Marketing and compliance – a new perspective

Stephen Gore discusses the brave new world of *Treating customers fairly*, and argues that the initiative should have positive benefits for companies with the right attitude.

The tensions between marketing and compliance are as old as the idea that businesses anxious to sell their products to the public should not be able to say and do anything they like to effect their sales. Traditionally, marketing has tended to see itself as young dynamic and innovative, justifiably impatient with the pedantic attempts of compliance to impose boring dullness and conformity.

By contrast, compliance has seen itself as exercising a necessary restraining hand on the tendency of marketing towards exaggeration and hyperbole, possibly resulting in misleading of customers and poor publicity for the business. The result is a dialogue of the deaf.[1]

These portrayals are of course caricatures, but anyone who has worked in compliance can probably point to instances of fraught meetings and telephone conversations in which they have been accused of adopting the most pessimistic interpretations that no competitors would dream of applying, and acting as a business prevention unit. On the other hand, anyone who has worked in marketing can probably point to instances of equally-fraught meetings and telephone conversations in which compliance has adopted an unjustifiably negative approach, and has unnecessarily deprived the firm of much-needed and profitable business.

Positive tensions

These tensions do not have to be entirely negative. Creative tensions can, if properly handled, enable each side to recognize each other's perspective, and can dispel the atmosphere of confrontation – perhaps even remove the feeling of opposing "sides". This does not mean that there will necessarily be agreement on all points, nor that one group will necessarily have to acknowledge defeat. Sometimes, such a frank discussion without rancour can enable a compromise to be reached that would not have been possible in a confrontational atmosphere.

It is interesting that, although senior executive involvement seems the most likely means by which creative tensions leading to compromise can be effected, in practice directors and top managers have in the past often stood aloof from the arguments between marketing and compliance. They were usually quite happy for them to sort out their difficulties unaided, but if intervention became necessary, they tended to favour marketing because they were anxious not to jeopardize new business opportunities and profits.[2] It was a brave compliance function that maintained its opposition to marketing ideas that had received the backing of senior management.

So far as the financial services industry is concerned, there was little formal regulation of interactions with customers[3] until 1988, other than complying with the requirements of the Advertising Standards Authority and the side-effects of more general regulation such as the Consumer Credit and Data Protection Acts. However, in April 1988, the Financial Services Act 1986 came into effect, subjecting financial services firms to formal rules drawn up by the self-regulatory organizations[4] responsible for the various aspects of financial services.

As each self-regulatory organization had its own rule book, each of which contained a chapter on

advertising, it might have been thought that any potential tensions between marketing and compliance could have been resolved by looking at the rules and acting accordingly. Unfortunately, it did not quite work out like that ...

Firstly, the rules were written in complex legal terminology and needed to be interpreted. Secondly, the regulators – in well-meaning attempts to be helpful – issued enforcement bulletins that were not "rules" but set out regulatory views that firms might "wish to consider", and also offered generalized comments on findings from inspection visits. The regulators also made off-the-cuff comments at industry seminars and discussion groups. The result was that interpretations became flexible, and there was if anything an increased scope for marketing–compliance tension, as each looked around for the interpretation most favourable to its views.

This was particularly important because most firms, when deciding on how to meet the challenge of the new rules, set up a discrete function to "do compliance". These departments often checked sales documentation, verified references, and of course signed off marketing material. There can be few members of compliance teams who have not had the experience of being asked late on Friday afternoon to sign off marketing material, raising some objections, and being told it had to go to print on Monday morning. Conversely, there can be few members of marketing departments who have not had the experience of frustrating delays whilst compliance quibbled about some obscure issue that did not appear to have troubled competitors in the least. The result of organizing things in this way has been that compliance involvement has tended to be last-minute and rather perfunctory – and also negative and restrictive. There was also an implicit expectation that, as the experts in the rules, the compliance team should devise reasons to justify what marketing wanted to do.

The silo mentality

A more serious consequence was that compliance came to be seen as "them"; the boffins in the ivory tower who periodically issued obscure edicts that bore no relation to commercial reality. Conversely, compliance functions often made little attempt to convince their colleagues by their integrity or the force of their arguments, as they always had regulatory pronouncements upon which to seek to rely, and the ultimate threat of withholding their signatory favours.

However, all has changed with the Financial Services Authority (FSA), the unified statutory regulator that replaced the self-regulatory organizations, and also the Securities and Investments Board (SIB), and assumed their powers in December 2001. Although the FSA recognizes the need for detailed rules in certain special circumstances, its preference – whether pragmatic or philosophical – is to develop principles for both firms and individuals, backed up by a code of practice. These principles are very generally worded, and firms must to a large degree decide what they mean for themselves.

The other integral part of the FSA's new approach has been the emphasis it places on senior management responsibility. It has introduced an "approved persons"

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régime that requires directors, partners and some other individuals discharging specialist functions to assume personal responsibility for their activities and to be accountable should their behaviour fall below the standard reasonably to be expected. The chief executive must nominate one named individual, normally a director, who must in turn accept responsibility for each aspect of the firm's activities

In order for senior managements to discharge these new responsibilities, many will need to take a closer interest in the workings of their companies than before. They will need to instil a compliance culture throughout the whole firm, rather than continuing to rely on the compliance department as the deliverers of compliant behaviour as well as the repository of compliance expertise.

Conflicts between compliance and marketing should now be things of the past. The senior manager with the nominated responsibility for marketing should ensure

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that a compliance culture is established by all the groups working under him – compliance, marketing and any other functions with expertise or insight to add – as an integrated team. Ideally, the compliance department should *not* take the responsibility of signing-off marketing material. This should be assumed by marketing itself, although of course compliance can offer guidance in difficult cases, and would also carry out some sampling and monitoring. Last-minute

arguments about approval ought not to happen in this scenario, as the compliance view will have been reflected in projects from the outset.

Although nearly four years has now elapsed since the FSA assumed its powers, progress has been patchy. Many companies have found it difficult to move away from the silo concept, and have been reluctant to assign compliance responsibility to marketing or sales departments, often openly stating that they are unable to trust them to apply the principles properly. Such an acknowledgment, which in effect admits that there is no compliance culture within the firm, will not impress the FSA.

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Most if not all the larger firms are now proceeding along the lines that the FSA intends, and many medium and small firms have also made an effort. However, the *Treating customers fairly* (TCF) initiative – introduced by the FSA last year – will very much accelerate the move towards principle-based regulation and enhance the need for all functions within firms to work together as a team.

A brief summary (see TREATING CUSTOMERS FAIRLY below) of the FSA's main concerns in developing the TCF initiative shows clearly that the need for marketing, compliance and others to work together as a fully integrated team, with the close involvement of senior management, has now become a fundamental imperative.

The FSA has made it clear that, in line with its general approach, it expects firms to establish what TCF means for them, in the context of their business and their customers.

In practice, that means that each company must now establish a TCF strategy group, under the command of a senior director or partner – perhaps even the chief executive – to get to grips with the issue and to deliver the required changes in behaviour and approach.

This group must draw up a business profile and customer structure in a reasonable degree of detail, and secure senior management agreement for their decisions. They must then assess their current activities and compare this with the desired state, to work out exactly what they need to do to implement TCF.

TREATING CUSTOMERS FAIRLY

FSA Principle 6 requires that a firm "must pay due regard to [customers'] information needs and treat them fairly.

The FSA is mainly concerned about:

- Corporate strategy and culture.
- Product design and governance.
- Promotional material.
- Sales and advice.
- Point-of-sale information.
- Complaints handling.

Embedding the principles

This, of course, is only the first step. The TCF initiative can only work if it is firmly embedded into the organization's strategy and its culture. The philosophy should be put in writing, preferably by the chief executive, and be communicated clearly to all interested parties. TCF should be explicitly on the agenda of every significant senior management meeting – just to make sure that nothing has been decided or proposed that would be inconsistent with the stated TCF philosophy.

And for every new development – such as a new product or variation on an existing contract, a new sales campaign, or a revision to the existing remuneration structure – that might have impact on TCF, one member of senior management, or a small sub-committee, should assume responsibility for ensuring that the commitments have not been jeopardized or compromised.

As ever, all these analyses and strategies must be in written form before the FSA will concede their validity. When it visits firms to discuss progress, it will look at what has been achieved, and check it for completeness and consistency. It will also expect to see the principles reflected in what actually happens in the firm – and especially that the more junior staff who are expected to implement the strategy understand what they should do, and why.

So far as marketing is concerned, although the FSA's main message is that every firm must decide for itself, it does have very clear ideas about financial promotions. Many firms will have already had the experience of having advertisements, even those in the more obscure provincial press, challenged by the FSA as not being clear, fair and not misleading. It is also clear that the FSA, in paying this close attention, is looking not so much at the rules themselves as at the intentions *behind* the rules.

The letter of the law is clearly no longer enough, and the FSA will not be receptive to quibbling Clintonesque arguments about what certain words may be construed to mean. Rather, it will look at the effect that a financial promotion will have on an unsophisticated reader, looking particularly at the headline message, the overall impression, and the effect of any diagrams, pie charts or other visual material. It will also come down hard on jargon words, especially those being used in a context different from that which the unsophisticated reader

ISSUES TO CONSIDER UNDER TCF

- Developing and promoting products for specific markets.
- Ensuring communications are clear, fair and not misleading.
- Making charges transparent.
- Balancing increasing sales against TCF principles.
- Delivering clarity to customers about the firm, its services and products.
- Honouring representations, assurances and promises made to customers.
- Monitoring external factors that may affect customers.
- Providing the management information required at all levels to ensure TCF.

might expect or understand. It will not be acceptable to argue that the warnings are conveyed in the small print at the bottom, and that jargon words are explained elsewhere in the text.

The FSA has also expressed surprise that a product can sometimes be launched with no detailed research on precisely which customers might buy it, and whether it will be suitable for them. Issues such as remuneration structure, the route to adopt after depolarization and relationships with distributors are clearly matters which must be determined at the highest level, after very careful consideration of all the issues.

Although the FSA says that it does not wish to discourage product innovation and competition, nor to seek to regulate products, it does consider it essential for firms always to think of the market at which they are aiming the products, and what documentation is appropriate for that intended market.

Even though firms are quite rightly motivated to make profits, and may well be under pressure from proprietors or shareholders to enhance them, that motivation must always be fairly balanced against the needs of customers. They must be open and transparent in the way in which they communicate with customers, and also in the way that TCF commitments pervade their operations.

It is difficult to see how some of the more traditional marketing approaches can survive such a regulatory onslaught. It is therefore even more important for compliance and marketing to engage in real discussions on how future strategies can be developed within the context of a TCF initiative. Compliance must more than ever assume the role of coach, helping marketing make what may be painful adjustments. Although ideally it would be better for marketing to sign off its own promotions, there could be a transitional period during which responsibility would remain with the compliance team.

In this event, it will be essential to ensure that compliance has the necessary resources to discharge that responsibility, and the continuing authority to reject promotions that do not meet the required standard. Resources and authority are, of course, two of the most sensitive corporate issues, so the commitment of senior management to TCF would be seriously tested in this area.

But this is not happening in a vacuum. The FSA has decided that the TCF initiative will be part of the ARROW[5] project, and that the current round of ARROW visits, which started in September 2005, will concentrate on TCF. The FSA is not expecting perfection, but will require companies to be aware of TCF, to have done the necessary analyses, to have identified shortcomings, and at least to have started to develop strategies to remedy them.

Everyone, including marketing and compliance, must unite to ensure that the firm is well on the road. TCF isn't like the old-style regulation – it cannot just be fobbed off onto compliance. ☐

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[1] Although "compliance" as a term is specifically associated with the recent history of the financial services industry, this tension between marketing or sales promotion and a "restraining arm" has been evident for at least a century in most industries, as consumer protection legislation has been gradually enacted. The long battle – concluded in the 1920s – between federal regulators and the Lydia E. Pinkham Medicine Company and the excessive claims made for its Vegetable Compound has been particularly well-documented – and immortalized in The Scaffold's song. Ed

[2] The many mis-selling scandals that have hit the financial services industry in recent years have, of course, shown this to have been a dangerous short-term perspective, with the long-term costs (both financial and reputational) far exceeding the temporary profit boost. Ed

[3] In contrast to the successive Acts of Parliament and the equivalents in other jurisdictions that have controlled the corporate and technical actions of banks and insurers since they first emerged.

[4] LAUTRO for the life assurance and unit trust companies, and IMRO for investment management, for example.

[5] As the FSA, unlike its predecessors, is a prudential as well as a conduct-of-business regulator, its responsibilities extend far beyond regulated business as such. It takes an interest in virtually all regulated firms' activities, particularly their systems and controls, their assessment of risk, their outsourcing arrangements, their disaster planning, and whether the apportionment of responsibilities under the Approved Persons régime is appropriate and adequately documented. The FSA's round of visits to all the larger firms following its assumption of its powers, known as the ARROW project, was designed to assess firms' progress, recommend improvements, and arrive at a risk rating – which took account of both the likelihood of serious regulatory failure and the impact should it occur – for each firm. Small firms are not subject to the formal ARROW process, but are subject to possible *ad hoc* and "theme" visits and to desk-top inquiries.