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Regulatory Compliance and Banks: Key Challenges and Effective Solutions

WHITEPAPER

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Introduction

Compliance is big business. The approximate amount of relief to customers from the Customer Finance Protection Bureau, enforcing customer protection laws, is a staggering $10.1 billion (2011-2014). This includes $2.6 billion in restitution to consumers; and$7.5 billion in principal reductions, cancelled debt, and other consumer relief.

This is money that could have found a place in banks' bottom line.

Regulations are integral to the banking industry, and the extent to which the bank complies with such regulations not just maintains its bottom line in terms of avoiding hefty fines, but also has a big bearing on credibility and integrity.

So how do banks comply with all that is required, and save themselves from the ill-effects of non-compliance?

The following four broad steps is the way to go:

- Understand all regulations
- Incorporate compliance into core business processes
- Ensure compliance does not shut shop. In other words, make sure implementation of regulations does not impede regular business operations
- Ensure that compliance does not come at the cost of customer satisfaction

Key Challenges

Compliance is not a smooth and straightforward affair, as the sheer number of non-compliance cases show. Here are the top challenges bankers face when trying to comply with regulations:

Huge Volume of Regulations

The 2007-08 financial crisis brought in new regulations, mostly intended to infuse transparency in financial systems, and ensure that banks maintain adequate capital.

However, ironically, the weight of these requirements itself causes a strain on the banks.

It is estimated that by 2020, all the regulations passed since the 2009 Pittsburg meet of G20 countries would be equal to a pile of papers three times the size of Eiffel Towers, and that it would take a dedicated reader 650+ years to simply read through all of these regulations

Not all regulations apply to everybody though. While some regulations pertaining to Know Your Customer (KYC) and anti-money laundering (AML) are applicable across the board, many regulations relate to capital markets, some legislations aim at protecting customers from rapacious charges, and some others focus on creating a conducive environment for banking. Some of the major regulatory requirements for banks include:

- **SEPA:** The Single Euro Payments Area (SEPA) makes it binding on banks to offer customers the same uniform basic conditions, rights and obligations when they make payments anywhere in the Eurozone, regardless of their location. For instance, a credit card holder in Germany could make payments in Spain, just as he would do in Germany. While this offers a world of convenience to customers, it denies banks an opportunity to collect additional fees and charges for international transfers, a stable source of income, and standard business practice across the world. At the time of implementation, the payment revenue(account for as high as 15% of the bank's profits) estimated to be foregone across all banks, stood at $108 billion.
- The Directive on Payment Services (PSD) establishes the legal groundwork to create a European Union wide single market for payments. It lays down a comprehensive set of rules, applicable to all payment services in the European Union, making cross-border payments at par with 'national' payments. Again, while customers benefit greatly, the challenge for banks is to overhaul their systems and procedures to comply with these directives.

Both these regulations force banks to change their business procedures, impacting operations. For instance, one of PSD's aims is to open up payment markets to new entrants, making competition more cut-throat. Overall, SEPA and PSD don't just put pressure on margins, they also pose a further challenge on the sustainability of a bank's bottom line.

Inconsistent Standards

Even as banks grapple with an ever-increasing number of regulatory requirements, the problem of inconsistent standards compounds the difficulty.

Banks mostly hit this roadblock when they try to globalise. Complying with different regulations in different regions adds to the cost of banking, and as banks pass on these costs to customers, the impact is felt across the eco-system.

Regulations like the International Financial Reporting Standards (IFRS) aims to standardise and improve safety and transparency in business and financial dealings across international boundaries. The goal is to increase the quality of information provided, and to reduce the complexity involved.

Though there is a move to bring in level playing fields in terms of capital, liquidity, and leverage across the board, there will always remain considerable differences in requirements, especially with regard to scope of application, and timing of implementation from one jurisdiction to another.

While it may take time before all financial institutions get on board with the same set of accounting standards (the US is still holding out on adopting this), technology can help increase the adoption rate, while ensuring safety and transparency.

Knowing What to Comply With and How

Compliance regulations fall into three broad categories:

- Policies already announced and at implementation stage, such as Basel III requirements
- Policies taking shape and which will be implemented in the near future. Banks need to get their systems and procedures ready, in time
- Policies at an early stage of development, at national and international levels, with uncertainty over their final shape. Banks may want to start complying with the spirit of such legislation, without going into specifics

At another level, banks also need to be aware of when a specific legislation or regulation would apply to them.

Clash with Business Goals

Statutory compliance, especially the latest ones legislated in the wake of the 2007-08 financial crisis, are intended to strengthen the industry. However, at times, such compliance directly comes in the way of the bank's ability to do business, and impedes competitiveness. A case in point is the Basel III regulations relating to capital requirements and requirements for increased liquidity. Such requirements undoubtedly make banks more resilient, and less likely to fail, but it also means less leverage.

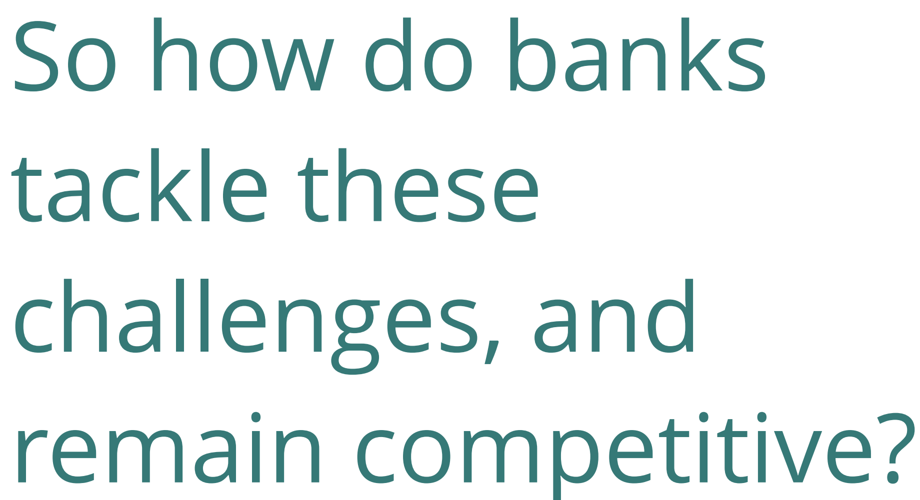
Regulations also stand in the way of innovation. The more time and money the bank has to spend on compliance, the less resources it has to innovate, and further their business model. Banking is a zero-sum game, and resources and effort in one area come at the cost of another area.

Banks generally use their discretionary spend to attain cost reduction, improved efficiency, customer service enhancements, new market entry, and product launches. The increase in regulations leave many banks with less money on such discretionary spend. On an average, 57% of the banks' discretionary budgets was spent on mandatory projects in 2013, and in 2014, this figure remained more or less consistent, at 54%.

Data Overload

In today's age of big data, data is always in excess, and banks are no exception. Unless there is a proper mechanism in place to cull relevant data from the mass, data overload can subvert the bank's systems.

Banks need data to get a 360 degree view of their customer. However, most banks, with their legacy architecture, use dated batch-driven data, which is not in real time. The data on hand is reactive as well, based on what customers did in the past,and this is of little use to predict customers' changing behavioural patterns. Moreover, customer data lies fragmented across myriad systems, channels, geographies, and other dimensions, creating problems in collating and consolidating data on specific customers. It leads to an ironical situation, where banks have the maximum information on their customers, but minimal actionable data.



So how do banks tackle these challenges, and remain competitive?

Better Controls

Better control equates to observing proper standards of market conduct. Bankers could implement controls at three levels:

1. Business line management
2. Adding a risk management and compliance layer to the process
3. Internal audit

The easiest and least-disruptive layer is at the business line management. Here, banks need to:

- Implement the required controls at the operational layers, and test operating procedures to ensure that they work as they should.
- Protect the integrity of their own systems from hackers and other cyber criminals looking to steal data
- Improve adherance to anti-money laundering (AML) and "know your customer" (KYC) rules in operational procedures

Automated workflows could ensure compliance, and make it easy to identify potential fraudulent patterns. Extensive, automated, built-in approval mechanisms also help banks function in a more agile but safe manner. All these would be in tune with the prevailing transparency laws that make it imperative for banks to maintain logs for all transaction related entities.

Improving Asset Quality

Banks need to improve their asset efficiency. Compliance requirements such as minimal capital requirements and contra-capital force banks to become more responsible with their assets, which they need to use optimally to remain competitive. Improving asset quality invariably involves enhancing data quality, so that silos are broken down, data becomes accessible, and full transparency sets in. This, in fact, clears the path for big data analytics, offering banks an opportunity to tackle shortcomings in management and technology, reduce costs for collecting and reconciling data, and improve risk management.

Banks need to derive insights from their usage data, and when doing so, focus on understanding exactly what is required for the customers. One way of going about it is by instituting a business architecture layer that delineates the customer facing layer from the underlying operational systems, and offers real-time, high volume data

analytics that enables decision making, even as it orchestrates transactions and services simultaneously. This will make the current legacy core architecture irrelevant in delivering customer experience.

An incidental benefit of having all customer data in real-time is that it will enable banks to become more agile in their reactions to the changing regulatory needs. Banks can report on customers or segments in a more transparent and easy way.

Developing a Customer Compliance Business Model

Banks, like any other business, focus on the customer, but instead of a purely “customer centric” model, they should promote a “customer compliance business model” that rewards the customer for compliance with the systems in place. The system still remains flexible, as long as all regulatory requirements are met.

Banks could devise solutions on top of existing systems, to capture compliance requirements inside the core processes itself, rather than go for an overhaul every time regulations change. Digitalization, with a focus on flexibility, and role based portals that offer data in a contextual manner helps banks in this regard. Banks could create innovative offers that come with in-built compliance from the customers’ side. The bank could reward such compliance with loyalty points that motivate customers to use this option.

Conclusion

With regulators determined to enhance enforcement, increasing punishments for violations, and making senior managers personally accountable, banks are turning to technology to supply them with tools that will help them co-opt the requirements into their internal business processes.

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With a team of highly skilled individuals and our innovative product development models, we help our clients remain at the forefront of cutting edge technology. A stable, mature and flexible product suite, Xelerate continues to develop with the market. With insights from our industry experts, a robust future-ready roadmap and seamless integration with any ecosystem, it is one of the most effective products to leverage.

For more information, please visit us at www.suntecgroup.com

If you wish to explore further on how SunTec can help you keep a check on your revenue through compliance, please drop us a mail at contactus@suntecgroup.com and we will get in touch with you

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