

HOW TO CREATE A
STRONG
COMPLIANCE
CULTURE

Continuity



“...in every organization there is a set of norms that appear to inform behavior of those within the organization, even in the absence of explicit and specific rules or instructions...”

**Federal Reserve Board
Governor Daniel Tarullo,
October 2014**

How to Create a Strong Compliance Culture

How do you foster compliance within a financial institution (FI)? It's a pressing question facing community bank and credit union leaders as the pace of regulatory change quickens. For the first time, regulators and examiners are clearly advocating that community FIs take a systematic, top-down approach to compliance activities representing a notable shift from how compliance has traditionally been handled. A decade ago, the goal was to simply meet regulatory requirements on a rule-by-rule basis. However, with more than 13,000 regulatory requirements currently on the books, it has become impossible to enforce compliance using this “checkbox” approach.

Today, examiner and regulator expectations reflect this shift. Community FIs must demonstrate a “culture of compliance” that enables agile and effective responses to regulatory change. Examiners are taking a closer look at the behavioral factors that increase this responsiveness, and how they are supported and reinforced by management.

The pressures to create a strong culture are also being applied internally. The costs and human capital resources required to maintain compliance have grown exponentially, which poses serious risks to the sustainability of many community banks and credit unions. These institutions are seeking new approaches to compliance not only to assuage examiner and regulator expectations, but to improve the stability and competitiveness of the business.

So, what constitutes a culture of compliance? What are the behaviors that support it? How do you cross the chasm of change? In this white paper, we will identify the characteristics of a strong compliance culture and how community FIs can assess their current cultural climate and ignite the changes required.

Culture /kuhl-cher/ the behaviors and beliefs characteristic of a particular organization or group: “Compliance Culture”

Five Principles of a Strong Compliance Culture

While it's easy to spot a strong culture of compliance when it's present, a hard and fast definition doesn't exist. It can't be mandated or driven forward with a dictatorial approach. Instead it's a byproduct of clearly stated values and the organization's commitment to making it easy to achieve them. However, there are five principles and characteristics that strong compliance cultures share:

- 1. Pervasive.** Compliance isn't relegated to a backroom or a separate set of activities. It's obvious, embedded and everywhere. Compliance and risk officers take an active leadership role across the entire business, interfacing with leaders of all business units and departments. They are involved in all major business initiatives including strategic planning, new revenue determination, marketing and beyond.
- 2. Invisible.** In a strong compliance culture, compliance is everywhere, but it's also nonintrusive. It's baked into every business process. Take lending, for example. Using data from a loan origination system already in use, loan officers can automatically determine whether a loan is under-reportable. Instead of being a separate, ad hoc activity, it's ingrained in the lending processes.
- 3. Dynamic.** FIs that demonstrate effective compliance cultures are constantly anticipating change, and don't view changes in compliance requirements as a roadblock between progress and performance. They have a standardized, systemized approach to identifying areas that have to change due to new requirements and implementing those changes in the least disruptive manner possible.
- 4. Business-aware.** No matter how much time and money is spent, it's impossible to achieve 100 percent compliance across every transaction. Yet, many financial institutions try to accomplish just that – often at the expense of business growth. Exemplary compliance cultures are built around driving revenue and growth while minimizing exposure to illegal and high-risk situations. Instead of aiming for 100 percent compliance, a community FI will set a more realistic and affordable goal that falls within its risk tolerance profile.
- 5. Outcome-centric.** Strong compliance cultures are outcome-focused rather than rule-focused. As mentioned earlier, they don't view regulatory requirements as roadblocks to success or reasons to say “no” to new business initiatives or tactics. Instead they see compliance as an aid to conducting business in a safe and sound manner. They ask how they can best meet their business objectives in light of what the rule requires of them.

It's important to note that compliance automation is a strong, proven enabler of the aforementioned principles. Today's compliance management systems are designed to minimize the intrusiveness of compliance activities and engineer them into existing banking business processes. They also provide a centralized and standardized way to process, implement and monitor change as regulatory requirements evolve. Finally, they provide a platform for evaluating and balancing compliance risk in a way that's unique to the tolerance of each FI. The implementation of compliance automation is helping community banks and credit unions of all sizes change their behavioral approach to compliance – most notably from a “culture of no” to a “culture of grow.”

Compliance is “effective” when it is:

- Embedded into existing workflows
- Achieved with minimum friction
- Accounts for human nature
- Provided at the lowest practical price point
- Results in few or no examiner criticisms

Mere Compliance versus Effective Compliance

Mere compliance is much like treading water. Eventually, no matter how strong the swimmer, exhaustion sets in. Effective compliance, on the other hand, is not only a path to survival but a catalyst of growth, differentiation and innovation.

In the case of mere compliance, common mistakes run the gamut from doing too little to overreaction. For example, an FI may do the bare minimum to stay in compliance and pass exams. This “do a little here, do a little there” approach can obscure the bigger picture and result in missed opportunities to improve business process efficiency. At the other end of the spectrum are FIs that try to achieve compliance perfection at any costs. These institutions often waste time, manpower and money that could have been funneled to revenue-generating activities.

Simply being compliant isn’t enough in the current regulatory environment because it is inherently reactive (regardless of whether the scope and scale of the actions are too narrow or too broad). Most importantly, mere compliance – like treading water – is not sustainable in the long term.

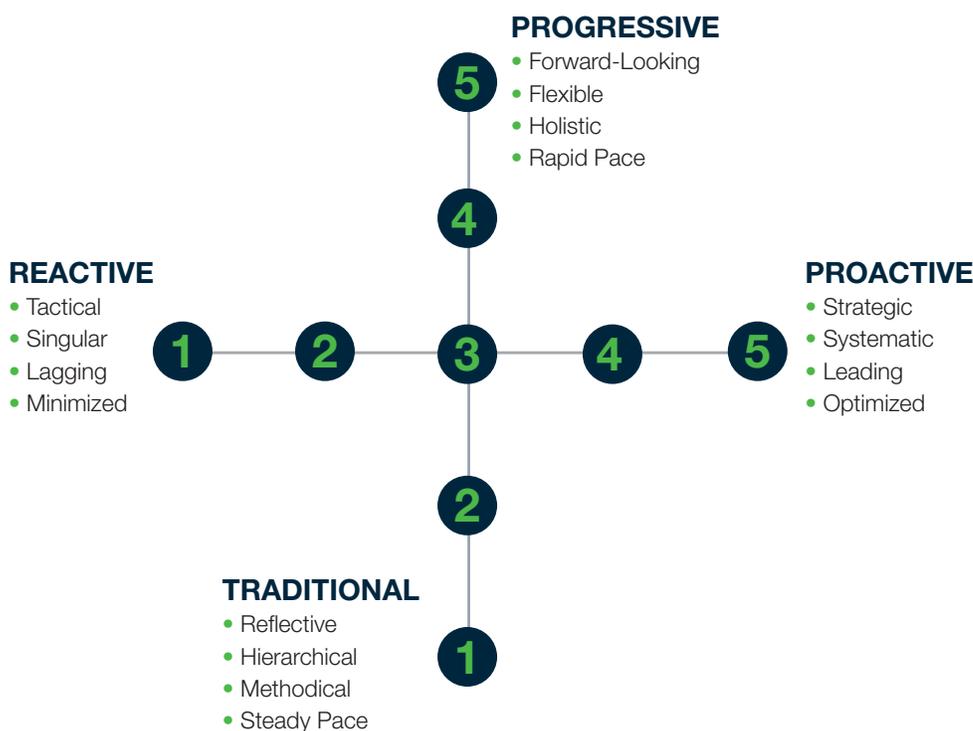
Effective compliance is proactive and culturally sustained. It’s a way of doing business. It’s embedded into existing workflows, and therefore achieved with minimum friction. It accounts for human nature and doesn’t aim to make everyone across the institution a fan of compliance – but it does make it easy to perform compliance duties in the course of doing their jobs. Effective compliance is also realistic. It’s accomplished at the lowest practical price point while still achieving the desired outcome, which results in few or no examiner criticisms.

One path to non-compliance is focusing only on the latest regulatory hot topics. This narrow view can obscure your ability to see the interconnectedness of regulatory requirements across different areas of the business.

Assessing Your Current Culture

As noted earlier, an FI's compliance culture is as unique as the institution itself. The organization's product/service mix, risk tolerance, growth objectives and leadership approaches must inform the vision as should the current state of compliance within the organization. Financial institution leaders must assess the existing compliance culture to determine the best path forward.

There are four areas that should be assessed – mindset, focus, function and management. Each of these areas represents common behavioral gaps between mere compliance and a culture that cultivates effective compliance.



Motivating Change – Reward or Punishment?

Once gaps are identified in a compliance culture, the hard work begins. Cultivating an effective compliance culture is a long-game endeavor and keeping the troops motivated is no small task. Incentives can play a key role in helping FIs accomplish their cultural objectives. These incentives should be tied to performance outcomes and identify the compliance outcomes to be generated. They should also discourage (or at least, not encourage) questionable behaviors.

“The secret of change is to focus all of your energy not on fighting the old, but building the new.”

Socrates

It's up to community FI leaders to determine whether reward or punishment will work better within their organizational ecosystem. However, many behavioral studies have proven reward-based tactics to be more successful in making the sustainable changes required for cultural change. If the FI determines that incentive-based compensation is the best fit, there are several risks to consider.

As mentioned earlier, one risk is that compensation systems will encourage undesired behavior – whether it's cutting corners on compliance or taking focus away from other key business goals. To mitigate this risk, FIs can apply conditions to earning the appropriate outcome or measure success using a scorecard approach that factors in level of risk incurred. Remember – the goal is to reward people for doing what is right as it relates to compliance, risk and the overall business goals of the institution.

Other concerns are that compensation systems may only reward revenue generation and may reward personnel too early – which does little to further a strong compliance culture. As such, FI leaders should consider incentives for those personnel that promptly identify and resolve compliance issues before they have a negative impact. It's also crucial to have quality control measures that validate compliant outcomes before incentives are paid.

Whether a FI chooses a reward or punitive approach to motivation, it's critical that compliance expectations be clearly and consistently articulated throughout the organization – starting with the executive team and down through the ranks. This means having a consistent approach to risk assessment, policy, procedure and audit frameworks, as well as explicit documentation of expected standards and validation.

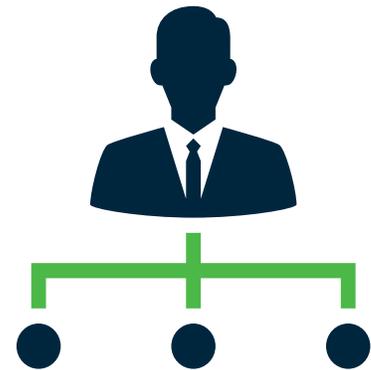
The Tone at the Top – Who Sets It?

A strong compliance culture has to be reinforced throughout the ranks of bank leadership, and “the tone at the top” needs to be established by the CEO and board of directors. That means inviting the compliance officer (CO) to be a trusted advisor and valued member of the executive team and participate in strategic business planning discussions. It also means giving them the resources they need to implement change across the organization.

This shift in tone requires COs to act and think a little differently. Today's CO must demonstrate strong business acumen in addition to compliance expertise. Compliance requirements and actions should be communicated

in terms of what resources will be required, how they will impact specific business activities (how any negative impacts can be mitigated or minimized), and the scope of economic consequences.

The CO must also educate executive leadership on what constitutes strong compliance behavior across the organization, and how those behaviors can be fostered. When this happens, the compliance conversation at the executive level shifts. Rote reporting now becomes frequent dialogue. Instead of tracking new requirements and institutional adherence, COs can plan and execute compliance strategies that make compliance easier and less resource-intensive. Finally, the CO can shepherd in a business and leadership culture that is committed to responsible profit generation – where the focus is less on “don’t break the law” and more on “do the right thing.”



Creating a strong compliance culture requires a consistent “Tone at the Top” which must come from the CEO and board of directors.

Conclusion

It’s imperative that community FI leaders understand the relationship between their reaction to compliance change and institutional success. The volume of regulatory changes will grow in 2015, especially as new rules go into effect and rollback measures and clarifications are issued for existing requirements. The best defense against the mounting workload and cost is creating a culture that responds to change with swiftness and efficiency. Agility has always been a strong advantage for community banks and credit unions, and embracing a true culture of compliance will help sustain that advantage. The rewards of doing so will go well beyond higher compliant transaction rates and fewer examiner criticisms.

A strong, pervasive compliance culture can’t be created overnight, but it can be expedited through the smart use of automation and regulatory experts to guide the way. Connecting, integrating and centralizing compliance-related processes improves outcomes while minimizing resource requirements. Embedding compliance into larger business processes makes these activities painless (if not invisible). And, most importantly, automation creates energy and space for the discussion of more critical questions, like: How can we improve revenue generation? How can we increase market share? How can we innovate our business? Only when compliance is part of the fabric, rather than an incongruent set of activities, can community FIs can truly get back to doing what they do best.

Continuity can help your financial institution build a compliance culture.

Learn more about the Continuity Compliance Core at www.continuity.net or email info@continuity.net.

Additional Resources

Interested in learning more about creating strong workplace cultures (compliance-related or otherwise)? Check out these excellent resources:

Compliance Officer 2.0 – Are You Ready? – A white paper by Continuity that explores how the role of compliance officer has evolved in community financial institutions, and how compliance officers can acclimate to these changes.

Switch: How to Change Things When Change Is Hard – An excellent book on creating last change in the corporate environment. Authored by noted organizational change experts Chip Heath and Dan Heath.

The ADDIE Model – Initially developed for military personnel training, this is a popular training/learning framework for teaching new behaviors within an organizational environment.

Good Compliance, Not Mere Compliance – Governor Daniel K. Tarullo, at the Federal Reserve Bank of New York Conference “Reforming Culture and Behavior in the Financial Service Industry”

Advisory to U.S. Financial Institutions on Promoting a Culture of Compliance
FinCEN, August 11, 2014

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ABOUT CONTINUITY

Continuity provides the Compliance Core™ for community banks and credit unions. The Compliance Core is engineered to reduce compliance risk and cost for financial institutions by bringing together strategic planning, technical execution and world-class insight into a single, subscription-based solution. These services are delivered using a compliance control platform that is continuously updated with regulatory data from D.C. and best practice compliance processes from other Compliance Core institutions. Built by bankers and former examiners, Continuity's Compliance Core helps financial institutions quickly adapt to regulatory change, streamline the workload and ensure compliance. www.continuity.net