



COMPLIANCE SOLUTIONS, LLC

# Changing the Valuation Paradigm of Compliance Risk Management FMS-NY NJ Mini-Session

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# Agenda

- Risk
- Compliance Risk
- Compliance Risk Factors
- Current Compliance Management
- Consumer Protection Risk Change
- Shift focus of Compliance Management
- Compliance Process Improvement



# Risk



- “Risk comes from not knowing what you’re doing.” - Warren Buffett
- “Risk varies inversely with knowledge.” – Irving Fisher
- “The first step in the risk management process is to acknowledge the reality of risk. Denial is a common tactic that substitutes deliberate ignorance for thoughtful planning.” - Charles Tremper



# What is Compliance Risk?

- Compliance risk is the potential for negative outcomes resulting from not properly adhering to rules and regulations in the carrying out of banking activity
  - The problems associated with not following the rules as we do our jobs as bankers





# Compliance Risk





# Compliance Risk

- Following the rules used to be “simple”
  - Thou shalt not discriminate in lending
    - Consumer Credit Protection Act
  - Thou shalt follow the money closely
    - Bank Secrecy Act
  - Thou shalt not take advantage of customers
    - Truth-in-Savings and RESPA
  - Thou shalt not share peoples private information
    - Gramm Leach Bliley
  - Thou shalt make sure the customer is who they say that they are
    - Red Flags
  - Thou shalt not make a loan in a flood zone without proper insurance
    - Flood Rules





# Compliance Risk Factors

- Complexity
  - Are the actions of the Bank more or less routine, easy or consistent?
- Volume
  - How many opportunities do we have to make a mistake?
- Disclosure
  - How much critical information do we need to share with customers about the Bank's actions?
- Documentation
  - How much information does the Bank need to retain to evidence that it is adhering to the rules?





# Compliance Risk Factors

- Operational
  - How much of what we do is dictated by our need to be compliant?
- Third party transfer
  - How much of our Compliance burden are we trying to pawn off on someone else?
- Technology
  - How much do we use technology to help maintain compliance?







# Compliance Risk Factors

- Regulatory Emphasis
  - How likely is an examiner going to be to find me in violation of the rules?
- Monetary Penalty
  - How much is non-compliance going to cost the Bank?





# Compliance Risk

www.somethingawful.com



## PIRATE CODE

THEY'RE MORE GUIDELINES, THAN ACTUAL RULES



# Compliance Cost

- “Every person that you’re hiring for compliance is taking away from your ability to lend” – Rep. Shelley Moore Capito (ABA Banking Journal- April 2012)





# Compliance as a Cost Center

- Compliance is not seen as a department that can benefit the bottom line of your bank
  - Have to do it
  - Generates no revenue
  - Compliance costs a ton of money
    - Salary
    - Technology
    - Training
    - Outsourced functions



# Compliance Management Impacts

- Limits the “role” of compliance to keeping the bank out of regulatory trouble
  - Focuses the role of compliance on only negative outcomes
    - Hard to know what will and won’t get a Bank in trouble
    - Puts even more pressure on the institution to be compliant
    - Prevents Compliance from looking forward
- Limits compliance spending to only “what is needed”
  - When it breaks, we’ll pay to fix it, until then it is good enough
    - A lot of stuff breaks
    - Costs to fix the breaks increase
    - Rapid depletion of compliance budget





# Tightrope Compliance





# Tightrope Compliance

- Works well in the short term
  - Passes most audits
  - Passes most exams
- May work well in the mid-term
  - More frequent findings
    - Audits or Exams
- May work well into the long term
  - React quickly to contain compliance violations
    - No downgrades of compliance ratings

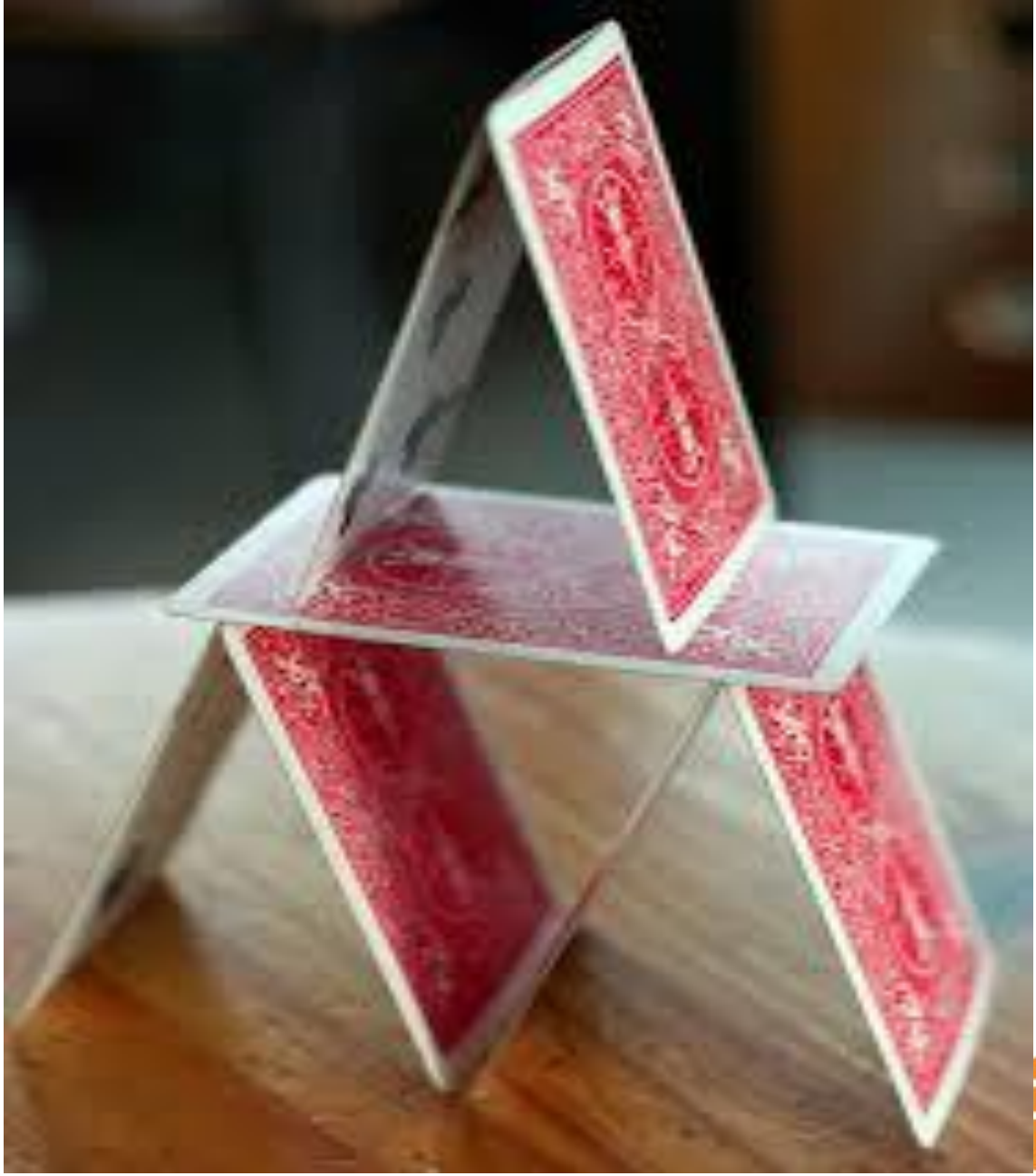




# The Risk of Tightrope Compliance











# “The Big Bad Wolf”

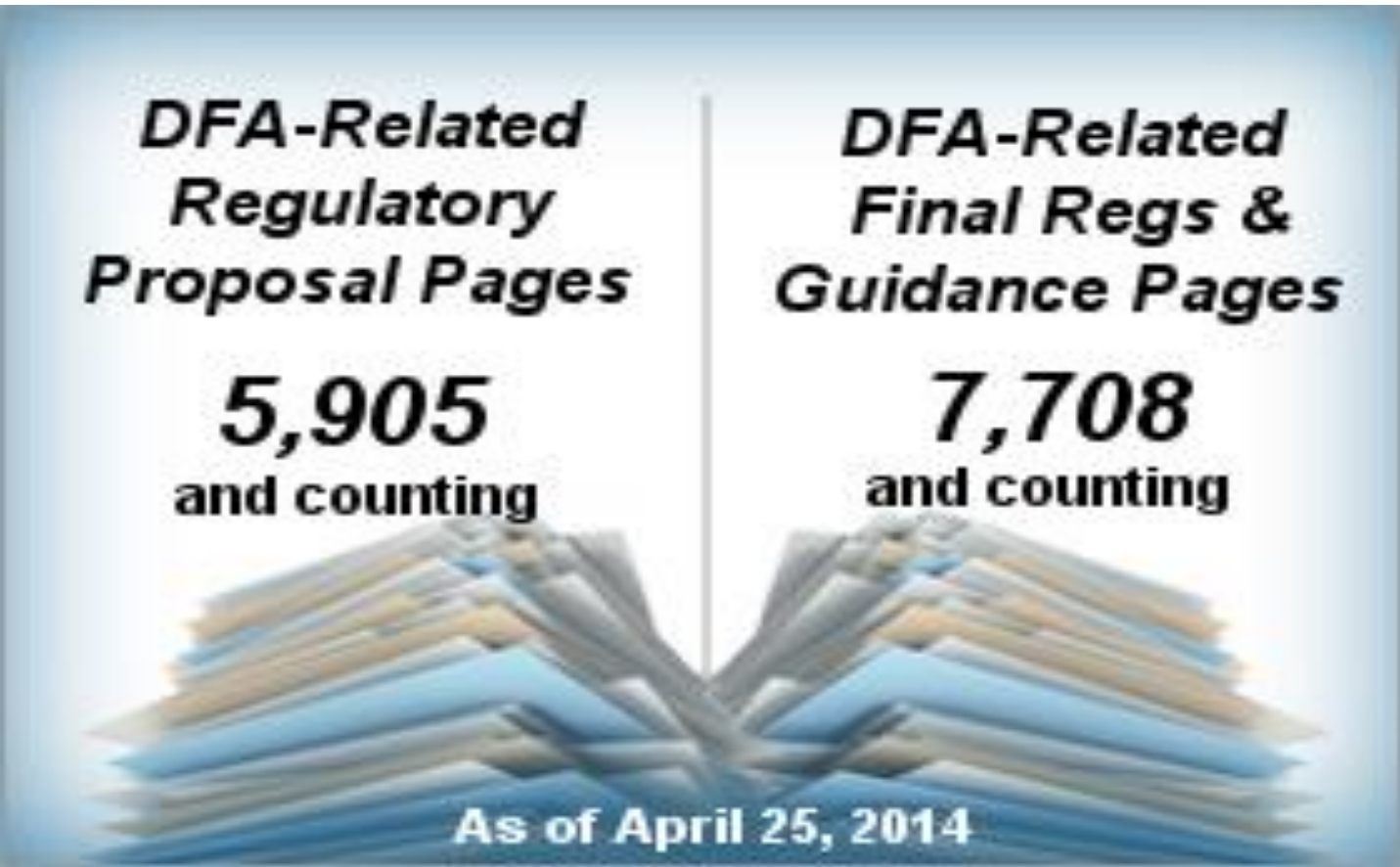




# The Other “Big Bad Wolf”



# Compliance Risk Game Changer





# Compliance Risk Change

- Dodd-Frank and Consumer Protection
  - Everything in Dodd-Frank comes down to protecting the consumer
- Shifts the focus of Compliance Risk
  - Introduces a “wild card” component
    - A consumers understanding of banking



# Consumer Protection Mandate

- “More generally, we are charged with the duty of ensuring fair, transparent, and competitive markets. We recognize that a key to protecting consumers is strong and vigilant enforcement. The possibilities here for injuring consumers are almost limitless. Maybe a customer service representative provided misleading information. Maybe consumers were told only about the benefits of a product and not about any of the limitations or risky features. Maybe important information about rates or fees was hidden or obscured.” –Richard Cordray, Director of the CFPB





# Rethinking Compliance Risk

- Compliance risk is the potential for negative outcomes resulting from not properly adhering to rules and regulations in the carrying out of banking activity
  - The problems associated with not following the rules as we do our jobs as bankers
- Is this still true now that consumer protection is required?
  - Thou shalt not take advantage of customers





# Impact on Compliance Risk Factors

- Complexity
  - Are the actions of the Bank more or less routine or easy... for a consumer to understand?
- Volume
  - How many opportunities do we have to make a mistake... which will impact a consumer negatively?
- Disclosure
  - How much **critical** information do we need to share with customers about the Bank's actions and can the customer understand it?
- Documentation
  - How much information does the Bank need to retain to evidence that it is adhering to the rules?





# Changing Risk





# Compliance Cost

- Current model of Compliance Management has become untenable
  - Short term costs are too large
- Compliance costs escalated quickly
  - Apparently no one even knows the real costs
    - <http://www.cnbc.com/id/100574254>





# Compliance as a Cost Saver

- Compliance is an area that can contribute positively to the Bank's bottom line
  - Have you to do it
  - Generates no revenue
  - Touches almost every area of the Bank
    - Deposits
    - Operations
    - IT
    - Lending



# Impacts on Compliance Management

- Expands the “role” of compliance to making the bank more efficient
  - Focuses the role of compliance on customer outcomes
    - Compliance for a reason other than just compliance
    - Allows the institution more control over what is “compliant”
    - Causes Compliance to look forward
- Changes compliance spending to “where it does the most good”
  - We can prevent breaks by making things better now
    - Spend now save later
    - Less money spent to fix breaks, because of fewer breaks
    - Compliance budget becomes limited to maintenance



# Compliance Process Management

- Always start with a Risk Assessment
  - Where is “compliance” needed the most?
- Tailoring policies and procedures to the institution
  - Does the policy or procedure make sense for the institution?
    - New technology? Better staff?
      - Can we eliminate unnecessary steps?
        - » Better consumer experience
    - Does the policy or procedure overlap another policy or procedure?
      - RESPA, HMDA, Regulation Z, Regulation B intersect at the application
        - Can we reduce overall compliance burden by being consistent?
          - » Clearer and more consistent consumer disclosures or documentation



# Compliance Process Management

- Does the policy or procedure require collection of information for compliance purposes?
  - BSA and CIP, CDD
    - We are required to get vital financial information from our customers
- Can this compliance information be used to generate revenue?
  - Data is a Bank's best friend
    - Cross selling opportunity abounds when you have the data
      - Better, stronger, more entrenched relationships with our customers
      - Happier customers



# Compliance Process Management

- Works well in the short term
  - Detects and corrects a lot of the “minor” problems before they become “major” problems
  - Can make the customer experience better
- Works well in the mid term
  - Allows the Bank to plan for improvements
  - Less time spent “cleaning and clearing” issues
- Works well in the long term
  - Better customer relationships
  - Maybe even increased revenue... Maybe?





# Questions?



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