation – forces their hand.

SUPPORT WHEN IT REALLY MATTERS

AlixPartners deploys senior and experienced teams who have faced the challenges you face, as both senior executives and consultants, to work alongside you to achieve your objectives. We combine subject matter expertise with deep digital experience to drive change and help your business to perform – when it really matters.

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ABOUT US

For nearly forty years, AlixPartners has helped businesses around the world respond quickly and decisively to their most critical challenges – circumstances as diverse as urgent performance improvement, accelerated transformation, complex restructuring and risk mitigation.

These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.