Achieving portfolio compliance amid increasing regulatory scrutiny

Overview

For lending organizations, the 2023 operating environment has been unrelentingly turbulent. Not only have banks been forced to buckle up and navigate a financial landscape fraught with unprecedented risk, they are simultaneously coming under intensified regulatory scrutiny.

The sheer volume of mandates that banks must comply with can be overwhelming even in a calm financial market. The Community Reinvestment Act (CRA), Dodd-Frank Act, Home Mortgage Disclosure Act (HMDA), Fair Housing Act (FHA), Equal Credit Opportunity Act (ECOA), and Truth in Lending (TILA) are among the bulk of prominent regulations that demand considerable effort and attention.

Now, as regulators put several of these laws under the microscope and take progressive actions intended to make lending more equitable, both surveillance and compliance demands are escalating. This is underscored in the trifecta of lending laws that have undergone significant revisions and are all slated for final approval in 2023 or 2024: CRA, and Sections 1071 and 1033 of the Dodd-Frank Act. In the wake of these considerable changes, banks must assess their readiness for compliance.

In this paper, we will examine the dynamics contributing to the current highly scrutinized banking environment; detail the potential compliance obstacles created by recent or pending regulatory changes; and demonstrate the type of solutions that lenders can harness to not only reduce manual efforts and improve data accuracy in compliance but achieve competitive advantages in the process.

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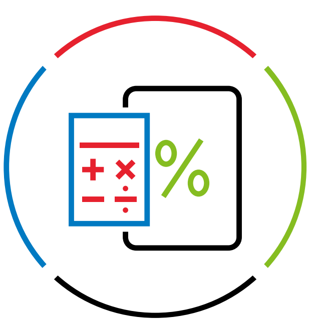
Traversing the threat-laden 2023 regulatory landscape



The 2023 financial ecosystem has been nothing short of tumultuous. Rising interest rates and soaring inflation have increased the cost of liabilities while decreasing investment values. The series of small- to mid-size bank collapses prompted a sharp decline in global bank stock prices and swift response by regulators in an attempt to prevent a global domino effect. Meanwhile, sustained political instability in the Russia-Ukraine conflict has disrupted supply chains and escalated asset pricing volatility.

As if all that turmoil wasn't enough, aggressive regulatory changes have resulted in tougher supervision of the banking community as a whole. Beginning this year, banks will face heightened obligations to collect, maintain and analyze mass amounts of data stemming from multiple reform measures. CRA is on the brink of substantial modernization, with a final rule expected soon and a 12-month implementation period to follow. In March, the CFPB issued a final rule amending Regulation B to implement changes to the ECOA under Section 1071 of the Dodd-Frank Act, and the CFPB is expected to issue a proposal later this year for section 1033 of the Dodd-Frank Act, with a final rule slated for 2024. Meanwhile, the possibility of tightening of regulations by the Federal Reserve is a real threat.

"Failure to comply opens a bank to the real dangers of costly penalties and regulatory sanctions, not to mention threats to reputation and operational integrity."

A snapshot of the looming measures that heighten compliance risk:

Modifications to CRA

Overhauled more than 30 years after its introduction, the revamped CRA represents an attempt to better align with how the nation and the banking industry have changed. Designed to strengthen and modernize its regulations, the proposed CRA changes would provide expanded access to credit, investment, and basic banking services in low- and moderate-income communities; address changes in the banking industry, including internet and mobile banking; yield greater clarity, consistency, and transparency; tailor CRA evaluations and data collection to bank size and type; and maintain a unified approach among the regulating bodies. The law will be effective on the first day of the first calendar quarter that begins at least 60 days after the publication date of the final rules, which are expected in August.

Section 1071 of the Dodd-Frank Act

In addition to amending the ECOA to require financial institutions to compile, maintain and submit certain data on applications for credit for women-owned, minority-owned, and small businesses, Section 1071 also addresses privacy interests in connection with the publication of the data. The modification requires the shielding of certain demographic data from underwriters and others involved in record keeping.

Section 1033 of the Dodd-Frank Act

The CFPB is looking to provide consumers with more choices and direction over their own financial data in section 1033 of the Dodd-Frank Act. Considered a step toward "open banking" in the United States, the proposal would increase supervisory activities relating to collection, use, and retention of consumer information, as well as heighten consumer awareness of and attention to policies and practices impacting their personal financial data.

Federal Reserve Potential Activity

On the heels of the collapse of several small- to mid-size banks, the Federal Reserve is considering tougher rules and oversight for banks of similar size. The series of bank closures earlier this year amplified fear across the financial system and sparked debate over the prospect of reversing the previous rule that alleviated oversight for regional banks. Some experts predict that the Federal Reserve's SVB report, released in April, lays the framework for far-reaching re-regulation and tougher supervision of mid-sized banks.

Magnified compliance microscope breeds serious risks — and consequences

In the wake of so many new proposals — the majority of which include a digital or data element — banks will be more challenged than ever to effectively manage compliance demands. With the CFPB applying more aggressive scrutiny, lenders must ensure that their reporting is both timely and complete. Failure to comply opens a bank to the real dangers of costly penalties and regulatory sanctions, not to mention threats to reputation and operational integrity.

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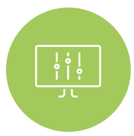
Among the most pressing issues that banks face in light of the bulk regulatory changes are:



Lack of coordination

When it comes to implementing significant regulatory changes, many institutions lack a predetermined strategy. Attempting to figure it out on-the-fly is not likely to yield success, nor is the siloed approach that many organizations resort to in the absence of an established tactical plan. To be successful, banks must consider the modifications in the context of change management; for example, how the new rules will impact IT departments and how they will compete with other organizational priorities. Coordination across the entire organization is essential to compliance fulfillment.

Data accuracy

Regulatory changes will impact multiple business units and processes across the entire bank. Some of the modifications will necessitate that data be collected and reported in new categories, or that supplementary detail be extracted in existing categories. In some instances, the modified requirements don’t align with the type of data that banks would normally store. In other scenarios, lenders may be collecting data differently than the agencies want it reported. For example, the new community development financing test requires line-level data for every loan and investment a bank makes, opposed to the current provisions that only expect the loan data in aggregate. The proposed CRA also adds another assessment type based on mortgage and small business loan activity rather than branch locations. In addition, new metrics will be required to measure loan distribution, and banks must pass new tests related to retail lending, retail products and services, community development financing, and community development services.

Staffing restraints

So many rules, so little time. In light of the new regulations, banks must carefully consider if their existing compliance staff will be sufficient to cover the requirements. Undeniably, managing fair lending compliance has become a major undertaking, necessitating countless hours of personnel time and demanding significant attention from management. The modified rules are likely to require a tremendous amount of training for internal staff. Additionally, the likelihood of increasing regulatory examinations can further strain resources.

Manual processes

The modified rules are likely to necessitate new technology deployment, as well as the establishment of checks and balances to ensure that reporting, collecting and protecting data is being executed in the right manner. Banks that have continued to rely on manual processes and traveled a slow path to automation are bound to experience particular pain on this front. The rule changes will undoubtedly require organizations to strategize about the tools they will need to acquire and the existing systems that must be modified in order to meet compliance. Manual processes continue to represent both a drain on resources and a source of errors across the lending landscape.

Operational risk

Escalating compliance requirements also produce a component of operational risk, as it can lead to heightened exposure and increase the likelihood of oversight. As market pressures continue to put banking leaders on edge and make personnel extra cautious, banks that are laser-focused on profitability and risk avoidance may inadvertently overlook critical compliance factors.

It can be difficult to know how lending performance will be viewed by examiners. In some cases, banks may even lack the necessary information needed to demonstrate performance level. Doing so requires thorough monitoring of diverse loan portfolios, and banks that do not have an established, comprehensive fair lending program in place risk serious consequences.

Conquering compliance risk and demands: Arm yourself with the proper toolkit

While effectively managing compliance details is critical to a bank's success, financial organizations must also have the means of proving that the assets inside their portfolios are compliant — and be able to report that to regulators.

The right technology solutions can help banks achieve all of these requirements, benefitting both sides of the organization. On one hand, lending operations teams can use compliance analytics and intelligence software tools to ensure they are correctly completing all compliance requirements. Compliance teams have the ability to access and provide the proper data to report and prove compliance to regulators. Both entities can view their current status at any time and assess their standing.

Compliance analytics and intelligence software eases compliance challenges and headaches by decreasing manual efforts and improving the accuracy of submitted data — freeing personnel from scouring websites, subscribing to, and reading publications from government agencies, attempting to properly format data, and other time-consuming processes. The industry-leading technology and complementary consulting services help lenders to manage and monitor their exposure to fair lending risk — and successfully mitigate it — regardless of the size of the institution. Utilizing this type of solution, banks gain the ability to:

- Immediately improve the quality of their data and information
- Control costs with a solution that meets today's needs while scaling to meet future requirement
- Increase access to valuable information and analytical insights that empower solid decision-making
- Reduce the costs and risks associated with managing information
- Extend the value of their existing IT investments

Some technology solutions can even be customized toward specific lending law requirements – such as CRA, HMDA and fair lending — which enables banks to proactively implement processes and controls to address the specifics of each regulation.

Beyond compliance: Considering concurrent benefits

While successful compliance measures are essential for maintaining good standing with regulatory agencies, they can also harvest additional returns. Banks that consistently and efficiently meet regulatory expectations can simultaneously seize competitive advantages that help differentiate from competitors, including:

Community engagement

Compliance with CRA regulations involves banks actively engaging with their communities, meeting the credit needs of low- and moderate-income neighborhoods, and supporting community development. Banks must demonstrate their efforts to provide loans, investments and services to underserved communities.

Reputational impact

While compliance with CRA, HMDA and fair lending regulations is a regulatory requirement, banks recognize that their reputation and public perception can be influenced by their commitment to fair and equitable practices. Proactive compliance efforts can help banks build trust, strengthen customer relationships and enhance their overall reputation as responsible financial institutions.

Market differentiation

Some banks leverage their compliance efforts as a marketing differentiator to showcase their commitment to community development, fair lending and corporate social responsibility. Banks that excel in meeting CRA obligations, demonstrating fair lending practices and supporting community development may highlight these efforts in their marketing materials, community outreach initiatives and public communications. This can help attract socially conscious customers and stakeholders who value ethical and socially responsible banking practices.

Conclusion

As banks prepare for a horizon laden with significant regulatory change and amplified scrutiny, the ability to alleviate obstacles to compliance has never been more pressing. Now is the time for banks to thoroughly assess their compliance readiness across the board. Although the volume of new mandates is enormous, with the proper solutions, lenders have the ability to not only meet compliance requisites but achieve competitive advantages in the process.

See where you stand

Assess your bank's readiness in assuring portfolio compliance.

See your score today

Learn how technology can improve your compliance and lending operations efficiency.

Meet with an expert

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Wolters Kluwer reported 2022 annual revenues of €5.5 billion. The group serves customers in over 180 countries, maintains operations in over 40 countries, and employs approximately 20,000 people worldwide. The company is headquartered in Alphen aan den Rijn, the Netherlands.

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