

# The Best Practice for Operating the Compliance Function (Code of Best Practice)

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## **I. The Aim of the Code and its Status**

As a registered and operating advocacy group for financial institutions, the Hungarian Banking Association (hereinafter referred to as the 'Banking Association') considers it especially important to reinforce its commitment towards establishing and adequately operating internal control functions. By creating the present Code, which sums up the best practices in connection with compliance activity (a part of internal control functions), our aim is to publish a guideline for practical operation, which helps our members in identifying violations and compliance risks, as well as to effectively management them. It is a priority for the Banking Association that its member institutions be able to detect and correct identifiable errors successfully through best practices and by establishing and effectively operating the compliance function.

One of the most dynamically developing functions in international and corporate financial culture is compliance, which, to prevail, requires that top corporate leaders be unquestionably committed to it. In accordance with this, our members shall strive to record their compliance practices in their Internal Rules of Procedure in line with the content provided in this recommendation.

Financial institutions shall set requirements (standards) for themselves, which ask of them that during their business activities they keep to the regulations which influence their basic functions as best as possible, beyond legal requirements. They must take into account that otherwise these events may have an effect on shareholders, clients, employees and the market and may lead to a less favorable opinion of the specific institution in question in the eyes of the public and thus damage its good reputation.

By creating the present Code which has no bearing on the legal provisions on compliance that are in force and regard compliance activities, the scope of application of the recommended practice may be extended, and therefore allow our members to manage compliance risk much more effectively, on the condition that the compliance function meets or follows the recommendations compiled in the present Code.

## **II. The Fundamental Pillars of Compliance Awareness**

### **1. Compliance Principles**

There are two different approaches to the guiding principles on the Compliance function. On the one hand, there are the principles which approach the Compliance function as a concept and apply to it globally as if it were an institutional unit, principles such as independence, integrity or confidentiality, discussed in the Chapter IV. On the other hand there are principles that employees of an institutional unit which handles compliance (or more simply put compliance staff) must apply in their work.

The Compliance function is fundamentally responsible for ensuring that legislation and other applying recommendations and guidelines are adhered to by the financial institution.

In the interest of the above, Compliance staff must pay special attention to proceed according to policies and regulations (whether they be external or internal), and thus set a good example for employees of their institution.

The numerous principles elaborated with regard to the Compliance function in Chapter IV must also apply to compliance staff: it is a fundamental requirement that Compliance staff possess the necessary qualifications and knowledge and that these should be continually developed to the greatest extent possible.

Taking into account that in general it is the integrity of compliance employees that ensure that their activities within the organization are trusted, they are obligated to do their work honestly and as fairly as it is expected of them, with due professional care and competence, as well as responsibility. They must always keep the compliance of their financial institution in mind during their work and they must under all circumstances strive to avoid compliance risk<sup>1</sup> in contrast to the profit oriented approach of the different business areas.

Compliance employees shall carry out their activities free of conflicts of interest on both a theoretical and practical level. In accordance with this, compliance staff must always proceed objectively, and must be free from external influence or bias in their work and during the investigation of any activity or process, including the collection of

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<sup>1</sup> It is considered to be compliance risk when the applying legislation or other regulations that do not classify as legislation (including domestic and international recommendations, directives, methodological guidelines to be followed, standards, market standards, requirements set in codes of conduct that have been undertaken, as well as ethical rules) and other internal rules are not adhered to and thus legal risk, the risk of supervisory or other official sanctions, the risk of significant financial loss and impaired reputation develops.

information, analysis, evaluation and disclosure, as well as the establishment of their position and its communication (consultancy activity). During their controls, compliance staff must always maintain their independence from the investigated department of the organization and other internal or external interest groups.

Compliance staff must refrain from all activities and behavior which is unworthy of the compliance department and the compliance function.

Compliance staff must handle all information and data handed to them as confidential, with no spatial and temporal limit to its confidentiality. Accordingly, compliance staff must never make the data and information which they possess public or pass it on to unauthorized persons, unless the disclosure of such information is warranted by legal or professional ethical obligations.

## 2. Training

The Compliance function also includes training activity as part of its operative tasks set in the Internal Lines of Defense Recommendation<sup>2</sup> (*hereinafter BVVA*).

The training, which regards compliance topics that are in accordance with BVVA adequacy must concern all persons who are employed by or have any other work engagement with the institution (*hereinafter: Employees*). In the case of employees who carry out tasks that are not registered among the Institution's core activities (such as operational tasks and those related to the sustainability of the establishment) the Compliance officer may consider exemption from training and examination obligations or may determine a set of special obligations.

Employees must take part in compliance training (*hereinafter: Training*) as soon as possible after their employee status is established. In addition to this orientation Training, a refresher Training is also recommended at least once per year, with which Employees may refresh the knowledge that they have already acquired and also have the possibility of getting acquainted with modified legislation and the provisions of other regulatory instruments.

A best practice – if the training system of the given Institution allows it – is the person to person transfer of knowledge from an employee in the compliance department with the proper professional knowledge and practical experience through a training class. This grants the possibility of complementing the training materials for compliance topics (*hereinafter: Training Materials*) with additional information and verbal explanations, and therefore ensures that the knowledge is transferred in an interactive manner and that those obliged to acquire it do so more effectively and with greater results. In accordance with the Institution's organizational operation, the

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<sup>2</sup> Recommendation No. 5/2016. (VI.06.) of the Magyar Nemzeti Bank (central bank of Hungary) on the establishment of internal lines of defense, their operation, and the management and control functions of financial institutions

teaching of particular compliance topics may be assigned to the activities of other institutional units.

A good practice to follow concerning Teaching Materials is to have them present the provisions determined by legislative, supervisory and other regulatory instruments in a way that is intelligible and easily understood by the Employees. They may aid the acquisition of knowledge and its practical application through presenting examples and actual cases.

Furthermore, a good practice during the creation of teaching materials is for the Compliance function to take into consideration that individual Employees who have different scopes of activity may require different levels of knowledge with regard to each compliance topic.

The compliance function must ensure that the knowledge acquired through training is measured through examination. It is recommended that a successfully passed examination be considered when assessing the requirements for the position.

If the Institution is part of a group, the Training must be organized at group level and through a set of unified principles.

In order for the Training Materials to be effective, it is required that the Compliance function regularly review them and transpose the modifications in the internal regulatory system, organization and practice of the institution into them, and do the same with changes in legislation, in the supervisory regulatory environment, as well as, in the case of group-level regulation, with the updates received from the parent company of the group.

A good practice for increasing the effectiveness of the Training is if the Employee has the opportunity to ask questions and provide comments to the Compliance function. Therefore, it is worthwhile ensuring anonymity in the submission process of questions and comments.

### **3. Raising Awareness in Other Institutional Units**

One of the most important tasks of the Compliance function is to establish the fundamental pillars of compliance awareness within the Institution and to get Employees acquainted with these.

In order to achieve this, the Compliance function must strive to create a Compliance culture within the Institution that promotes the compliant behavior of Employees, and incentivizes them to behave in a compliance-aware manner not just for the sole purpose of avoiding supervisory and internal sanctions, but also to maintain the good

reputation of the Institution, as well as to deal with customers in a fair and ethical way.

It is especially important to realize that the presence of a Compliance function within the organization does not absolve marketing and other operative departments from the continued enforcement of compliance rules during the implementation of their own proceedings and during their work.

Regular training activity organized by the Compliance function may also be a further instrument of raising compliance awareness within the Institution.

In view of individual institutional units, it is advisable to create and organize trainings on different topics, with which it becomes possible to present the compliance topics in a categorized (*each topic is discussed in an individual training session*), unstructured form. It is good practice if individual training sessions are created in a way that they conform to the activities of the specific institutional unit as best possible, as well as to its specific tasks, its everyday compliance cases in practice and thus promote the efficient acquisition of knowledge and increase the usefulness of the training for Employees.

It is considered good practice if the Compliance function also applies other instruments than the traditional classroom and e-learning educational activities for the supervision and development of the compliance awareness of Employees. Such instrument may be: mock transactions, pop-up exam questions within the internal network or other ad hoc type ways of checking one's knowledge, which do not classify as part of the examination system.

It also promotes the compliance-aware operation of the Institution if the compliance function, in accordance with the institution's scope of activities, takes part in the creation of the institution's internal proceedings, practices, processes; as well as if it is granted the necessary authorization by the management of the Institution for the aforementioned activity. If the Compliance function regularly initiates (e.g. every quarter or every half-year) personal consultations with the leaders of the main business departments, and together with the departments they evaluate the compliance awareness of that department, this promotes the formation of a proper compliance culture.

It strengthens the compliance awareness of the Institution if the Compliance function does not exclusively draw the attention of the Institution's departments to the existence of individual Compliance risks, but instead proactively promotes the elimination or moderation of the risk through recommending solutions. It can be a good practice if the Compliance function strives to maintain a constant presence in the life of the institution (e.g. participation in projects; delegating representatives to the permanent and ad hoc committees of the organization), and regularly shares certain case studies and recommended solutions that apply to them through internal communication channels.

If we want to consistently enforce the fundamental principle that the institution's compliance should be realized at two levels – in the entire organization of the Bank, as well as in the institutional unit which carries out the compliance function – then it can be logically deduced that a connection and constant cooperation between the two levels is only possible if the supervisory, oversight and advisory functions assigned to the department directly responsible for compliance are complemented by constant contact with the entire organization and with the system of the so-called compliance trustees, appointed by individual institutional units. It is a compliance requirement that compliance oversight be in operation within the professional organizations as well, and that institutional units should develop the need to ask for professional help and collaboration in compliance through compliance trustees and to indicate to them processes and phenomena, which endanger the compliance and security of the Bank and Bank Group.

Making the Compliance function accessible to Employees is an indispensable element of establishing compliance awareness. So is granting them the opportunity to consult the officers of the Compliance function about handling matters such as that of defining a position or resolving issues in connection with prudent operation, whether that be in person, on the phone or through an electronic channel. It is recommended that, in order to raise awareness, the Compliance function aid the institution in its operation through intelligibly formulated responses, which are confirmed by thorough justification.

#### **4. The Cooperation of Defense Lines within the Organization**

The institution carries out the compliance activities as a vital component of the bank's organizational system, therefore its functions and tasks must be defined in a way that is in harmony with the financial institution's other institutional units that deal with supervisory tasks. In general, areas where task sharing may be possible are Internal Control, Bank Security, IT Security, the Legal Department, Data Protection, Operational Risk Management, Consumer Protection, the prevention of Money Laundering, and Anti-Fraud activities.

The cooperation between institutional units which take on the above functions helps to resolve tasks more effectively, and aids in the management of situations where conflict of interest or violation is suspected.

Heads of institutional units shall meet at least once per month, which helps promote the flow of information between their units. These occasions, in addition to serving as a discussion forum for current issues, also help discuss problems and search for common solutions.



The creation of a hotline between Internal Control, Bank and IT Security, the Risk Management and the Compliance Function may play key significance in detecting violations. The joint control of a violation discovered by one of the units and the splitting of tasks allows for a faster and more precise solution. Information may flow through telephone, e-mail or in-person meetings. It is recommended that the organization consider granting access to the anti-violation system it operates for the heads of institutional units who manage other control functions.

The investigation of processes by Internal Control may be well complemented by conflict of interest controls conducted within the framework of the compliance function.

When ethical rules are violated, it may be useful to obtain information on IT and system use from Bank/IT Security. The application of so-called interrogative techniques from the interview practice done by Bank Security is well suited when investigating a concrete case of violation of rules.

It is recommended that the precise rules for work distribution, their processes, and the concrete tasks of units as well as determining how they are separated should be stated in a document or policy within the institution to clearly mark the boundaries between the different functions and eliminate possible redundancies.

### **III. „Classic” Compliance Functions and Methods**

When carrying out compliance activities, the method chosen for the fulfillment of tasks and achieving results is critical for ensuring that the Bank is compliant. The selection of methods shown below makes it possible for the Bank's compliance function to notice non-adequate practice in any sector or for any product or service and to react to it in a way that reduces operational, sanctioning and reputational risk to a minimum level. As a line of defense, the compliance department plays two roles in minimalizing risk: a supportive and a controlling role.

#### **1. Supportive Function**

##### **1.1. Advice in Response to Individual Requests of Opinion**

The compliance department may always be of help when compliance risks for a given decision needs to be mapped out, and when risk reducing solutions to these need to be applied. It is necessary to reach a level of compliance awareness where the opinion of the compliance function is requested almost automatically in cases when compliance with the law becomes questionable in the area concerned.

The organization may decide that this preliminary review function should become part of its mandatory approval process. (e. g. the compliance function mandatorily reviews

all internal regulatory documents to be published or transactions with higher business risk or the creation of marketing materials and telemarketing scripts.)

## **1.2. Consultancy based on Readily Available, Continuous Information**

### ***1.2.1. Participation in General Meetings/Committees***

The participation of the Compliance department in different committees ensures that the compliance aspects are also enforced (principle of equal treatment, consumer protection, conduct risk, etc.) in the Bank's decisions. The Bank's Bylaws state which committees the head of compliance or the compliance department will take part in. In addition, they also regulate the nature of this participation: voting, standing invitation, possibly veto power or right of opinion.

The meeting's referrals may already contain the compliance function's position on the topic in advance.

Committees where the participation of the Compliance function is recommended:

- Pricing committees;
- Committees for decisions concerning investment services;
- Incentivizing, remuneration and sponsoring committees;
- Committees for approving/supervising the introduction of new products;
- Operational Risk (OpRisk) Committee;
- Ethics Committee.

In addition the Compliance function must regularly report to one of its high-level managing bodies, to the Board or to the Supervisory Committee - depending on the management structure of the institution.

### ***1.2.2. Access to materials of the General Meeting and Committees***

It is recommended that the compliance function have access to the materials of committees from all institutional bodies and therefore have insight into the risks associated with the operation and decisions of individual bodies.

### ***1.2.3. A permanent Reviewer's Role in Internal Regulation***

The aim should be for the compliance function to become a mandatory reviewer in the elaboration and modification of internal policy. Involving the function is especially important in the case of the following policies:

- pricing principles;
- instructions for products;

- collection and claims management procedures;
- the procedure for providing investment services;
- informing clients;
- complaint handling procedure;
- tenders, purchases.

If necessary, the compliance function may become a mandatory reviewer of all internal policy.

Depending on organizational structure, the operator of Internal Policy may be the compliance departments itself. In this case, during the mandatory review process, the compliance department supervises the policy framework, its form and logical correlations and if necessary, it also manages the internal regulatory IT system.

## **2. Control/Supervisory Function**

### **2.1. Targeted, Themed and Follow-Up Controls**

Compliance control activities may be divided as follows:

#### **Classification according to regularity:**

- **regular control:** regular, repeated control activity, set by legislation and other regulators;
- **case by case, ad hoc controls:** based on events/reports encountered during the year;
- **controls set in the annual plan:** targeted control in the annual plan's priority marked areas (based on compliance priorities, business, regulatory, supervisory demands).

#### **Classification based on methodology:**

- supervision of electronic/paper-based registries;
- desk/on-site review;
- investigations conducted by the compliance department based on risk evaluation.

#### **Classification according to content:**

- **Conflicts of interest**

- *Regular*: the management and control of declarations of incompatibility during onboarding<sup>3</sup>;
  - *Case by case*: investigations into reports and encountered cases;
- **Ethics, whistleblowing**
  - *Case by case*: the investigation of ethical issues and reports of whistleblowing;
- **The flow of information and the passing on of information** (Chinese wall, need-to-know, data protection)
  - *Case by case*: the compiling of professional analyses before changes in the organization are made and in response to a reported case;
- **Employee transactions**
  - *Regular*: employee transactions (fixing of one's own account, day-trade transactions, pre-clearance), investigating reports of large orders; investigating whether one adheres to trade bans announced based on watch lists and restriction lists; the monitoring and prevention of insider dealing and market manipulation;
- **Compliance monitoring**
  - *Regular*: the regular or case by case monitoring of target areas that fall under the scope of compliance according to legislators. Some key areas are:
    - *MiFID, MiFID II,*
    - *Bubor Benchmark,*
    - *Remuneration.*

## 2.2. Establishing and Operating Monitoring/Risk Analysis Systems

In order to detect, screen, analyze and manage compliance risk, an efficient compliance function operates monitoring systems or receives information from systems operated by other professional departments. The referred functions of monitoring systems ensure compliance in those areas or in the case of those products and services, where the detection and management of compliance risk is not possible due to the number of events or the diverse, complicated structure of the organization. The diffusion of these systems within the institution can increase the understanding and acceptance of the compliance function.

Compliance systems do the following:

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<sup>3</sup> 'Onboarding' here means starting a legal procedure against a natural or legal person who enters into a contractual relationship with a credit institution or investment service provider under any title (employment, financial service, investment service, operations, etc...)

- identify the possible compliance risks which may arise under the given system's supervision and determine their extent;
- are suitable for incorporating compliance risk reducing controls and for measuring the effectiveness of these;
- make it possible to reduce compliance risk .

Possible monitoring/risk analysis systems:

- Annual compliance risk analysis;
- Monitoring of conflict of interest;
- Monitoring of insider and market influencing transactions;
- MiFID monitoring system (employee transactions, client transactions, bank transactions);
- AML filter system;
- Sanctioning filter system;
- Fraud monitoring;
- Filtering of electronic transactions;
- Branch inspections;
- Test purchases and their evaluation;
- Analysis of complaints;
- Sale tracking/check-up calls.

## **IV. Organization**

### **1. The Fundamental Principles of an Effective Compliance Function (Department)**

#### **1.1. Independence**

Principles of Independence:

##### a) Appointing and recalls:

The head of the compliance function is a leader with individual responsibility, appointed and relieved by the institution's highest ranking executive. When deciding who the head of compliance will be or when relieving him/her of his/her duty, the highest ranking executive of the institution must consult with the institution's main decision-making body in advance. The main decision-making body of the institution and the supervisory authority (MNB - the central bank of Hungary) must be notified when a new head of compliance is appointed or when his/her employment is

terminated. In the case of the latter, the reasons for his/her discharge must also be given by the above mentioned bodies.

b) Position within the organization:

Efforts should be made to provide the head of the compliance department with the same job classification concerning remuneration and his or her position within the organization as the other two head officers of the internal lines of defense (the head of internal control and the head of the risk management departments).

c) Independent budget, scope:

The compliance department operates as an independent organizational unit, which possesses the appropriate authorizations and the status of which is regulated by the institution's key document, its Bylaws. The compliance department makes recommendations for the following year's material and financial plan in its annual work plan, which it submits to the main decision-making body of the institution. It works with an independent budget, which is decided on by the institution's main decision-making body each year. After this decision has been made, the head of the compliance department is at liberty to decide freely on how the budget will be spent. He/she however, must annually report on this to the institution's main decision-making body.

d) Conflict of interest:

Employees of the compliance department, especially its head officer, must not take on any position where conflict of interest may arise in connection with their compliance related activities and/or any other task of theirs. They cannot take on leading positions at other companies which maintain a business relationship with their institution.

e) Access to data:

Employees of the compliance department shall be granted unlimited access to all information, data, documents, persons and references that are necessary for completing their tasks. Any activity or theirs that is related to this cannot be restricted in any way. The institution's internal control department will periodically verify the legality of this access.

f) Reporting:

The compliance department shall present its observations and recommendations to the Bank's upper management and directorate free from any external influence. Its accounts, reports cannot be rendered more difficult by technical obstacles, such as countersigning, preliminary review or approval of another department.

g) Independent organization: an independent unit within the institution

## 1.2. Professional Capacity

Compliance activities must be provided for with an **adequate number** of resources. Compliance tasks, their magnitude, their nature and the level of their complexity must be taken into account. The **knowledge and experience** of employees must be assessed before they are appointed.

Employees active in the Compliance department are expected to possess all **abilities** they **need** to fulfill all their obligations in an honest, professional and unbiased manner.

To adhere to the clause above, competence, motivation, continued education, the skill of personal reflection, as well as a maintaining of close relationships with coworkers is required in order to preserve and expand knowledge and skills.

## 1.3. Integrity and Confidentiality Obligations

All member of the Compliance department are obliged to complete their tasks in an **honest, objective and impeccable** manner. They must also, under all circumstances adhere to their obligations of **secrecy** and exceptional confidentiality when handling information, during and after office hours. The integrity of employees to be appointed must be assessed.

## 1.4. Right of Initiative and the Right to Gain Access to Information Needed to Complete Tasks

The Compliance department must be given the chance to start an **independent investigation** every time there are signs that the requirements set in rules, regulations and codes of conducts have been misinterpreted.

Furthermore, the Compliance function department must be granted the opportunity to participate in **fraud investigations of larger magnitude**, regardless of whether the fraud was internal or external. The department has its own investigative rights. It is recommended that the Compliance department should be responsible for E&F Risk Management as the center of competence for ethical and fraud risk. Managing the development and implementation of E&F risk reduction methods is the task of the Group Compliance function.

The Compliance department has the right to voice its opinion without restrictions and to disclose the results from the investigation it conducted on issues within its scope of application. The head officer and employees of the Compliance department must not be subject to any kind of disadvantage due to stating their opinions or evaluations.

Members of the Compliance department must be granted **authorization** to gather information on any kind of activity, to conduct meetings with employees, to have access to company offices, documents, files, the data of subsidiaries (including the minutes of the meetings of advisory and management bodies) if they require these to complete their tasks.

The Compliance department must be granted the opportunity to **inquire** at management level in connection with decisions made by other institutional units within the organization that concern the Compliance function (**escalation procedure**).

The head of the compliance department has the right to **block** certain **transactions**, to **notify** authorities in the case of suspicious transactions, to **submit complaints** to authorities and to **cease** client relationships. With regard to New and Active Product Procedures, the Compliance function may apply prohibiting conditions.

Compliance head officers at subsidiaries are required to immediately notify local management and the higher level Compliance department towards which they have reporting obligations in all cases where they discover that the integrity of the Group is threatened.

The Compliance department must be **notified** of all projects and activities which have Compliance implications and due to which it might become necessary to modify internal procedures and controls.

## **2. Compliance within the Institution**

It is a good practice for the Compliance department to have a **formal status** and an appointed Head of Compliance.

In order to ensure its **independence**, the Compliance department should be placed under and have reporting obligations towards the following entities:

- the Head of Group Compliance of the financial institution as well as the Chief Executive Officer (CEO) or the Chief Risk Officer (CRO) of the local management in order to realize **functional management** efficiently and to simultaneously ensure **partial independence** from the management body.
- the Head of Group Compliance of the financial institution and the Head of Compliance of the financial institution/independent bank should report to the President of the Executive Committee/Board or the CRO of the independent risk department.

Those occupying compliance-related positions may not participate in services or activities monitored by them. Their other activities (if applicable) **may not be brought into conflict** with Compliance tasks, and all necessary measures must be taken to eliminate potential **conflicts of interest**.



The **remuneration** of those who occupy compliance-related positions must be determined so that it does not endanger the objectivity of these persons and in a way that no such possibility should ever arise. The Remuneration Committee (or Board) monitors the remuneration of the Head of Compliance.

All Head Officers of Compliance may **contact** the President of the Executive Committee, the President of the Board, the President of the Audit/Supervisory Committee, the appointed auditor of the company, or the supervisory authorities **directly**, if considered necessary.

### **3. Cooperation with Other Departments**

An adequate division of functions and a common responsibility-sharing system should be introduced within the Bank.

Compliance activity is closely related to the activities of other institutional units of the Bank (e.g. risk management, internal audit, law, HR, etc.) and the details of this cooperation should be laid down in regularly monitored cooperation agreements.

Beyond this, it is advised to organize meetings with the institutional units closely linked to compliance activities, as well as those that present increased risks.

The compliance department remains responsible for all tasks even if compliance tasks are partially undertaken by another organization and must therefore require the entrusted organization to report on its tasks.

### **4. Efficient Group Compliance**

As regards credit institutions, investment firms and insurance companies under consolidated supervision on the basis of sectoral legislation, the Internal Lines of Defense Recommendation (BVVA) provides a compelling guideline to ensure compliance at group level. It outlines the required organizational structure as well as the ideal division of responsibilities and duties between the group's head institution and the subsidiaries.

Based on the BVVA, it is necessary to develop a vertically structured, two-level compliance organization, where the upper level is occupied by departments performing functions at group level and the lower level consists of the departments of subsidiaries and group members with such functions. Since the duties and responsibilities differ, the group function cannot replace the independent compliance function of the subsidiaries.

Group compliance is a complex task:

- it must handle compliance risk management at group level;
- it should provide professional guidance to the departments at lower levels;
- it must monitor and align the compliance activities of subsidiaries, and thus carry out the necessary regulatory tasks.

In order to realize the latter, the first step should be the elaboration of a management structure that takes the characteristics of the given subsidiaries into account, especially the legal requirements resulting from different sectoral rules as well as the scope and complexity of their services.

A practice that maximally ensures efficient operation at group level is if at the level of group members, out of the differing requirements that result from diverse sectoral rules, the strictest requirements are chosen to apply at group level. This will ensure the consistent application of the fundamental principles of the function, the fundamental regulations that they are based on and the practice that is built on these.

In case the extent and the weight of differences prove the elaboration of a common practice impractical, the regulatory system must be capable of managing the discrepancies between subsidiaries. Even so, attempts should be made to manage the requirements that apply to the whole of the group at group level. In this case subsidiaries will develop their own individual practices, where in addition to the professional guidance given by the department responsible for group-level compliance, the supervisory function becomes prevalent.

During the elaboration of the management structure, it is necessary to establish the jurisdiction of the group compliance function and that of the independent compliance function of the subsidiaries (centralization, decentralization) and attempts should be made to find a proper balance. The management structure should prevent the group function from gaining unilateral management and allowing it to control the lower levels of the function without taking into consideration the comments and needs coming from these levels; at the same time it should allow for the group function to carry out its tasks effectively.

The Head of Group Compliance or his/her deputies should be prevented from taking a leading role in the management of the group or the subsidiaries (Supervisory Committee, Executive Board) or becoming members of any management body as a position of such nature goes beyond the group alignment of the function and terminates the independence of the compliance function (the objectivity of his/her opinion and the fact that it is free of any influence should not be called into question).

It is a good practice to have a group compliance policy (strong centralization), or, in case it proves to be impractical, to create a group strategy in which the following are recorded: the fundamental principles of the compliance function; its relation to the control functions; the division of duties and responsibilities between the upper and lower levels of the compliance function and between the compliance function and other control functions. Group members should develop their own compliance policies in line with this strategy and must not deviate from the set principles.

In case the compliance function is realized at group level, it is the duty of the group's lead institution to, in order to ensure effective group operation, formulate straightforward and precise requirements in terms of the duties and expectations towards subsidiaries as well as the resources necessary for the realization of these. It may facilitate the process if all members of the group can participate in the formulation of the fundamental compliance principles.

A good practice that facilitates the efficient flow of information may be if the departments of the subsidiaries that perform compliance functions have reporting obligations towards the institutional unit performing group compliance function in addition to the management body of the given institute. This obligation can be complemented by regular reporting duties that suit the characteristics of the group in terms of volume.

An effective and mutual flow of information between the lower and upper level of the compliance function and between each group member is indispensable for aligning the function at group level and for performing the supervisory duties of the upper level. To achieve this it may be an effective practice to establish a compliance working group or compliance committee, a consultative advisory body that would meet on a regular basis, with the participation of all member institutions, in addition to a regular and case-by-case reporting obligation towards the group-level Head of Compliance.

In order to develop a uniform group compliance practice, it is a good practice for the group compliance function to proactively assist the compliance departments of the group members by regularly providing them with resolutions, guidelines and calling their attention to what needs to be noticed.

Consequently, the supervision of the proceedings of group members is advised based on the occurring compliance risks, as is attempting to elaborate and constantly develop group-level best practices based on group member cases, and in the meantime strictly adhering to confidentiality principles.

## **2. Strategic aims**

The compliance function identifies and professionally manages risks arising from external and internal regulations in collaboration with the financial institution's management and all bank departments concerned. Meanwhile the aim of the Compliance function is to ensure the given financial institution's efficient operation and good reputation.

As a second line of defense, the main responsibility of the compliance function is to provide solution oriented, continued support for business divisions, and to thus assist in the fulfillment of obligations resulting from legal, supervisory and internal rules, and ethical norms.

A key strategic aim of the compliance function is to provide effective and preventive compliance activity which takes the interest of the management and the business owners into consideration, but at the same time meets supervisory requirements. Its aim is to shed light on the compliance risks within the organization for the upper management and the supervisory committee of the financial institution and to propose effective, fast solutions for handling and eliminating these.

It supports these aims by operating internal control systems and constantly developing them, which can effectively measure and manage all risks that arise

during the everyday business activities of the financial institution. Some of its key activities are the following:

- the harmonization of compliance activity extended to the entire bank group;
- the lawful support of business activities and general business operations
  - through high level consultancy and
  - regular training, which focuses on prevention and problem solving;
- decreasing human risk;
- assistance in the revealing of illegal behavior and sources of loss, which could prevent the financial institution from operating prudently;
- Assistance in the responsible handling of cash and financial assets by detecting malpractice and extra high-risk operations in time.

The compliance function strives to incorporate compliance activity in the life of the organization, to strengthen its position within the financial institution, to improve the image of the department within the enterprise and to improve the compliance culture of the organization.

### **3. Resources Needed to Realize Strategic Aims**

It is of key importance for the management to be committed to compliance objectives (tone from the top), which should be noticeable through the role the compliance function plays and the place it has (independence) within the organization. In relation to this, it is considered good practice to have special conditions for the displacement (e.g. longer notice period) of the Head Officer of the Compliance department at the least, but on a “best effort” basis, of all employees of the compliance department.

The compliance department submits an annual work plan to the highest decision-making body of the institution, wherein it makes recommendations in connection with the plan for resources for the upcoming financial year, in terms of personnel.

Operating an efficient compliance department requires an adequate allocation of resources both in terms of quantity and quality (with regard to personality and professionalism). It is recommended that the financial institution should have 1% of its total employees (also) dedicated to compliance tasks, and depending on its function, to have a minimum of 2 employees available for handling, substituting for, and collaborating on a given special compliance task from each subdivision,