

## **HOW TO PAY YOUR COMPLIANCE OFFICER**

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### **INTRODUCTION**

Without speaking for other members of SCAN<sup>1</sup>, we can confirm that the President of SCAN wishes he had enough money to purchase the above pictured car. Compliance officers are often thought of as a line of defence, a guardrail, a control function... which is all true. However, you can have a control function job and still want to be richer than Jeff Bezos. The two desires are not mutually exclusive.

For some reason, many people think compliance officers actually do not want to own the car in the photo and instead want to be the person that lays out the orange cones to ensure safe driving.

At SCAN, we have lots of respect for the cone person. In fact, we expect that we are one of the few organizations that look at this photo and think about the plight of the cone person. But the importance of cone placement is not what this article is about. This article is about compliance officers making BANK<sup>2</sup>... with an analysis of the applicable Monetary Authority of Singapore (the “MAS”) guidelines included as a bonus.<sup>3</sup>

### **FRAMEWORK FOR COMPENSATING A COMPLIANCE OFFICER**

The goals of compensation are to attract people to work for your organization and to retain people who are already there. Compensation is also used to motivate employees to work at their peak performance and lift morale.

In general, compliance officers can be compensated in the same manner as other employees at a

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<sup>1</sup> The views and opinions expressed in this article are those of the author(s) and do not necessarily reflect the views and opinions of SCAN or any of its members.

<sup>2</sup> Of all the urban slang options for “getting paid”, I (Chris Holland) was most confident in the use of the “making BANK” phrase. I had no confidence that I would use the phrase “Scrooge McDuckin” correctly.

<sup>3</sup> For simplicity, we have focused on the compliance officers of financial institutions rather than compliance officers of other industries, although the issues discussed are likely to be the same.

financial institution (“FI”) in that they can receive a salary, bonuses, benefits and equity compensation. However, in the MAS’ Guidelines on Risk Management Practices – Internal Controls (the “**Internal Control Guidelines**”), the MAS wrote that to avoid providing incentives to condone excessive risk-taking in a FI, the compensation policies for compliance officers, as well as other staff in risk management, control and valuation functions, are expected to be “sufficiently independent of the performance of trading activities or sales and revenue targets” (the “**Sufficient Independence Expectation**”).<sup>45</sup>

### **What Does Sufficient Independence Mean?**

An employee’s compensation cannot be completely independent from a FI’s financial performance. While an employee’s salary is a fixed amount, job security and the ability for a FI to offer salary increments will be affected by the employer’s financial performance.

Still, some compensation structures provide greater incentives to condone risk taking than others. We consider the Sufficient Independence Expectation to be a general standard that the MAS expects FIs to incorporate considering the scale, nature and complexity of their businesses. A FI can never eliminate incentives for (i) front office staff to take excessive risks or (ii) control staff to condone excessive risk taking. Instead, a FI can design a responsible compensation framework that mitigates the incentives and provides qualitative metrics for control staff compensation.

### **Considerations for a Responsible Compliance Compensation Framework**

Among others, the following matters should be considered when a FI develops its compensation framework for control functions:

- the range of envisaged ratios of fixed compensation to discretionary compensation;
  - in general, discretionary compensation incentivizes risk-taking more than fixed compensation; and
- the manner in which appraisals will be conducted, including:
  - how the conclusions of the employee’s performance are reached,
  - how compensation amounts are determined,
    - how much is in cash and how much is subject to vesting periods or the FI’s long-term performance; and
  - how the appraisal and the amount of discretionary compensation or salary is communicated to the employee.

While all these considerations are relevant to front office staff, FIs should pay increased attention to these matters for control functions because of the importance of avoiding the improper incentivization of control functions.

### **Comparing Compliance and Front Office Discretionary Compensation**

Front office staff may be compensated under frameworks that are more closely tied to revenue performance. For example, if equities trader executes trades generating S\$1 million of revenues for a FI, the trader may receive a percentage of such revenues as part of the trade’s compensation. These incentive compensation structures may (i) be documented or unwritten, (ii) be paid in cash or non-cash compensation, (iii) be tied to a quantitative formula or (iv) constitute a large or small portion of the trader’s overall compensation. If these incentive schemes constitute a large portion of the trader’s overall compensation, they may be inappropriate if a FI does not sufficiently consider corporate governance metrics as part of the employee’s total compensation.<sup>6</sup> Regardless, such revenue-based incentive schemes are, almost always,<sup>7</sup> inappropriate for control functions.

### **FORM VS. SUBSTANCE IN COMPENSATION**

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<sup>4</sup> See Paragraph 2.10 of the [Internal Control Guidelines](#).

<sup>5</sup> It is interesting that revenues rather than profits are cited here. Cuts in compliance programs would likely affect costs, and thus profitability, rather than revenues and still adversely affect a FI’s risk profile.

<sup>6</sup> Id.

<sup>7</sup> Compliance officers are like James Bond – we like sports cars and prefer to never say never.



While compliance officers are not always the best at math, we can safely say that any compensation amount that can be determined on a qualitative basis can also be derived as a percentage of a FI's revenues. We would be naïve to ignore the potential of a FI to reverse engineer an appraisal to yield an amount that is the same as the amount which would be paid under a framework that provided inappropriate incentives to condone excessive risk taking. Most corporate governance frameworks can be compromised or defeated by bad actors. However, this fact should not be used as an excuse to not establish a robust governance framework. Instead, FIs must establish sufficient governance frameworks with the knowledge that FIs' senior management and Board of Directors will be accountable for any failures to execute the frameworks in good faith. We note that the MAS emphasized recently emphasized the importance of senior management accountability in Outcome 2 of the [Guidelines on Individual Accountability and Conduct](#).

## **THE RISING COST OF COMPLIANCE**

Can a compliance officer be paid too much? No.... Admittedly, we are biased here at SCAN.

There have been many things written about the rising cost of compliance for FIs. One theory to explain this trend is that while the higher costs hurt a FI's bottom line in the first instance, what is really going on is a rebalancing of compensation between the front office to control functions. Such a reallocation alone would not have any adverse financial impact on a FI absent unintended consequences. In practice, control function compensation will be considered as part of overall employee compensation and the FI's financial results. How much a FI should pay their employees, in the aggregate or individually, is ultimately subjective.

## **CONCLUSION**

Deciding the right amount to pay an employee is not easy. Often, every employee at a company may think they are underpaid. However, compensating control functions present unique issues<sup>8</sup> because control functions inevitably limit revenue making opportunities, even if the control functions benefit the financial health of the FI in the long-term.

Many people believe compliance officers are incentivized to say no or do not care about the firm making money. This belief is not true. However, compliance officers have fewer incentives to take risks relative to front office personnel, which is a deliberate aspect of the MAS' corporate governance framework.

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## **ABOUT SCAN**

SCAN is a non-profit society registered in Singapore. Our mission is to (1) highlight Singapore as a leader in effective regulatory compliance, (2) reinforce the benefits of conducting business with a culture of compliance and (3) share insights and best practices among members.

Please email us at [info@scansingapore.org](mailto:info@scansingapore.org) or call 8186 1708 to learn more.

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<sup>8</sup> For a further discussion about how control functions should be paid see [“Fixed or Contingent: How Should Governance Monitors’ Be Paid?”](#) by David Larcker and Brian Tayan on October 1, 2012.