

# HOW to make the shift to principles based compliance

## Article

### HOW to make the shift to principles based compliance

In this article I want to propose ideas as to how a firm might go about moving compliance to a principles based rather than rules based focus. Imagine a project team had been formed with the following objectives:-

- To evidence how this firm meets the FSA's Principles for Businesses
- To show financial, reputational and customer service benefits from the exercise

By taking the Principles as a starting point, rather than rules and guidance, what those principles mean in the form of outcomes that the firm must achieve will allow tailoring of the principles to the business activities of the firm. For example, Principle 8 Conflicts of Interest, which states that "A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client."

If you were translating this into outcomes then you may decide that the following statement would describe the result you want to achieve:-

*"We will ensure that our customers do not suffer any disadvantage as a result of the conflicts that occur from time to time as a result of our business model"*

Firstly, this statement recognizes that conflicts do exist, secondly that they arise because of the way you do business, thirdly it sets a clear standard for the firm to achieve when considering the systems and controls it wishes to put in place.

If you are trying to reach this outcome then your next steps would be to establish:-

- Where conflicts arise and in what circumstances
- Whether they can be avoided altogether by a change to the way you do business and whether this would have any impact in relation to profit, reputation or customer service
- If they are inevitable, in what circumstances could customers be harmed.

This fresh look at why Conflicts arise could lead you to a conclusion that there is more to be gained than lost by continuing to operate this business model. It will also allow you to separate those conflicts that cannot impact on customers and those that are likely to cause harm. By separating high risk conflicts from low, a sensible policy that places the majority of safeguards and controls where they matter rather than a one size fits all.

Now consider the interests of different parties to the conflicts you have categorized. Who should be told they exist and when, how can you ensure this is done and what records should you keep to enable you to make sure that customers interests are paramount?

For those conflicts where it is impossible for customers to suffer you may not want to put any policy in place at all, until you carry out this exercise you will not be certain that this is the case, after all a conflict by it's very nature, suggests that harm must be possible. Take two business models for giving mortgage advice

Model 1: All products sourced by the firm meet certain minimum standard set for the soundness and service standards of the lender, range of products and competitiveness of price. Different commissions are received from different providers but advisers are paid the same regardless of the product they recommend.

Model 2: The firm sets minimum standards for the soundness and service standards of the lender and has a sales process that ensures customers are given suitable advice. It pays the adviser according to a scale linked to the level of commission paid by the lender.

In Model 1 it is difficult to see how a conflict exists between the adviser, the firm or the customers interests, in Model 2 the conflict is clear.

When you are clear about what needs to change to meet the outcome the firm has set you can draft processes that take account of the relative risk of different scenarios, the level of reporting and oversight and the potential risks to your firm of failing to follow those processes.

At this point you can check back to the rules that apply to your business and make sure that you are meeting these. Having undertaken this exercise a number of times it has never been the case that the rules have not been met.

The benefits of this approach are:-

- The firm knows why it has adopted systems and controls
- The low risk areas are distinguished from high risk areas
- Gains in terms of costs reputation and customer service are possible

Most importantly the firm owns its approach rather than external rules being seen as an imposition and inconvenience.

### **Series of three articles: Principles Based Regulation**

1. Whose idea was it anyway and why?
2. The current thinking and clues from TCF
3. HOW to make the shift to principles based compliance

Jayne Owen  
Chief Executive, Corporate Training Partnerships Ltd  
jayneowen@ctp.uk.com  
01327 858292



Published by Complinet November 2007