



## Outsourcing compliance can improve outcomes part one

May 08 2015 Julie DiMauro, Compliance Complete

Regulators are regularly telling companies to bolster their compliance programs, and some of these businesses have turned to outsourcing all or parts of the chief compliance officers role to outside experts. Doing this can help small, mid-sized and even large firms to harness independent advice and consider new approaches to creating a credible program that by adding extra layers of protection and better communication.

Part One of this two-part article series will explore how and why practicing chief compliance officers are outsourcing portions of their compliance program to outside consultants, and examine how such consultants view this work. Part Two will synthesize the lessons learned from their experiences and from recent enforcement actions and regulatory guidance.

The Securities and Exchange Commission (SEC) has provided some rules on compliance at investment advisors and investment companies, saying it expects the firms to designate a compliance officer that has authority over the firm's compliance program.

This has not prevented some firms from outsourcing the whole compliance role, but it underscores the firm's need to manage the program itself, even while accepting external guidance.

### Consultants role

Most firms have someone internally who does some of the compliance functions for the firm and manages the outsourcing process, said Deirdre Patten, CEO and founder of Patten Training & Review LLC. But companies can be stretched too thin when it comes to managing all aspects of the compliance function.

Patten said that when firms call upon outside consultants to help provide training to their employees, it is often to help them track it. Even large firms that handle most aspects of training themselves may need help assessing which employees have taken certain training programs, assessing the areas of compliance that are tripping up staff the most, or providing regulator-required attestations.

Also, when a company is using a new product or offering a new service, their employees need targeted training on how to get registered to do so and ongoing training to do it appropriately, she added.

Sometimes the consultant can help the firm perform the risk assessment that helps it and its new products and risk committees within the board of directors decide whether to approve of the new service line, based on the regulatory risks involved in the relevant jurisdictions.

Using consultants has enabled its staff to speak candidly about their concerns, said a chief compliance officer from a small Texas broker-dealer who wished to remain anonymous so as not to compromise any business relationships. The consultants are viewed as independent sources of expertise and can sometimes generate more honest debates about where the gaps in compliance are in the firm.

Using compliance experts from outside the business enables the business to assess its risk profile. That's because the employees generally adopt the compliance approach that their immediate manager has, giving the consultant a

view as to where middle managers stand in creating the right tone and compliance culture within the firm, the CCO said.

When asked about the vetting process for selecting a consultant, the CCO said that the main concerns were that the consultant have specific privacy protection processes in place to guard the firm's customer and financial data.

Also, those consultants must have well-constructed business continuity plans, since some of the hiring firm's data will be housed on their servers.

At the end of the day, as the CCO, I have to attest to FINRA (Financial Industry Regulatory Authority) and the SEC that I have tested my third-party vendors, including compliance consultants, and that those tests are part of my written supervisory procedures, the CCO said.

Importantly, the firm using such contracted assistance must always remember that the regulatory responsibility lies with the firm and cannot be outsourced.

I stress to clients and prospects that we are happy to help with their actual work, but the regulatory burden reporting to the authorities, for example -- and compliance responsibility is theirs, said Tina Petruzzello, Founder and Compliance Principal at Boston Compliance Associates.

For Petruzzello, the mock audit is the most popular outsourced compliance work her business supplies firms of a variety of sizes. Having an outside source conduct an independent review provides a less biased assessment of the firm's current compliance program, she said.

The SEC mandates that advisers have written policies and procedures that touch on all relevant business compliance topics, as well as the steps the firm has taken to resolve issues as they arise.

The emphasis is on fully developing a customized compliance manual within the firm. Not having a robust one has produced many deficiency letters. We often come in and help re-write or enhance such compliance manuals when clients get such a letter, Petruzzello added.

Comments such as we did not know we had to fill out that form or we didn't think that requirement applied to us are commonplace, she said, noting how her clients are facing an ever-changing and multi-player regulatory landscape.

To begin working with a new firm, consultants should get an appreciation of the firm's compliance culture.

A consultant needs to know if the compliance work will be evaluated and appreciated at the highest levels of the firm which helps produce buy-in and make our job doable. The consultant needs to understand the firm's business model, but also get a sense as to what keeps impeding the firm in either creating the program, communicating its elements to staff, or assessing its effectiveness.

### **Inside the firm**

The point of contact at the firm for consultants is generally the CCO, along with the CEO, and Petruzzello said having at least two points of contact is best, just in case there are unclear directives.

The process of supplying and receiving such services can involve challenges. Patten and Petruzzello mentioned how allocating the workload can create tension when it comes to sharing turf. The relationship works best when mid-level and top managers help explain the purpose of the hired expert and encourages employees to use the expert as a resource.

Once trust is established and employees see that we are there to help and not to report on them or spy on them, the questions and feedback start flowing and really don't stop, Petruzzello said.

The consultant's feedback is part of the validation or invalidation of your controls, said the CCO of a global investment advisory firm based in Asia, who wished to remain anonymous because he was not the firm's official spokesperson. It's a feedback loop: implement-validate-improve, and it never ends.

This CCO noted that any consultant that sees it as its role to destroy the image of the compliance team is getting the job wrong. Unless the consultant has been mandated by a regulator as an independent monitor as part of a settlement agreement or other enforcement action, the consultant's remit is to enhance the CCOs ongoing work.

Although there is no regulatory imperative that firms disclose their use of consultants, both CCOs mentioned it is not good practice to hide it. Employees should know who these outsiders are and companies should tell regulators in filings how such service providers provided enhancements to the compliance program.

When the outsourced work is carefully structured, monitored, and tested, and the firm demonstrates it understands that it is on the hook for all of the work by the service provider, the regulator has not intervened to say it disapproves of such outsourcing, one CCO noted.

### **Could third-party review be required?**

SEC Chairman Mary Jo White indicated last May that she was open to the idea of outsourcing examinations of investment advisers, calling it creative. She was responding to a suggestion made by SEC Commissioner Daniel Gallagher that the agency should propose a rule that would require advisers to hire third-party contractors to review their operations. The proposal has not been made formally by any commissioner yet.

Outsourced compliance expertise can be found in law firms, boutique consultant firms and among solo practitioners.

Patten notes that some consultants are hired on a project-specific basis and others have an ongoing relationship with the firm, so when questions arise, they use the consultant as their go-to source of information. Another model is the information technology expert that firms access to enhance their cybersecurity/data-protection programs and prepare for events that could compromise their data security.

Whatever the type of relationship used, Patten says she makes sure to document everything the firm does in response to her recommendations. If the firm takes a path other than what you have advised, you should carefully document it.

CCOs should document everything the consultant has recommended, the specific steps the firm has taken in light of those recommendations, and any reasons for not taking them.

The risks imposed by using outside consultants must be considered, and all of the controls surrounding the ongoing work of the consultant should be spelled out, as should the criteria upon which the consultant was selected and the background checks used in evaluating their credentials and disciplinary histories, said the CCO from the financial services firm in Asia.

When you get too much pushback from prospective compliance consultants during your investigation of their credentials and references, it's a sign to close the door, he said.

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