Whitepaper

No rest for the wary: Deregulation is regulatory change too

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Executive summary

Given the flurry of Trump Administration executive orders that portend a significant deregulatory trend, many in the banking sector are seeking to understand the compliance implications for their teams, their operations, and their overall business. This article highlights the importance of understanding deregulation as a form of regulatory change and provides strategies for maintaining compliance in a deregulated environment.

My aim is to instill a recognition of the need to proactively identify emerging risks, particularly at the state level, while helping illustrate the critical role of technology in supporting the compliance function, and the importance of documented collaboration to ensure there is agreement, support, and a permanent record of compliance policy changes adopted — whether in response to deregulatory factors or other drivers — at your institution.

Introduction

Deregulation was not invented by the current administration. It refers to the reduction or elimination of government regulations in a particular industry. For our purposes, it may also refer to the dissolution or merging of federal regulators. Deregulatory initiatives and campaigns have evolved over the years in the financial services sector, generally aiming to increase efficiency, promote competition, and foster innovation — at least that was generally the plan.

It's up for debate whether deregulation efforts of the past have substantively met any of those stated goals. What they have done, in some cases, is raise concerns about the risks they can pose to financial stability and consumer protections. Let's examine the impact of current deregulation efforts on the compliance function for banks and consider ways for compliance personnel to (once again) navigate a rapidly changing regulatory landscape.

Impacts of deregulation on compliance

This is not the time to lay down your weapons for managing regulatory change. In fact, as an attorney and former Chief Compliance Officer, I would argue that the time is now to harden your compliance defenses. If you conduct any important, compliance-related tasks manually today, you may be exposing your institution to unnecessary risks, especially during this period of tsunami-like information waves coming out of Washington, DC.

Deregulation may lead to changes in compliance requirements; after all, that's the point. But how will your institution document and carry out its response to these changes? Without a central repository of the laws, rules, and regulations that apply to your business model, a record of how you manage those risks, and a way to report on your efforts to prove compliance, how will you function in such a rapid-fire era? Five years from now, will you know why your bank stopped providing a particular disclosure in a certain state, or why it began charging fees for something new and who approved charging that fee?

In my experience, there is no better way for the compliance function to hold decision-makers accountable than documentation. Other valuable, compliance-related records often get lost when they have no logical central repository where they can be mapped to the specific obligations they address like meeting minutes, audit outcomes, complaint data, risk assessments, examination findings, policies and procedures, and controls. It is simply not possible to make and maintain those critical connections in a practical way using spreadsheets. Deregulation today demands that banks have sustainable and scalable ways to monitor, manage, and prove change.

For the compliance function, states will soon become more impactful than ever. They will be enacting laws and approving regulations to fill any perceived void on the federal side. In fact, several states engage in this practice now through legislation relating to privacy, cybersecurity, and other areas of consumer protection. In the not-too-distant future, your institution may be dealing with multiple, perhaps conflicting state regulations instead of one federal obligation. And where a federal regulation does exist on the same topic, pre-emption may not be the answer, as it has become more difficult than ever to determine when it applies and often ends up in drawn-out litigation.

For all these reasons, robust, automated horizon-scanning and documentation of decision-making are paramount. The pendulum will swing back the other way eventually and your bank will want to have a record of what the institution did and why during this period of uncertainty. Compliance staff will come and go, but their institutional knowledge needs to be captured in a way that ensures it endures.

Case studies on the impact of past deregulation efforts on compliance frameworks and the financial services industry itself illustrate these challenges and highlight the need for robust compliance strategies.

Potential risks and challenges

Increased risk of misconduct
With fewer regulations, there may be more opportunities for financial misconduct, such as internal or external fraud.

Compliance complexity
Deregulation can lead to a more complex regulatory environment, as banks navigate changing federal regulations and potentially diverging obligations from the states.

Product innovation
Deregulation may be seen as a good time to take risks with products or services for which there is currently little regulatory guidance.

Uneven oversight
Non-bank financial services providers are currently regulated by the Consumer Financial Protection Bureau (CFPB), resulting in a somewhat even regulatory playing field with banks. If non-banks are removed because of changes to the CFPB's oversight remit, banks may be left with an uneven regulatory environment again. And if your bank partners with a non-bank, you will likely need to step up your oversight and monitoring of its relationship with your bank, its customers, and their data.

Reputational risk
Failure to maintain compliance in any environment can damage a bank's reputation and lead to loss of customer trust.

Strategies for compliance in a deregulatory environment

Leverage technology
Use technology solutions, such as compliance program management software, to streamline compliance processes and improve effectiveness and efficiency. Technology can automate many of the time-consuming tasks of the compliance function, freeing up personnel to conduct more critical tasks. Use data analytics to monitor compliance activities, identify trends, and detect potential issues early. Create strategies to mitigate changing and emerging risks related to deregulation. This might include enhancing internal controls, increasing monitoring efforts, or investing in new technologies. Automate the monitoring of regulatory/deregulatory changes and the assessment of the impact of those changes on your obligations, consider forming a multi-disciplinary task force to evaluate their potential impact on operations and customers. Foster collaboration between governance bodies, compliance personnel, legal teams, and other departments to ensure a comprehensive, informed approach, including accountability. Maintain thorough documentation of how the institution is responding to changing regulatory requirements, including the approval of any changes. This is especially important where decisions are made that may impact consumers.

Update your compliance program
When considering potential deregulation, review your bank's existing compliance program to identify any gaps or areas that need strengthening. Policies and procedures should be revised to ensure they remain effective and relevant in a deregulated environment while addressing new risks or regulatory changes. Understanding how deregulation might impact your risk profile is also essential. Reduced regulation could increase risks, such as financial misconduct or operational vulnerabilities. Additionally, a thorough analysis of regulatory changes from states with oversight responsibilities will help anticipate potential impacts.

Foster a compliance culture
Secure resources and support from senior leadership for compliance initiatives that will help the compliance function better evaluate and manage the impact of deregulation on the bank's compliance and risk programs. Leadership commitment is crucial for fostering a strong compliance culture to promote ethical behavior. Involvement by leaders helps ensure that compliance is seen as a shared responsibility. Acting ethically toward customers should always be paramount — and all employees should know where to report anomalies or ask questions.

Prepare for future changes
Conduct scenario planning exercises to prepare for deregulation developments. This activity can identify potential challenges and help your bank develop contingency plans. Establish and maintain open lines of communication with regulatory bodies to seek guidance and clarification on regulatory changes and their implications. Participating in industry associations and forums can help you stay informed about the regulatory trends and best practices of your peers.

Provide training to all employees
Are your employees aware of the implications of deregulation and their role in maintaining compliance? Ensure that staff understand any changes to policies and procedures, receive training on evolving compliance requirements, understand their role, and know whom to contact with questions or concerns. Encourage continuous learning and professional development to keep personnel up to date on the latest regulatory developments and best practices. Compliance personnel should understand the unique risks associated with emerging products and collaborate with other lines of defense, IT, business, and operations to ensure protections are in place for the bank and its customers.

Changing supervision

Changes in leadership at the federal agencies responsible for oversight of the banking industry can have significant implications for the regulatory environment and compliance practices within the sector. New agency leadership can bring a shift in regulatory focus and priorities. For example, a new agency head may prioritize consumer protection differently than their predecessor. Leadership changes can also lead to new policies or guidance or the rollback of existing ones. This can affect how regulations are enforced, and which areas receive more scrutiny.

Banks may need to adapt to new compliance requirements or changes in existing regulations. This can involve updating compliance programs, training staff, and investing in new technologies. During a transition, there may be periods of uncertainty as new leaders establish their agendas. Compliance personnel need to stay up-to-date and be prepared to adjust quickly and to keep their governance and leadership informed.

Emerging trends in deregulation, such as the rise of fintech and digital banking, are also likely to shape how regulators view banking regulation and compliance, increasing their reliance on technology and data analytics to better evaluate compliance risks.

Changes in agency leadership can affect the relationship between banks and regulators. New leaders might seek more collaboration with the industry, or they may take a more adversarial approach. The type and frequency of guidance provided by regulators can change, impacting how institutions interpret and implement compliance measures.

Investors may also react to changes in regulatory leadership, especially if they anticipate significant shifts in policy that could affect the profitability and risk profile of the bank.

Overall, changes in regulatory agency leadership can create both challenges and opportunities for compliance personnel. Staying informed, being adaptable, and maintaining strong compliance frameworks are essential strategies for navigating these changes effectively.

Lessons from the past

Throughout history, the US has experienced numerous examples of deregulation in banking. Unfortunately, deregulation often exposes shortfalls in banks' management of risk and may itself lead to financial crises. Examples include the *1980's Savings and Loan Crisis, the Financial Crisis of 2008-2009,* and the *2023 Bank Failures*. Recalling these events may help the compliance function frame up the need for technology resources to help manage what lies ahead and helps illustrate the complex and often unintended consequences of deregulation in the banking sector. They highlight the critical importance of balancing deregulation with effective oversight.

Predictions for the future

Automate or stagnate. Today, there are too many changes coming at the banking industry too fast to be able to monitor them all, much less manage them all, without technology. Banks that have not already embraced automation need to quickly consider how they plan to manage all that lies ahead. We know that US states will likely fill the void left by federal deregulation — especially where consumers are impacted. We know that new digital asset regulations are coming to help manage crypto products. We also know that as deregulation efforts are put forth, some banks may be tempted to pursue activities that put their very existence in peril. Having a centralized, automated process in place that documents accountability and manages compliance risk helps cut down on any temptation to lapse into a "wild west" syndrome.

Conclusion

In coming time, there will be a return to "normalcy" for banks and compliance professionals. While we may not know what that looks like just yet, we can help our banks navigate the intervening rough waters ahead. While almost all compliance activities will benefit from automation, during a period of rapid regulatory change, leveraging technology to facilitate your regulatory change management process will provide the most value now and for the future of your bank's compliance function.

Understanding deregulation as a form of regulatory change is crucial. By adopting proactive strategies and leveraging technology, banks can navigate the challenges while maintaining financial stability, regulatory compliance, and most importantly, consumer protection.

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