

Roundtable summary: Tomorrow's Compliance Solution

This is the summary from a series of discussion events and interviews that Tomorrow's Company held around tomorrow's compliance solution with over 20 Chief Compliance Officers. It highlights the choices facing compliance due to the pressure to meet society's ethical expectations not regulatory minimums, and to achieve this through culture rather than compliance codes. Culture, in the context of corporate governance, is defined as behaviours and values of groups within an organisation.

Tomorrow's Company is a business-led non-profit think tank with the purpose of inspiring and enabling companies to be a force for good. This discussion formed part of the Futures Project which was a research programme looking at progress over the last 20 years in order to identify the key obstacles and drivers for change; and in this context present a renewed vision for business. The final report from this program is *UK Business: What's Wrong? What's Next?*

Challenges facing compliance

1) Meeting the higher bar of society's ethical expectations

Simply acting within the laws and regulations is now often insufficient. The ethical expectations of society are in many cases higher than those imposed by laws and regulations. Then in turn, laws and regulations often catch up with higher societal expectations. Therefore, tomorrow's compliance department will stay ahead of laws and regulations by meeting the higher bar of society's ethical expectations through linking the compliance lens with the overall vision and values of the organisation. This will be critical if business is to regain the public's trust.

2) Managing compliance in the extended enterprise

Companies are increasingly being held to account for the actions of associated companies, such as suppliers and third parties in the extended enterprise. Increasingly, regulators expect companies to have responsibility over their extended enterprise. This is further complicated by the use of intermediaries for payment, the OECD Foreign Bribery Report (December 2014) identified that 75% of cases involved payments through intermediaries. The focus of regulators is reinforced by the public who don't differentiate between a company and its suppliers. Compliance is already required across the extended enterprise; this is likely to increase.

3) Increasing cost of compliance

As regulations become more onerous and operations more complex, this increases the cost of compliance. For example, new regulations such as the Modern Slavery Act are important in tackling social problems, but will also increase the burden on compliance. The compliance department is also having to broaden its scope to meet society's ethical expectations both within the organisation and the extended enterprise.

4) Compliance codes versus behaviours and values

Recurring corporate scandals are showing the limits of managing risk with compliance codes. Employees cannot be monitored all of the time so the true test of risk management is what employees do when they are not being watched, and this comes down to their behaviours and values. The investigations following scandals often point to a breakdown in behaviours and values, rather than poorly worded compliance codes. Tomorrow's compliance solution will work to embed behaviours and values that encourage employees to 'do the right thing', complementing compliance codes.

5) Breaking down the silo and legal focus

Making the above challenges harder is that compliance too often exists within a silo in the organisation. Too often the compliance department is seen as the party that says “No” and are only consulted when things go wrong. This can be accentuated by the bias to legal backgrounds within compliance departments. Furthermore, only 35% of Chief Compliance Officers are involved as part of the annual business strategy development meetings. “Most individuals see the Chief Compliance Officers as the bad guy who is around only when something is wrong” (2015 PwC State of Compliance Survey). Tomorrow’s compliance department will need to work more closely with other departments and embed within the first line of defence a proactive level of compliance.

The choices ahead

Companies in the future will need a greater focus on meeting society’s higher expectations through fostering a culture that encourages employees to ‘do the right thing’, instead of meeting minimum regulatory bar with compliance codes. Embedding a set of behaviours and values that are aligned to corporate purpose helps encourage individuals to act responsibly even when they are not being monitored and when financial incentives may encourage the opposite. This is based on the underlying presumption that an element of trust underpins corporate governance, whereby a trusting management “knows” that his or her employees will work diligently and in good faith to meet their commitments while a trusting employee knows that a manager will adhere to agreed-upon standards of oversight (Larker, D.F and Tayan, B, 2013). Embedded values and purpose are also a much more cost effective means of managing risk, than constant monitoring.

This raises difficult questions about the remit and structure of a compliance department. There is a choice between a compliance department focusing simply on ensuring the organisation meets regulations and laws, towards taking on a much broader role that encompasses meeting societal ethical expectations, embedding behaviours and values and looking across the extended enterprise. Some people argue that a compliance department should become more integrated into the organisation in order to achieve the latter. Others argue that a compliance department should remain a legal function with responsibility for the broader challenges resting with business unit managers.

The points below are written for a compliance department looking to broaden its focus from regulations and codes towards ethical behaviour, values and culture. However, the points are also relevant for other means of achieving this aim, such as leadership from business unit managers, CSR, HR or other individuals.

Senior endorsement – One area of clear consensus from the roundtables was that compliance officers cannot be effective in the broader non-legal areas without senior endorsement and the board. Therefore, a key role for compliance officers is to obtain the support of executive and business unit managers in these areas. Embedding a set of behaviours and values to act ethically needs to come from the top, set by the board and supported by business unit managers throughout the corporate hierarchy.

Align incentives, codes and values – Compliance codes are often more effective when they are aligned with financial incentives and the stated values as well as having sufficient employee engagement during the development of these codes and values. However, too often codes, incentives and values are all determined by different departments and often contradict one another. Tomorrow’s compliance department will work closely with business unit managers in setting incentive structures and codes in-line with the organisation’s values.

Embedding behaviours, values and measuring culture – Recurring corporate scandals show the importance of behaviours, values and culture in encouraging employees to act responsibly and hence in managing risk. Tomorrow’s compliance department will work closely with HR to embed the expected behaviours and values that help manage the key risks that compliance identifies.

This will involve working together with cultural change programs and employee engagement initiatives. Alongside the work to foster the right culture, there will be a focus on measuring and assessing the culture as a key part of assessing the level of risk appetite that will be taken by the organisation.

Diversity in experience, expertise and skills – In order to carry out work in the broader area of behaviours, values and culture, compliance departments need a greater diversity to enable them to influence and engage others effectively. Historically, there has been a bias to legal backgrounds, but as compliance departments shift to a broader focus, backgrounds will also need to broaden. One global company attending the roundtable had 50% of the compliance department with non-compliance backgrounds, partly achieved by having staff on secondment.

Reporting lines – Compliance departments have historically reported to the general counsel, in-line with the historical legal focus. As compliance departments broaden their focus, they may be more effective if they report directly to the CEO or the Non-Executives. This would help to avoid the focus purely on legal issues, and instead increase the emphasis on embedding behaviours, values and culture in order to meet societal expectations.

Advisory and educational role – A clear theme was the need for compliance departments to support business unit managers as the first line of defence, rather than working separately. Successful compliance departments will increasingly take on an educational and advisory role. Part of this is encouraging individuals to ask compliance for advice before doing something, rather than only when things go wrong. It also involves targeted training modules which are tailored towards the roles and individual risks faced by employees instead of a wide “carpet bombing” approach.

Simplify codes – A number of organisations at the roundtables spoke about the detrimental impact of having too many compliance codes. One organisation said they had 1500, far more than an employee can realistically absorb. Many companies spoke about a desire to simplify, but difficulty in achieving this. Tomorrow’s compliance department will have a greater use of principles based compliance guides that are realistic for employees to remember. This may be aided by the use of technology such as apps to aid accessibility.

Technology and measurement – Technology is significantly increasing the quantity of data that can be collected across the organisation. Successful compliance departments will utilise this data to assess risks and support business unit managers in factoring this information into decisions. This will form a key part in a compliance department’s ability to measure and assess the behaviours, values and culture across the organisation in order to develop and roll-out enhancement plans.

Focus on behaviours, values and culture – The need for a focus on behaviours, values and culture over codes raises another problem for compliance – culture is hard to measure. It is hard for an organisation to evidence that it is managing risks through a focus on behaviours, values and culture. This is in contrast to compliance codes that provide an automatic evidence trail to cover the organisation legally in case something goes wrong. Whilst hard to measure, tomorrow’s compliance department will assess behaviours, values and culture to enable a more targeted approach where weaknesses are identified and addressed, consistent with the recent focus from the FRC.

Assessing the culture of third parties – In the future, companies will not only perform financial due diligence of third parties, but also assess the behaviours, values and culture through “ethics audits”. Organisations are increasingly including additional audit clauses to enable them to perform compliance audits and training for their extended enterprise. The focus on behaviours, values and culture within an organisation will also enable closer monitoring of the culture of their extended enterprise.

Key questions

- Are we aiming for the minimum level required by regulations, or the higher bar of society's ethical expectations?
- Are responsibilities to enable compliance given to the first line or the second line of defence or both?
- How are we balancing the use of compliance codes versus fostering and embedding the right behaviours, values and culture?
- How do we ensure that our individual incentive structures are aligned with our compliance codes and the intended behaviours, values and culture?
- Does the compliance department cooperate with the CSR and HR department as well as business unit managers to achieve this alignment?
- Who is supporting the executive and business unit managers in meeting society's ethical expectations by fostering the right behaviours, values and culture?
- If it is compliance, then does the compliance department have the necessary skill-set? Are there a sufficient number of people with diverse, in particular non-legal, backgrounds? Do they have the right endorsement, reporting lines and technology?
- Does compliance have a legal focus on meeting regulations, with legal backgrounds and reporting to the General Counsel? Or does it have a broader remit to ensure the organisation acts responsibly whilst fostering the appropriate behaviours, values and culture?
- Are compliance codes and their supporting training programmes relevant, meaningful and focused on fostering the appropriate behaviours, values and culture? Do they engage the end user on the consequences of getting it wrong? Do they engage sufficiently with the extended enterprise?
- How do we define the behaviours, values and culture that could be in line with purpose set by management and also relevant to the extended enterprise? Should it be prescriptive and defined or based on trust?

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