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Compliance Management for Banks in Current Scenario - A Holistic Approach for Hedging

Abstract

Hedging refers to a method of reducing the risk of loss caused by price fluctuation Portfolio managers Banks & Corporations use Hedging techniques to reduce their exposure to various risks.

New banking products, increased government scrutiny and intense focus on operating efficiencies bring forth greater risks so Banks and financial services organizations of all sizes are now more concerned than ever about risk and compliance management. Effectively managing compliance risk can help prevent damage to an institution's reputation and also reduce potential for fines and penalties that could result from violations of laws and regulations. Basel III dictates a required level of risk management compliance for banks and is intended to limit the threat of financial crisis, malpractice and instability worldwide.

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Introduction

Banks and financial services organizations of all sizes are now more concerned with Hedging which means reducing or controlling compliance risk through holistic approach of compliance management.Compliance risk is the current and prospective risk to earnings or capital arising from violations of or nonconformance with, laws, rules, regulations, internal policies and procedures, or ethical standards. Compliance risk can also exist when governing laws or rules related to specific bank products or activities may be ambiguous or untested. Effectively managing compliance risk can help prevent damage to an institution's reputation and also reduce legal risk and the potential for fines and civil money penalties that could result from violations of laws and regulations.The costs associated with implementing an effective compliance program can be significant.

Today's business climate is complex and increasingly difficult to predict. Stakes are rising in a global market in which competition is fierce and brand loyalty is fickle. The question is, given today's highly regulated environment, how banks can control risk and manage their performance effectively?

Aim of the Study

This paper discusses the current risk and compliance environment for banks and financial institutions, and strategies for successfully implementing Governance, Risk and Compliance (GRC) programs to adopt a holistic approach for Compliance Management.

Compliance: An Exercise of Risk Management

Compliance function in banks is one of the key elements in a Corporate Governance framework and also plays a very important role in identifying, evaluating, and addressing legal and reputational risks of banks. Compliance is a form of risk management. In the case of compliance, most of the risk we manage is based in or created by laws and regulations rather than by market forces or customer behavior some key sources of risk are staff turnover, a product complexity, rapid growth of the bank or a bank product, economic forces in the bank's market, and technology

Basel III also dictates a required level of risk management compliance for banks and is intended to limit the threat of financial crisis, malpractice and instability worldwide.

Risk is becoming a popular management tool. Bank auditors currently use risk as a key audit tool. Bank examinations are increasingly based on risk assessment. This trend toward risk assessment and risk management is a natural fit for compliance.

The Tread way Commission's Committee of Sponsoring Organizations (COSO) identifies risk in several categories: external factors, internal factors, and risk relating to change.External factors are risk sources over which the bank has no control but may be able to observe and predict. The smart risk manager will see it coming and have a strategy for responding.

Internal factors are risk sources over which the bank (but not necessarily the compliance manager) may have control. The compliance risk manager should use his or her knowledge about the bank to identify internal risk factors and take steps to minimize them. Controlling internal risk therefore involves choosing the optimum balance between risk control and business opportunity.

Risk relating to change involves a combination of factors that are and are not within the bank's control. Change related risk may be the result of the development of new products which trigger a new analysis of compliance risk Change may also occur because of changes in the economy, the bank's market, or legislation. In this type of change, the bank is in the position of responding rather than driving the change.

A compliance management system is the method by which the bank manages the entire consumer compliance process. It includes the compliance program and the compliance audit function, sometimes referred to as compliance review or self-assessment (fair lending). The compliance program consists of the policies and procedures which guide employees' adherence to laws and regulations. The compliance audit function is independent testing of an institution's transactions to determine its level of compliance with consumer protection laws, as well as the effectiveness of, and adherence with, policies and procedures.

Board and Management Supervision and Administration

Compliance with law and regulation must be managed as an integral part of any bank's business strategy. The board of directors and management must recognize the scope and implications of laws and regulations that apply to their bank. They must establish a compliance management system that not only protects the bank, but also uses resources effectively and minimizes disruptions in daily activities.

To ensure an effective approach to compliance

The board and senior management should review the effectiveness of its compliance management system. This review should include reports which identify any weaknesses or required modifications to changes in laws, regulations, or policy statements. Prompt, capable management response to those weaknesses and required changes is the final measure of the compliance system's effectiveness.

Senior management must assign well qualified staff and resources to properly implement and administer the compliance program.

Compliance Program

All banks, regardless of size, should have a compliance program. A carefully devised, implemented, and monitored program will provide a solid foundation for compliance. Management should evaluate its institution's organization and structure and create a program to meet its specific needs and the diversity and complexity of operations. A compliance officer or committee should be appointed with specific responsibilities and authorities. The nature, scope, and complexity of bank operations will determine the duties, responsibilities, authorities, and accountability of the compliance Officer the formality of the compliance program will increase in direct proportion to asset size, complexity, or diversity (including geographic) of operations

Internal Controls

Internal controls are those systems through which the bank provides and ensures continuing compliance. These generally consist of sound organizational structure, comprehensive policies and procedures

An effective compliance program includes compliance policies and procedures as per needs of the bank.

Policies provide the framework for the bank's procedures and a source of reference and training for the bank's personnel. Comprehensive and fully implemented policies communicate the board and senior management's commitment to compliance clearly to all personnel.

Procedures should be developed to implement the bank's policies. This may include appropriate regulation cites and definitions, sample forms and instructions, and, where appropriate, directions for routing, review, retention, and destruction of the transaction documents. When used, these programs often must be modified to meet individual bank needs to ensure the effectiveness of the program the degree to which the compliance program is formalized is not as important as its effectiveness. This is true especially in smaller community banks where policies and procedures may not be in writing but are communicated to the staff on a regular basis.

Training

Education of the bank's personnel is essential to maintain a sound compliance program. All personnel should be generally familiar with the consumer protection laws and should receive comprehensive education in laws directly affecting their jobs. They must also be trained in policies and procedures adopted by the bank to ensure compliance with those laws.

Standards for the frequency and method (e.g., formal, on-the-job, external) of training should be addressed. For example, some statutes. Periodic training will help to ensure adherence to policies and procedures adopted by the bank and to regulatory changes. The method of training may vary greatly depending on the size of the bank or department, time requirements, and the importance and complexity of the subject matter

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Compliance Audit Function

The other component of a comprehensive compliance management system is a compliance audit function. It enables the board and senior management to monitor the effectiveness of the compliance program. The audit function tests the bank's compliance with consumer protection laws and adherence with policies and procedures. An effective compliance audit function will address all products and services offered by the bank, all aspects of applicable operations, and all departments and branch locations.

The Benefits of Effective Compliance Management

Managing an effective compliance program can provide many benefits to improve overall performance and to facilitate the achievement of business goals. An effective compliance program can impact an organization's bottom line by reducing legal and reputational costs. Therefore, management should strive to not focus solely on compliance as a generator of costs and should identify the benefits it can add to financial performance. In addition to reduced legal and reputational risk, there can be additional benefits to effectively managing compliance risk. An effective compliance program can also identify operational weaknesses. This can be useful in improving an institution's overall internal controls. In addition, effective compliance management sets a positive tone from the top of the organization and establishes a strong compliance culture

Compliance Policy and Compliance Functions in Banks

Undoubtedly compliance function is an integral part of the governance, particularly in banks owning to its sensitive and fragile character. Compliance function, if not supported by management, does not bring in desirable results.. In fact, management of Compliance risk itself is a major issue in banks.

In case of listed banks, capital market related regulatory framework is also to be compiled with. Not only this, nowadays issues confronting various tax laws, money laundering and right to information need to be properly addressed. Compliance area is relevant and crucial in identifying, evaluating and addressing legal, operational and reputation risk. These issues ought to be addressed at Board level to ensure that prevailing procedures, systems and controls capture the desired information so as to allow Board to better perform their risk management function.

Compliance policy, outlining the compliance philosophy of the bank, role and set up of the compliance department, composition of its staff and specific responsibilities duly Approved by the board of directors should be in place. The policy should be reviewed annually by the board. The board is expected to review compliances on a regular (daily, quarterly) bases.

It is also important to recognize and appreciate the performance of human resources dealing with compliance related issues. For example, the compliance risk in all new product and process should be thoroughly analyzed and appropriate risk mitigates by way of necessary checks and balances should be put in place before launching. The chief compliance officers should be a member of the 'new product' committee / s to ensure that the new products / processes have clearance from all perspectives including compliance.

The activities of the compliance function should be subject to annual review by the internal or management audit. Instances of all material compliance failures which may attract significant risk of legal or regulatory sanctions, financial loss or loss of reputation should be reported to the Board / Board committee promptly

Need for Compliance Officer

It is imperative that compliance officers in PSBs should also be qualified professionals who unlike a core banker, are better suited to perform the functions of a compliance officer and also ensure corporate governance measures, shareholder's grievance redressals system and safeguard investor's interests. Reserve Bank ought to take a lead in this direction and emphasis appointment of a qualified professionals as compliance officer and secretary to the bank's Board.

Need for Compliance Committee

Bank boards must have a compliance committee of the board to oversee the level of compliance and ensure that banks are complying not only with the banking laws but with all the laws to which a banking company is exposed. It could be labour laws, industrial laws, international laws, environmental Laws Accounting standards or other various taxation laws. Now days, new generation legislation such as money laundering Act, etc are also in place to which banks are exposed A slight non compliance could invite high financial and reputation risks

Conclusion

The Banks shouid consider compliance to be one of its most important management issues and has to enhance its compliance structures to ensure that the actions of executives and employees alike will earn the trust and support of observers, enabling them to build solid bonds of trust with the local community and to maintain their reputation as "an appealing bank that provides customers with reassurance and satisfaction over the long term."

The role of compliance and compliance committee can go a long way in effective compliance related governance in banks.

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