

Chapter 11

Liability or Ethics? The Real Value of Compliance

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ABSTRACT

The purpose of this chapter is to reconsider a traditional approach to the compliance function of firms from a modern perspective, which broadens its concept as a company's liability to only secure its adherence to applicable laws and avoid regulatory sanctions in serving company's interests. The observation of issues regulated by the compliance function in the contest of managing situations of conflict of interest (COI) in different spheres concludes that, in fact, those issues, to a greater extent, relate to sustaining ethical behavior in business rather than stem from regulatory norms. Based on the findings of this analysis as well as other different sources, a new definition for effective compliance has been developed with the focus on adherence to ethical principles in respect to third parties, which addresses compliance function in terms of corporate social responsibility (CSR) and its sustainability role setting a vector for a further research.

INTRODUCTION

The term “compliance” goes hand in hand with corporate governance and risk management. It has come to be understood as an organization's function to protect business from adherent risks. Let's refer to two reliable and reputable sources for a widely accepted definition of a compliance function. One of the first definitions was introduced by The Basel Committee on Banking Supervision (2003) in its consultative document “The compliance function in banks” which defines a bank's compliance function as “an independent function that identifies, assesses, advises on, monitors and reports on the bank's compliance risk, that is, the risk of legal or regulatory sanctions, financial loss, or loss to reputation a bank may suffer as a result of its failure to comply with all applicable laws, regulations, codes of conduct and standards of good practice (together laws, rules and standards).”

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Liability or Ethics?

The International Compliance Association (2016) provides the following explanation of compliance: “in the context of financial services businesses compliance operates at two levels: level 1 - compliance with the external rules that are imposed upon an organization as a whole; level 2 - compliance with internal systems of control that are imposed to achieve compliance with the externally imposed rules”.

Traditional understanding of compliance function concludes its role in serving a company’s interests mainly by securing its adherence to applicable laws to avoid regulatory sanctions. In this sense, the role of compliance is limited to the liability of a company created by external factors and the regulatory environment. And until recently this has been a widespread approach to its valuation, and its significance has been perceived by some as no more than a formality to meet the requirements of regulators and auditors. However, nowadays, the paradigm of compliance is shifting from merely a liability to its broader function which also impacts economic relations and may have additional value for companies and society. According to ISO 19600 Guidelines on Compliance management systems (2014) “organizations that aim to be successful in the long term need to maintain a culture of integrity and compliance, and to consider the needs and expectations of stakeholders. Integrity and compliance are therefore not only the basis, but also an opportunity, for a successful and sustainable organization”.

This work provides a review of reports, researches, opinions, statistics, legal cases, company practices to examine the value of compliance function not only to organizations but to stakeholders, society and sustainable development.

THE SCOPE OF COMPLIANCE REGULATION

What is effective compliance today? Nowadays though compliance in its traditional meaning is still defined through adherence to laws and rules, more often it implies fair business practices, integrity and principles of business ethics. Director of ethics and professional standards, at CFA Institute (Chartered Financial Analysts), Mr. Michael McMillan clarifies the correlation between compliance and ethics:

Just because you have a good or great compliance program doesn't mean people are not going to be behaving unethically or not have an environment that encourages unethical behavior. Compliance really focuses upon rules and regulations. Are you following the rules, are you following the regulations and the laws of your company, or the laws and regulations of the country or environment in which you work? Ethics are about encouraging behavior that is above just following rules and regulations. It is requiring to get people to act more in consonance with the values of the company. Ethics should permeate the entire company. (McMillan in DiPietro, 2014).

Thus, it is logically to conclude that compliance without strong ethics will be not effective.

The general concept of “ethics” implies what actions are right or wrong in particular circumstances. “At its simplest, ethics is a system of moral principles. They affect how people make decisions and lead their lives. Ethics is concerned with what is good for individuals and society”. (BBC Ethics guide, 2014). So the compliance system of an organization will function when employees are not only informed on forbidden and illegal practices but when they also understand and follow the ethical principles. “If you have a strong ethical culture then you don’t really need to have a huge compliance department because people are going to do the right thing because that’s what the values of the company are promoting. The stronger the ethical culture of the company the less you need a large or well-developed compliance

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