

The Compliance Culture of Hunter-Gatherer and Farming Communities

*By Jove, I am not covetous for gold. Nor care I who doth feed upon my cost;
Such outward things dwell not in my desires. But if it be a sin to covet honour, I am the most offending
soul alive...*

*This day is call'd the feast of Crispian. He that outlives this day, and comes safe home, Will stand a
tip-toe when this day is nam'd, And rouse him at the name of Crispian.*

*And Crispin Crispian shall ne'er go by, From this day to the ending of the world,
But we in it shall be remembered-We few, we happy few, we band of brothers;
For he to-day that sheds his blood with me Shall be my brother.*

St. Crispian's Day Speech (excerpt)
William Shakespeare, 1599

The St Crispian's Day speech, from Shakespeare's King Henry V is a work of fiction imagining King Henry's inspirational speech to his troops prior to the historic battle of Agincourt. At the time, a 27-year-old King Henry and his men were outnumbered by the French 5 to 1, suffering from fatigue and dysentery and, miles from the port of Calais to safety across the English Channel.

In one of the most historic battles of the Middle Ages in Europe, King Henry and his men not only survived, but also won a stunning victory against a much larger and well rested opposing force.

The St Crispian's speech is also the last word on leadership, "setting tone from the top", and an ideal jumping off point to discuss management's role in establishing a culture of compliance.

The Regulatory Obligation to Establish a Culture of Compliance

An Ultimate Designated Person's ("UDP") obligation to establish a culture of compliance (see section 5.1 of National Instrument 31-103) is one of the least discussed, and most important requirements introduced by NI 31-103.

Compliance permeates virtually every decision made in the normal course of the business such as the products and services a firm chooses to offer, its marketing plans, hiring decisions, compensation arrangements, etc. Unlike other support functions such as accounting and technology, compliance cannot be simply roped off from the rest of the business and designated to certain staff.

Furthermore, in smaller firms, the actions of any person can affect the firm's reputation and its regulatory risk. From that perspective, each staff member is a Compliance Officer and part of a "band of brothers" (and sisters) that must work together to protect their business, and each other.

A firm's compliance culture is the first and most important line of defense against regulatory problems.

There were two factors that, in our view, made the St Crispian's day speech powerful. First, King Henry not only spoke his words but also lived them. At that time, to be the King of a country was equivalent

to being the country itself. A King's life was never to be sacrificed carelessly. Choosing to go into battle to face certain death rather than surrender, and proclaiming to the various peasants, farmers and other volunteer soldiers assembled there that they were his "brothers" would have been a forceful demonstration of his conviction, at the time.

Secondly, the environment in which the speech was delivered, the impending attack from the well-armed and organized French force, was conducive for the message to be accepted and internalized.

To establish a strong culture of compliance, Management must not only live the culture, but must also strive to create an environment in which a compliance culture can thrive.

Living Compliance

Management can show leadership on compliance matters by walking away from situations that would compromise the Firm's reputation or its compliance with regulatory expectations. These can include decisions regarding the acceptance of clients, purchase orders, or referral agents.

For example, no serious firm should consider lending itself out to unregistered firms that simply need a Dealer to "book trades" to get around a registration obligation.

It also means that Management must hold all staff to the same codes of conduct on matters such as personal trading, and reporting potential conflicts.

Creating a Compliance Environment

However, a firm's ongoing decisions and actions are largely guided by its cultural environment rather than Management.

In our experience, the cultural environment of a registrant firm can be classified as either a hunter/gatherer or farmer environment.

Early societies were organized as hunter-gatherers, moving from place to place, hunting prize game. However, they also suffered from long periods of starvation, and would sometimes have to abandon weaker members of the tribe.

Societies gradually evolved into farmer communities, with a focus on possessing and safeguarding land from external threats, maximizing crop yields, and ensuring an ongoing supply of food for themselves and future generations.

Hunter-gatherer firms tend to be task and opportunistic driven, while farmers are process driven.

For example, when hiring staff or working with referrers, a hunter-gatherer will focus on the clients and business opportunities the individual can bring to the table. However, a farmer is equally concerned about whether that person can work with the rest of the team, and whether their approach and philosophy are in line with those of the Firm. A farmer is willing to walk away from great contacts and opportunities if there is no appropriate fit.

A hunter-gatherer firm is very much in tune with the new industry trends, or growing market segments, and is always open to strategies to exploit these. Farmers tend to pick their areas of specialty and seek to dominate them.

A hunter/gatherer will do what is necessary to ensure successful product distribution, including paying generous incentives to salespersons and referral agents, to meet a closing deadline. The focus of a

farmer is on future distributions, not simply the current offering. A farmer recognizes that they need to cultivate a pool of investors to whom they can go repeatedly for funding. Out size distribution fees and other structures that reduce the investor's opportunity to earn a reasonable return are counterproductive to a farmer.

Farmers will investigate client complaints matters with great seriousness, and are very interested in determining whether the complaint points to a fundamental weakness in their processes. A hunter/gatherer will typically treat a complaint as a legal issue.

I'm not suggesting that hunters/gatherers are greedier or more self-interested than farmers. A Farmer can be equally, if not more greedy and self interested. However, because of their orientation towards building and growing a long-term business, farmers are naturally led to decisions and actions more in line with reducing risk, and complying with the spirit of regulation.

Hunter-gatherers, on the other hand, are a magnet for regulatory problems due to their short-term focus and failure to recognize that compliance is an ongoing process and not a task.

In our experience, hunter-gatherers are typically the group that experiences the most anxiety from new regulation. Because of their task orientation, this group will often try to distil new regulation into a series of tasks (e.g. find someone who can be the CCO, inject capital, buy, borrow or steal a compliance manual, etc.)

Hunter-gatherers often complain that regulators are trying to drive them out of business. In our view, they are correct. They will never be at peace with regulation, because regulation wants them to be farmers.

Management needs to honestly consider whether they have created a hunter-gatherer, or farmer culture within their firm, and determine what is necessary to re-orient the business.

Tell tale signs of a hunter-gatherer firm include high staff turnover, extreme peaks and valleys in revenue (compared to their industry), an unstable investor base, and frequent changes to their business models and key sources of revenue.

St Crispian's Prologue

King Henry V, if he was alive today, would make an ideal Ultimate Designated Person and Chief Compliance Officer, and would have had no fear of National Instrument 31-103. He lived his convictions and instilled those in others.

For those interested in seeing the whole speech, we've attached a link. Enjoy.
<http://www.youtube.com/watch?v=OAvmLDkAgAM>

Ara Compliance Support

Ara Compliance Support is a boutique firm that provides compliance support to firms in the securities, investment management and insurance industries. Our focus is to help small and mid-size firms reduce their compliance risk and, apply their time more efficiently. We offer a full range of services including ongoing compliance support and, compliance consulting on a project basis.

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