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Re: The Compliance Function in Banks

To the Secretariat:

This letter is in response to the October 2003 Consultative Document on “The compliance function in banks” that has been issued to “assist the bank in managing its compliance risk” by offering principles for “general application.” The Basel Committee is seeking comments on this draft guidance and the American Bankers Association is offering the following brief comments on the document.

ABA brings together all elements of the banking community to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest bank trade association in the United States.

The American Bankers Association supports the first principle that “the role and responsibilities of the compliance function should be clearly defined.” With the plethora of domestic and international compliance issues facing our members, today’s compliance officer faces greater challenges than ever before. To assist the function, senior management must outline the scope of the work and certainly provide resources to accomplish the required duties.

As the representative of the most diverse membership in the U.S. banking industry, the ABA strongly cautions the Basel Committee from concluding that the compliance function should be organized in any one particular manner.

Specifically, all institutions for a number of valid reasons do not endorse the principle that the compliance function “should be independent from the business activities of the bank.” More importantly, the announcement of that second principle is contrary to the opening statement in section 4 that “the exact approach chosen by banks in individual countries (as to where the compliance function will

be located) will depend on various factors, including their size and sophistication and the nature and geographical extent of their activities.” To emphasize the point that banks address the compliance function in a number of ways, we refer to a June 2003 “Nationwide Bank Compliance Officer Survey” published in the ABA Banking Journal (“Compliance Watch 2003”) that, among other things, found:

- The larger the bank, the less likely that compliance is its own entity, reporting to top management. Institutions under \$1 billion in assets reported directly to top management in 67% of cases; \$1 billion to \$5 billion indicated that this was the situation in 37% of the cases and over \$5 billion institutions reported that structure in only 14% of the time.
- In fact, the larger the institution, the more likely the compliance function reports to risk management: 3% for institutions under \$1 billion; 13% for institutions between \$1 billion and \$5 billion; and 37% for the larger institutions.
- Likewise, larger institutions place compliance in the legal function quite often: 23% among the institutions over \$5 billion and 9% in institutions between \$1 billion and \$5 billion.
- Overall, compliance reported to Audit in 5.6% of the cases; 2.6% to Legal; 5.6% to Risk Management; 5.7% to Operations; 2.4% to Administrative Services; 62% to top management and the rest to various other sections.

ABA would be happy to provide the Committee with a copy of this survey upon request.

Thus, ABA is opposed to having the term “independent” imply where the location of the compliance function should be and we also urge the Basel Committee in section 10 to modify the current definition of the compliance function **from:**

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”).

To:

An independent function that identifies, assesses, advises on, monitors and reports on the bank’s compliance risk, that is the risk of *material* legal or regulatory sanctions, financial loss, or loss to reputation a bank may suffer as a result of its failure to comply with *applicable financial institution* law, regulation, *related self-regulatory organization standards or guidance*, and a bank’s code of conduct (together “laws, rules and standards”).

These suggested changes, we believe, create reasonable standards that can be readily understood and enforced.

Finally, to be consistent with the above suggested changes, section 12 should be modified to delete reference to “codes of practice promoted by industry associations” as that approach is too broad and vague.

Principle 1

ABA supports the principle that the board of directors have a “clear commitment” to compliance as a means to “promote the values of honesty and integrity” throughout any institution. The concept that the board reviews a bank’s compliance policy annually is a good recommendation, but there is a need for flexibility with any review since there are a myriad of compliance obligations by various institutions.

Principle 2

Since compliance also covers how to respond to regulatory violations, we agree with the general principle that senior management should ensure that there be “appropriate remedial or disciplinary actions if breaches are identified.”

Principle 3

To coincide with the ABA’s mission to enhance the importance of the compliance function within all institutions, we strongly support the comment that senior management needs to ensure that there are sufficient resources to perform the compliance function.

Principle 4

The cornerstone of an effective compliance program is how it is perceived within the institution. ABA supports giving the compliance function a formal status within the bank. However, we do not agree that a formal document approved by the board must place the compliance function apart from the business activities of the bank. The decision on the location of the compliance function should be left with the bank. We would add that section 19, which stresses broad staff communication on the compliance “charter,” is important and supported by the industry.

Principle 5

The American Bankers Association supports the need for a strong and effective compliance function but opposes achieving that goal through all of the specific criteria currently outlined in paragraphs 20-25. For example, ABA urges the Committee to stress that the head of compliance be a member of senior management.

Also, as stated above, the term "independent" should not imply that a bank is prohibited from placing its compliance function within a business unit.

Many banks have successfully established independent compliance units within business units, concluding that active participation in business activities facilitates the proactive identification of compliance problems before they raise significant compliance risks. We suggest that the Committee eliminate all of Principle 5 at this time until there are more discussions with the banking industry on current methods of ensuring independence.

ABA would be pleased to work with the Committee on this critical issue.

Principle 6

ABA supports this principle (having the compliance function identify, assess and monitor risk as well as reporting to senior management about those risks) as a necessary part of the compliance function. The responsibilities outlined in section 26 are important, but it should be emphasized that some smaller institutions will not have the resources to complete all of the listed responsibilities.

Principles 7-9

ABA offers no specific comments other than to point out there are many avenues for establishing the necessary qualifications to enable compliance professionals to carry out their duties. For example, in the United States, the Institute of Certified Bankers (ICB) provides a designation (Certified Regulatory Compliance Manager) to those who pass a written exam and continue their membership through continuing education and training. There are similar programs in the U.S. and globally. In addition, our Association, like many others, provides extensive compliance assistance through conferences, schools and publications. For more information, see, www.aba.com.

Principles 10-11

ABA believes that although the Document should clearly separate the roles of audit and compliance, it should not establish a rigid model that either requires audit to perform independent testing of compliance separate from that performed by compliance, or precludes reliance upon Compliance Department testing in appropriate circumstances.

Within a bank and among banks, the roles and responsibilities of audit and compliance can vary greatly, depending upon the compliance risks of the institution, the relative expertise of the respective departments, and other factors unique to the institution. Mandatory redundancies of independent reviews of low risk areas based on inflexible standards may result in inappropriate resource allocations that fail to address higher risk areas within an institution.

Conclusion

The American Bankers Association appreciates the opportunity to express our views. We would be happy to offer any additional assistance to the Committee in the future.

Sincerely,



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