NSCP
THE NATIONAL SOCIETY OF COMPLIANCE PROFESSIONALS

MAY 2017 SPECIAL REPRINT
Currents

Managing the Impact of High CCO Turnover in Financial Services Sector

By Carlos Guillen

In 2016 when search firm Russell Reynolds released its study of the role of the corporate compliance officer in the financial services sector(1), the most alarming finding was that there was a 40% turnover rate among CCOs over a two-year period. This does not come as a surprise to those of us in the compliance world. We have been dealing with the growing impact of CCO turnover for some time as asset management firms, banks and insurance companies have had to grapple with the increasing complexity of compliance regulation and the dearth of qualified CCOs.

Adding to the CCO turnover issue have been recent SEC actions taken against corporate compliance officers which may have helped accelerate the rapid rate of departures and create a reluctance by qualified professional to take on this role. For example, the enforcement action taken by the SEC against BlackRock Advisors(2) where the agency charged the then-CCO for causing the firm's compliance-related violations by failing to ensure that the firm adopted the required policies and procedures sent a chilling signal to the compliance community.

To compound the problems presented by CCO turnover was the finding by the Russell Reynolds study that 43% of new hires were external or from outside the financial services industry. Transitional challenges coupled with lack of industry familiarity have placed enormous pressure on firms and their new CCOs to ensure that there is continuity in record keeping, policies and procedures that provide audit-readiness for the compliance function.

High turnover rates among CCOs can greatly impact overall compliance programs, but understanding which specific areas are at most risk when a firm goes through a CCO transition period is critical. The cost of compliance turnover can be enormous both in terms of short term disruption and expense, as well as in the longer-term if a compliance break-down in a transition period or even prior brings about a regulatory enforcement action. These are costs that should be measured in dollars and in potential reputational harm.

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What areas of a firm's compliance program are most vulnerable? According to Jaqueline Hummel of Hardin Compliance Consulting and Jonathan Wowak of Cipperman Compliance Services, the five compliance areas where breakdowns are most likely to occur in a CCO transition period are:

- *Day-to-day responsibilities:* Without the continuity of having a CCO in place, firms usually find themselves scrambling around to handle day-to-day tasks such as email review, reconcilements, trade reviews – all relatively routine compliance activities but which represent the core of information base for compliance monitoring. For firms with multiple offices, the challenge of keeping current on these tasks is even more daunting. The net result can be a serious disruption in workflow that will have to be reconstructed at a later date, or a breakdown of workflow processes.
- *Code of ethics reporting:* This is one of the most important compliance functions that is at the highest level of risk for financial firms during a CCO transition. Code of ethics reporting is governed by strict deadlines that must be met in accordance with SEC rules. Repeated failure to meet these deadlines may incur regulatory scrutiny and potential fines
- *Marketing review:* The timely review of marketing materials is a continuing responsibility for the compliance officer, and any gap in this review process can cause firms irreparable harm in terms of expense and reputation. In a CCO transition, there is a higher likelihood that marketing materials will slip through and get published without approval. The absence of the CCO can create a vacuum that is difficult to fill since the review criteria is very subjective and an acting CCO will not

know the subjective criteria previously applied by the former CCO. As a result, there have been numerous times when marketing materials have been recalled or web sites shut down due to unapproved material that slipped by resulting in great expense and firm embarrassment.

- *Fund Valuation:* CCOs for asset managers such as mutual funds will sit on valuation committees which must determine fair market value and pricing policies daily. Any gap in the CCO transition may result in a lack of key documentation, interrupt the workflow of this important committee and holding up important valuations.
- *Annual Review Testing:* Annual Review testing is an ongoing function that is one of the CCO's most important responsibilities. The SEC evaluates a firm's compliance program and procedures based on the annual review and any gaps or slippage in required testing and audits will invite further SEC scrutiny. In a CCO transition, no one really knows what tests have been completed or are in progress, and because CCO departures are normally very quick, there is no time for reconciliation or updating. As Jaqueline Hummel from Hardin has noted, "Testing results impact your ability to write the annual review, and if you cannot find these records, there's no intuitive way of finding them." As a result, firms must go through the costly process of duplicating testing to ensure that they are in compliance for their annual review.

For the most part, the areas of marketing and code of ethics reporting are where the greatest number of compliance breakdowns occur during a CCO transition period.

CCO turnover and the ensuing transitions have not escaped the attention of the SEC. "Usually what we see with CCO turnover is that they are replaced immediately by a person within the firm - a CFO, a controller or sometimes even an office administrator - who doesn't have the relevant experience and cannot continue the program," noted Jonathan Wowak of Cipperman Consulting. When an employee who has dual or more roles in a company is assigned the CCO role, problems are more likely to occur in the compliance area. Specifically, in the areas of books and records, added Wowak, there are laws which stipulate what types of records you must keep, where and for how long. And sometimes during the CCO transition period, these books and records seem to go missing, or are not archived correctly or not managed properly during this period which creates exposure for the firm. When the SEC sees a CCO transition, this represents "low-hanging fruit" for them, and they will hone in on this time period for testing.

According to the leading compliance consulting firms, the best ways to mitigate the risks posed by CCO turnover are either having in place 1) a CCO transition plan with clearly stated standard operating procedures; 2) a comprehensive technology platform; 3) or bringing in outside resources to assist in the CCO transition period. Unfortunately, too many financial firms have none of these in place and take the attitude that they will deal with it when it happens.

CCO Transition Plan

The SEC looks favorably on a firm having a plan in place for a potential transition. While they may end up disagreeing with aspects of a firm's plan, the SEC will give a firm credit for having a plan in place. What should a CCO transition plan cover?

The CCO transition plans needs to be a clear roadmap for the interim compliance team to be able to perform the required testing and to access key data and testing results. There should be written standard operating procedures that cover exactly how tests have been performed and where the results have been stored. Lastly, the data needs to be stored in a central location not in separate folders, spreadsheets or on emails which is too often the case. It is difficult enough to recreate naming nomenclatures for specific tests or find test results for an SEC examination, but not being able to access testing data is the first hurdle that a CCO transition plan must address.

Technology Platform

Technology can and should be the best friend that a firm can have in place to manage a smooth CCO turnover transition. A comprehensive technology platform can easily address all five of the critical areas that are at risk including the day-to-day reporting responsibilities, code of ethics reporting, marketing reviews, valuation and annual review testing. For the day-to-day workflow, a technology platform integrates all workflow processes including testing, calendar items, upcoming deadlines, email review, reconcilements and automating code of ethics reporting. The system can also house the compliance standard operating procedures so the new team can understand what needs to be done going forward.

A comprehensive technology software platform allows a compliance officer to replicate certifications easily and efficiently; maintain activity logs and audit trails to confirm specific activity. The platform should make it easy to access and retrieve data, and ensure that the reporting is consistent from period to period.

One of the real cost benefits of having a technology platform in place for a CCO transition period is the team efficiency that it can generate in terms of reduced man hours by incorporating standardized processes for testing, providing consistent compliance reports, eliminating manual reports and minimizing paper work. Technology provides aggregation tools and centralization of data and records that avoid having to find documents and testing results which may be scattered in folders, emails or spreadsheets in a desk drawer.

Outside Resources

A third and effective means for preparing a firm for a CCO transition is to bring in outside expertise such as a compliance consultant firm which can help plan for the transition, or step in afterwards to assist the in-house compliance team. Since many firms will assign the compliance responsibilities to someone who has minimal prior experience, having a consultant on board will be immensely helpful to avoid the compliance breaches that can occur as well as help recreate workflow and critical reporting functions.

With CCO turnover remaining alarmingly high and the SEC zeroing in on the firms undergoing compliance transitions, it only makes sense for financial firms to consider implementing one if not all the above steps to ensure a smooth transition from one CCO to another.

CCO Turnover May Signal Internal Problems

Another concern that should weigh on the minds of financial firms is how a CCO departure may be perceived by the financial marketplace and specifically by the regulators. If a CCO leaves, it's usually indicative of some greater problem in the organization. For instance, if a CCO leaves a firm having just gone through an SEC compliance examination, this may suggest that the SEC found that their compliance program was deficient, their compliance officer did not have sufficient expertise to administer the program, or had a conflicted position such as CEO.

Managing CCO Turnover Costs

At the end of the day, the cost of CCO turnover can be effectively managed if a firm has the right tools and attitude in place. There will always be time and productivity costs associated with a transition in the compliance function, but these can be minimized by technology. It's the hidden costs that firms may not be paying attention to when they fail to prepare for a possible CCO departure.

Some firms move quickly by replacing that compliance head with an internal person until a new CCO can be hired. Unless this person is well versed in the compliance procedures that have been established, he or she will be putting out fires and dealing with day-to-day problems as reports and tests back-up. There are always needs that will be pushed off until the new CCO arrives. This cost of turnover is hard to quantify because these businesses are complicated and everyone runs their businesses differently.

And then there are the real and reputation costs for approving and circulating marketing and advertising material that may have not been properly vetted in a CCO transition. Advertising is one of an adviser's highest risk areas, and is one of the most frequent compliance breakdowns. Pulling back ads, reprinting brochures or even taking down web sites can be expensive., not to mention the reputational harm caused by such actions.

Probably the most significant cost of a CCO transition is a compliance breach that leads to an SEC investigation and fine. Since it has been documented that the SEC focuses on firms that have undergone compliance transitions, there may be a higher likelihood that compliance breaches will be discovered due to some of the potential compliance problems that have been outlined here.

A just released Compliance Risk Study[3] from Accenture Consulting of 150 leading Compliance officers at banking, capital markets and insurance institutions across the Americas, Europe, and Asia Pacific, found that "while investment in the function is rising and expectations have matured, Compliance has in many cases not taken advantage of the tools and technologies that can help it effectively leverage this investment."

Conclusion

CCO turnover has become a major problem for financial services firms, leaving them vulnerable to increased compliance breaches in the ensuing transition period. The tools and technology are available to manage the transition process effectively and minimize a firm's exposure to compliance lapses. The challenge is for firms to recognize that the cost for being unprepared for a CCO turnover is much greater than the cost for investing in the management tools and technology that will protect their business and their reputation. ★

(Endnotes)

1. http://www.russellreynolds.com/insights/thought-leadership/how-the-chief-compliance-officer-role-is-transforming-across-financial-services
2. https://www.sec.gov/news/pressrelease/2015-71.html
3. https://www.accenture.com/us-en/insight-compliance-risk-study-2017-financial-services