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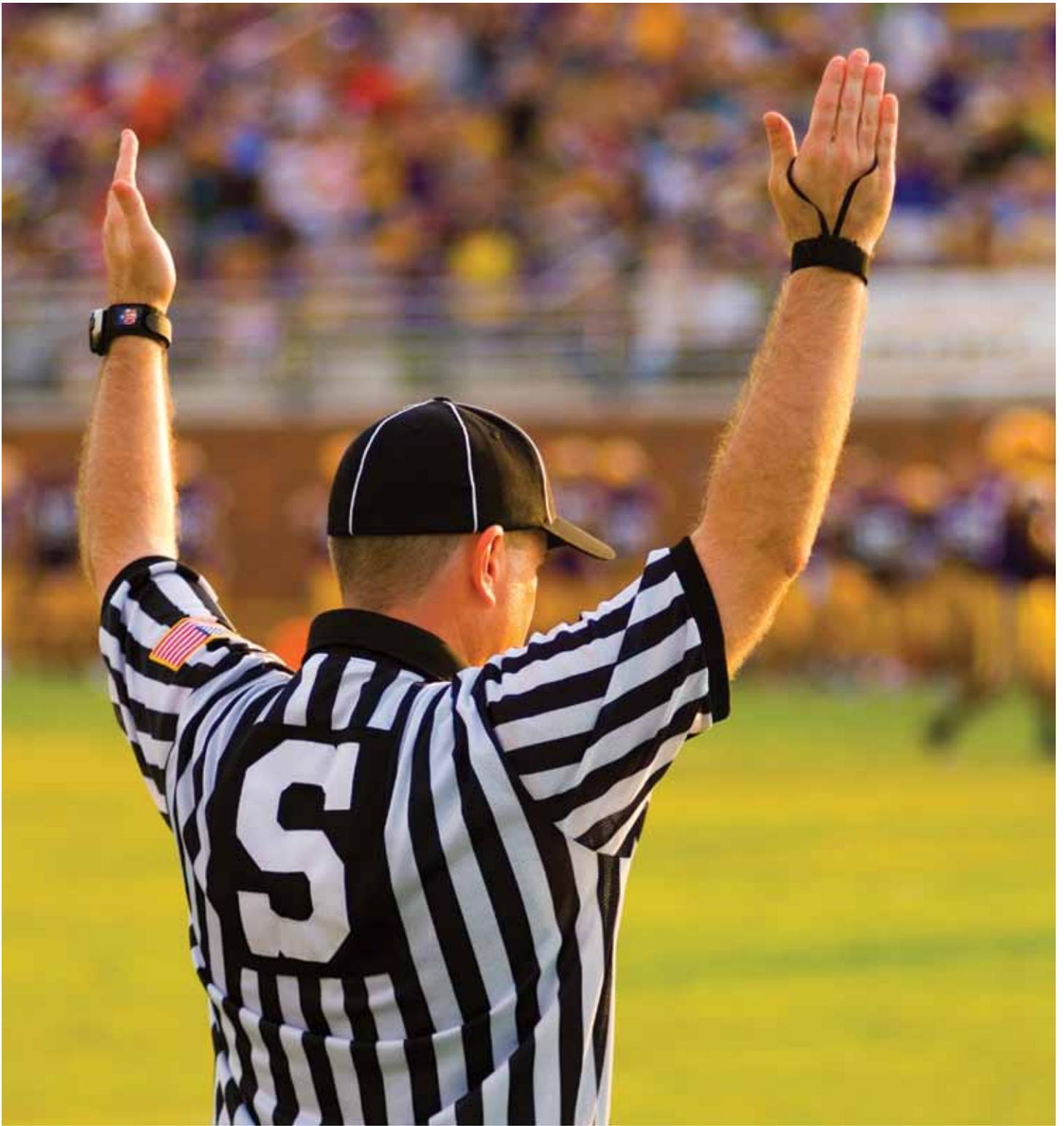
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# ROADMAP TO ACHIEVING SUCCESS IN REGULATORY EXAMINATIONS

BY MARK A. EGERT

There are few events as disruptive and stressful to a chief compliance officer as a group of auditors descending en masse on his or her firm for an extended period of time to conduct a regulatory examination. Similar to the situation of a student studying hard all semester and then taking a final exam for which he will be given a single grade, the regulatory examination is where the firm, as well as the CCO's efforts to develop and implement an effective compliance program, will be judged. Many factors determine how well a firm will be graded and many are beyond the control of the firm or its CCO. A firm, however, can put itself in the best position possible to achieve a successful examination by following a few important steps.

During my 15 years in-house as chief legal officer and CCO, I managed more than 40 regulatory examinations. In private practice, I assisted clients on many more than that. I have seen some audits go extremely well, and I have witnessed others get terribly derailed. I have been faced with examination findings that simply made no sense or seemed grossly unfair, and have had examinations that have resulted in zero deficiencies — leading my firm's CCO to issue a firm-wide memorandum applauding the achievement.

The purpose of this article is to provide a roadmap of steps that have proven to work well in achieving successful examinations, as well as missteps to avoid in dealing with examiners. The suggestions offered in this article should apply equally to any type of financial institution, including broker-dealers, investment advisers, hedge funds, banks and insurance companies, and to audits that are routine, cycle examinations or for cause, part of a regulatory sweep, or stemming from a complaint or investigation.

A successful examination does not necessarily mean one that results in zero deficiencies. That accomplishment is rare. Like football, in which the referee could call holding on every play, if so inclined, an examiner could find multiple deficiencies anywhere he or she examines, especially given the complex nature of most regulations and the subjective manner of interpreting the rules. Much depends on the luck of the draw.

Sometimes a firm is assigned an examiner that is inexperienced, overly concerned about missing potential problems and

simply unwilling to engage in any type of dialogue about the application of a given rule or the firm's compliance. At other times, a firm is confronted with an overzealous examiner who is determined to build a reputation and career by finding as much fault as possible with every firm visited.

A successful examination, therefore, is more a matter of obtaining a reasonably small number of serious findings — and hopefully no referrals to the enforcement division of the applicable regulatory authority — given the applicable facts and circumstance. The ability to achieve this result, in large part, depends on the preparation and response done at three distinct stages — pre-examination, during the examination and post-examination. The steps recommended at each of these stages are explained further below.

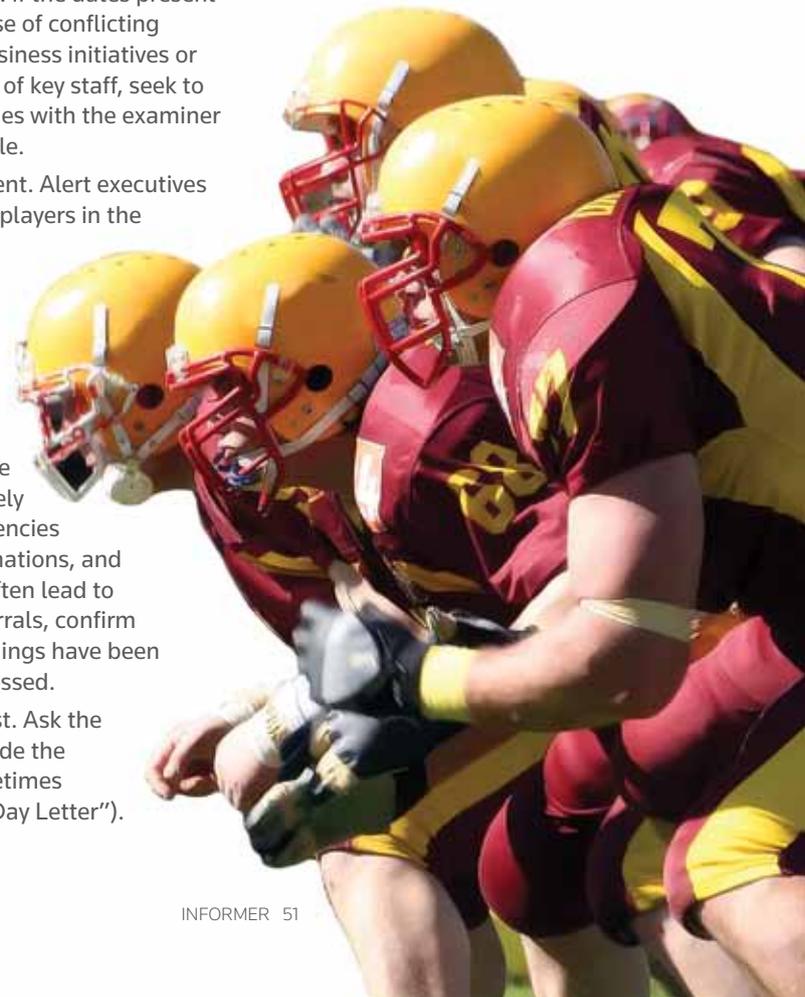
#### PRE-EXAMINATION STEPS

As soon as the CCO becomes aware that a regulatory examination of the firm will be occurring, the following steps are recommended:

1. Communicate with examiner. Contact the examiner to clarify key facts — the proposed date to start and end the examination, scope, number of examiners on-site and space or equipment needs. If the dates present a problem because of conflicting examinations, business initiatives or the unavailability of key staff, seek to resolve those issues with the examiner as soon as possible.
2. Notify management. Alert executives and other crucial players in the organisation of the pending examination and issues likely to arise.
3. Review prior examination findings. Since the examiners are likely to focus on deficiencies from prior examinations, and repeat findings often lead to enforcement referrals, confirm that the prior findings have been adequately addressed.
4. Obtain request list. Ask the examiner to provide the request list (sometimes called the "First Day Letter").

Be organized and have a plan for document collection, review and production. Distribute request lists to responsible parties and clearly allocate responsibility among them. If any request is unduly burdensome, attempt to narrow the scope.

5. Provide documents promptly. Where possible, attempt to provide the information sought earlier than the deadline or at least on time. When a deadline cannot be met, make certain to communicate with the examiner. If warranted, ask to provide the documents on a rolling basis or ask the examiner to prioritize their requests.
6. Check recent developments. Be certain to review the areas to be audited to ascertain if there have been changes or proposed amendments to the regulations, market practices or the firm's business. Consider review of regulator's speeches as to "hot topics" and concerns, notices about their examination priorities and similar pronouncements. Research recent penalties imposed on other firms in the areas to be reviewed.
7. Notify employees. Warn employees that the regulators will be on-site and explain the conduct expected of them.



**STEPS TO TAKE DURING AN EXAMINATION**

Once the examination commences, the CCO should seek to use every opportunity to build trust and credibility with the examiners. The following steps help to achieve this goal:

1. Arrange a kick-off meeting. If the examiner did not propose a kick-off, ask for one. To show that the firm takes the examination sufficiently serious, seek to have senior managers attend. Have appropriate executives explain the firm's: (a) overall business, the products and services offered and changes since the last examination; and (b) the firm's compliance culture and system of internal controls.
2. Designate a point person. Have a single person designated as the point person responsible for interaction with the examiners, whether the CCO or another person in the legal, compliance or regulatory affairs department.
3. Establish a protocol for interaction. Clarify with the examiner the preferred manner for requesting documents (e.g., all requests go only to the point person or designated persons), interviewing employees (whether legal or compliance staff must be present) and how sensitive documents will be handled, such as watch lists, employee compensation and internal audit reports.
4. Maintain logs of requests. Keep a list of documents requested, documents provided and outstanding requests. Keep copies of all documents provided; examiners occasionally lose documents, or confusion may develop at some point as to which version was provided.
5. Seek to identify problems early. Ask the examiner to communicate as soon as possible about any potential deficiencies. Try to address those findings during the examination, rebut any inaccuracies or, if necessary, escalate the matter to the examiner's supervisor. Ask the examiner to inform you if any concerns arise about the firm's responsiveness to requests or its handling of the examination so that you can attempt to resolve those concerns promptly before they turn into larger problems.

**POST-EXAMINATION STEPS**

Once the on-site part of the examination has ended, the following steps may help to achieve a successful conclusion:

1. Request an exit interview. Like the kick-off meeting, if the examiner does not propose an exit interview, the CCO should suggest one. Involve key staff and managers. Ask the examination team to explain any deficiencies and attempt to address any concerns or misunderstandings or present any final arguments against the findings. Be prepared to answer likely questions, such as the cause of the deficiency, expected steps to remediate it and who in the organization will take responsibility for such remediation. It is important to be realistic and to avoid making promises the firm cannot keep.
2. Seek examiner's assessment. At the end of the examination or during the exit interview, consider questions you could ask the examiner to gauge the seriousness of the findings and their overall impression of the firm. For example, you could ask the examiners to rank their concerns, identify which, if any, deficiencies are expected to be referred to the enforcement area, or their perception of the firm (e.g., what it is doing right, what could be improved, how it stacks up against its peer group and other firms the examiner has audited).
3. Clarify next steps. Either at the exit interview or as soon as possible after the close out, clarify with the examiner such matters as the expected date of preliminary or final examination report, the firm's ability to review and comment on the report before it becomes final, and the time within which the firm may or must respond to findings and similar issues.
4. Take action to ensure confidentiality. To avoid disclosure of the firm's confidential material to third parties, ask the regulators for Freedom of Information Act treatment of the records provided, or ask them to return the documents when they are no longer needed.
5. Remember internal reporting. If warranted, report on the findings to management and, if applicable, parent, head office or another corporate center. Agree on an appropriate action plan,

resources, timing, responsible parties and the like. It may be helpful to document areas where no deficiencies were found and other accomplishments or positive aspects of the examination.

6. Address deficiencies. Promptly address any findings from the examination. After resolving the findings and prior to the next examination, it may be helpful to conduct testing to ensure that the policy or procedure that was adopted or amended has been properly implemented and is being followed. Consider conducting a mock audit, either with internal resources or third parties.

Although a regulatory examination can be a highly disruptive and stressful event, it can also serve as an opportunity, if handled correctly, to validate a firm's compliance program and internal controls. An effectively managed examination can be used to build trust and confidence in the firm not only during the examination but also for future dealings with the regulatory authority. A CCO can use an audit to demonstrate to management the expectations of the regulators and how they interpret their rules, to train employees, and to assess the firm's compliance efforts.

The steps recommended above cannot guaranty a firm will achieve a perfectly clean regulatory examination with zero deficiencies. The roadmap provided in this article, however, offers steps that, over time, have proven to be effective in minimizing findings and enforcement referrals that might otherwise result from a regulatory examination. If a firm undertakes the type of preparation and responsiveness suggested at the pre-examination stage, during the examination and at the post-examination stage, it will be taking great strides toward putting itself in the best position possible to achieve a successful examination. ■

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