What Ticks Off a Regulator?

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Our Roadmap Today

I  The larger context

II  Key regulatory and supervisory trends

III  How to approach stakeholder relationships in this context?

IV  Conclusions and Q&A
I. The Larger Context:
Three key dimensions of the operating environment for any company

<table>
<thead>
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<th>Dimension «Markets»*</th>
<th>Dimension «Industry»*</th>
<th>Dimension «Regulation»*</th>
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<tbody>
<tr>
<td>Geopolitical risks</td>
<td>Intense competition,</td>
<td>New competitors</td>
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<td>Interest rates</td>
<td>margin pressure</td>
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<td>Currencies turbulence</td>
<td>Pressure for efficiencies and operational excellence (standardization of processes)</td>
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<td>Need to access new clients/markets</td>
<td>Shifting market opportunities</td>
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<td>Pressure to innovate products, services, sales channels, etc.</td>
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<td>Pressure to digitize and manage cyber security</td>
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<td>Pressure to consolidate</td>
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How to best approach this dimension?

II. Key Regulatory and Supervisory Trends:
Five areas growing in intensity across jurisdictions

Conduct risk
Consumer-oriented compliance
Incentives and compensation
Financial crime
Cyber risk, data protection, new technologies
1. Conduct risk

Sample emerging regulator concerns include

- Is compliance giving sufficient focus to senior management risk?
- Does compliance help or influence management in "grey zones", or when ethical dilemmas arise?

2. Consumer-oriented compliance

Sample emerging regulator concerns include

- How much of the compliance time / resources are being applied in this area?
- Is there clarity on whose interest prevails in a conflict situation?
3. Financial crime

Sample emerging regulator concerns include

- Does the business model incorporate the costs of financial crime compliance?
- What is the company doing to attract and retain high-performing compliance talent in this area?

4. Cyber risk, data protection, new technologies

Sample emerging regulator concerns include

- Are Compliance, Risk and IT talking?
- Enough being done against "soft data leakages"?
- Is AI/BD being used to increase compliance effectiveness?
5. Incentives and compensation

Sample emerging regulator concerns include

- Sufficient “pay at risk”?
- Malus? Clawbacks?
- Is compliance excellence rewarded?

III. How To Approach Stakeholder Relationships in this Context

Is this the right approach?

“Compliance would like to manage its relationship with the regulator”
“Managing” could give rise to these impressions

The Chief Compliance Officer (CCO) of a company should avoid appearing as a lobbyist to regulators.

The goal is optimizing engagement

- If done properly, it is for both sides’ benefit
But optimizing engagement requires knowing how to optimize relationships with all stakeholders.

The landscape of regulators is vast…but regulators often share some common characteristics.
So how to deal with regulators? How not to «tick them off»? Hint?

S.M.P.

1. Shoes
2. Marriage
3. Pet Peeves
Tip #1: An effective relationship with the regulator starts by walking in their shoes

Regulators are often...

- Understaffed, each has multiple companies to regulate
- Likely paid less than you
- And also under pressure
Regulators too are blamed for compliance failures; it’s not a new phenomenon...and it is intensifying

- The Wall Street Journal, March 26th 2018

“Danish and Estonian regulators under EBA investigation over Danske incident”
- Banking Tech, 19th February 2019

“Is the SEC to Blame for Lehman’s Failure?”
- The Atlantic, April 20th 2010

“Why Didn’t Bank Regulators Prevent the Financial Crisis?”
- Federal Reserve Bank of St. Louis, 23rd 2017

The pressure on regulators is multiple

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And a dynamic has set in as more regulation is connected with international standards

1. Shoes
2. Marriage
3. Pet Peeves
Tip #2: Consider the relationship with the regulator as involving three phases, comparable to a marriage.

- **Phase A**: Relationship in ordinary periods, business as usual
  - Invest time learning about the people at the regulator, their organization, their news
  - Introduce yourself
  - Keep the regulator informed of changes on your team
  - Regulator does not know everything...inform on industry and other developments

- **Phase B**: Relationship when a proposed rule or when an assessment or inspection

- **Phase C**: Relationship when a major disagreement, a charge of a violation, or enforcement

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You may need to fall back later on the “trust capital” you’ve built up during this phase...

You need to invest in your relationship to build trust

Regulators will more likely give you the benefit of the doubt, if you have build up enough “trust capital”

Part of Phase A is reporting to the regulator in a timely fashion
...and in a transparent, complete, yet crisp manner

- Professionally written
- Highlight key points
- Use graphics where possible
- Use side-boxes for additional comments
- Double-check accuracy of a) statements and b) numbers

Another tip:

- Don't create panic or overstate
- But don't underplay the seriousness of the situation
Report also on prevention, not only on problems

➤ Area of difficulty for many compliance functions

➤ But “prevention” not equal to “reporting on being busy”
  ▪ Not “how many we trained”, but “how we measure effectiveness”
  ▪ Forward looking not only backward looking KPIs

You are not just “reporting”

➤ Your are also further building up the relationship

➤ By bringing “reasonable assurance”
  ▪ You are showing that you are doing your best and acting in good faith
  ▪ But avoid overpromising!
Phase B

Phase B  Time to think of joint gains, while protecting your interests

Use rulemaking as opportunity to provide constructive input

If an examination, err on “over-preparing”

Defend your position, but it is a phase to further build your reputation as helpful, collaborative, and fair, not to be adversarial

Recall it is a «transaction»: relationship is of higher value

In this connection recall this tip...

Be tough on the problem, easy on the people

Compromise on ego, not on principle

Offer options where they exist

Explain business and values rationale

Inspired by the work of Roger Fisher, Professor at Harvard University and author of Getting To Yes

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Phase C

A critical time when the relationship is tested

- Don’t bring friction-creating attitude or people
- Avoid threats
- First weapon: reason and principles, not legal bombs!
- Worst time to hide things from the regulator
- No bridge-burning, the regulator will remain your regulator

Summarized

Phase C:
- Temperature is hot, but you need to stay cool
- Defend your rights with dignity and fairness

Phase B:
- Capitalize on the good relationship
- Work for win-win outcomes

Phase A: things are cool:
- Build a positive relationship with the regulator
- Spend most of your time in this area
1. Shoes
2. Marriage
3. Pet Peeves

Tip #3: Know your regulators’ «pet peeves» or «hot buttons»

Typos”, grammatical errors, incomplete data
• Interpreted as lack of attention to quality…even disrespect to the regulator
Bringing only legal or government affairs people to meetings
- Some regulators want to hear directly from business, compliance, and other control people

Arriving late for calls or meetings, or leaving early
- Can be interpreted as company culture...could wind up in the minutes

Surprises

Questioning the authority of your interlocutor

Dribs and drabs
Is there something special about... the regulator and Compliance Function relationship?

They expect it to be frank and straightforward.

They see Compliance as the conscience of the company.

They expect Compliance to think independently.

If the regulator sees compliance as "stalling, "waffling" or "equivocating", what will they think of Management?
But limits to commonality of interests

And some Compliance Officers see regulators as an ally

But recall: each has independent duties and interests. And the regulator can bite.

Nonetheless, recall this dynamic

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Properly engaging with the regulator, means organizing/ coordinating internal stakeholders, though without Compliance losing independence.

1. Coordination: Why?

2. What needs to be reported?

3. How to report?

4. Exercising any potential independent CCO duty

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IV. Conclusions

It’s about optimizing, not “managing” the relationship with the regulator

- Done the right way, part of value preservation and creation
- Regulators are human: the “how” is as important as the “what”
- Important to ensure internal coordination...but without endangering Compliance’s independence
- Recall S.M.P: shoes, marriage, pet peeves

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