Managing Change in an Increasingly Regulated Market

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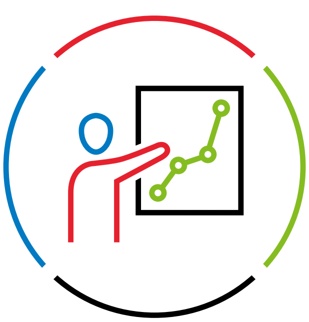
Overview

Today's lending community is bracing for sweeping regulatory changes and the anticipated tightening of federal oversight for midsize banks. More robust surveillance and scrutiny — coupled with significant new requirements in data collection and reporting — are exacerbating an already tumultuous lending environment and creating complex, powerful, and intersectional headwinds. To weather this unprecedented storm, banks must prepare now.

As regulators revamp lending laws and take actions, compliance demands are escalating. In the wake of these considerable changes, it has never been more critical for banks to be able to demonstrate strong regulatory change management capabilities. To do so, they require purpose-built technology solutions that have been tailored to meet the specific needs of the financial community.

In this paper, we will assess the dynamics contributing to the current highly scrutinized banking environment; consider pending and potential increases to regulatory rulemaking and oversight; and examine how implementing a holistic approach to compliance — paired with the proper technology solutions — can help lenders to successfully mitigate risk and manage regulatory changes.

Framing the moment: Assessing current market conditions



Even during the most serene market conditions, regulatory change management poses significant challenges. The sheer volume of mandates that banks must comply with is overwhelming; not only do regulations change constantly, but they can also be massive in scope and depth — making the process nearly impossible to successfully manage without technology.

However, the 2023 financial ecosystem has been unrelentingly turbulent for lending organizations. Not only have banks been forced to navigate a landscape fraught with unprecedented risk, they are also simultaneously coming under intensified regulatory scrutiny. From rising interest rates and soaring inflation, to sustained political instability in the Russia-Ukraine conflict, volatility is widespread.

Additionally, the March failure of Silicon Valley Bank (SVB) — followed by the subsequent collapse of several additional small-to mid-size US banks — took a profound toll on the banking industry. As a result, the Federal Reserve is [considering tougher rules and oversight] for midsize banks similar in size to SVB. At the same time, aggressive regulatory change is on the horizon, including substantial changes within the modernized Community Reinvestment Act (CRA) and significant new requirements in Dodd Frank Section 1071 Small Business Reporting regulations.

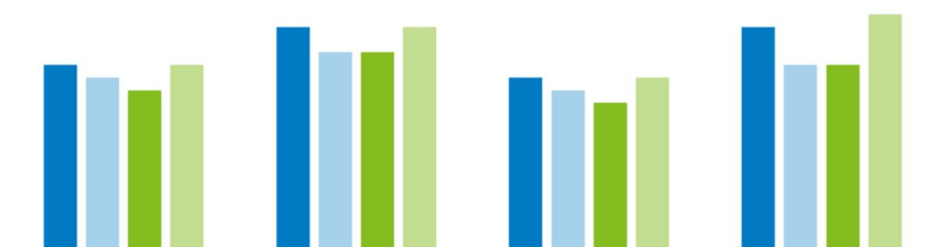
The confluence of these market conditions underscores the importance of banks investing in the optimal technology to help streamline, automate, and ensure compliance.

Preparing for the substantial regulatory changes on the horizon

Compounding the many disruptive market conditions faced by today's lending organizations are efforts to manage an extraordinary amount of regulatory change. For example, Section 1071 of the Dodd-Frank Act requires financial institutions to compile, maintain and submit to the Consumer Finance Protection Bureau (CFPB) certain data on applications for women-owned, minority-owned, and LGBTQI-owned small businesses. Not only does the rule contain 81 data elements — including application dates, loan amount, pricing information, information about the business, and information about the race, sex and ethnicity of the principal owners of a business — it requires collected data to be reported in a standardized format to the CFPB beginning in October 2024.

The challenges of meeting these ongoing conditions were underscored in the findings of the 2022 Wolters Kluwer Regulatory & Risk Indicator survey, which evaluated the lending community's regulatory and risk concerns, realized and anticipated regulatory impacts, and level of current risk management efforts. When asked about the overall compliance and risk areas demanding their focus, 58% of respondents cited the ability to maintain compliance with changing regulations as one of their biggest concerns. In addition, 55% of lenders expressed concern over their ability to keep track of regulations, as well as their ability to demonstrate compliance to regulators (54%) — all factors up by several points compared to last year's survey.

Overall Level of Compliance and Risk Concern (*Percentage Very Concerned*)



	Ability to keep track of changing regulations	Ability to maintain compliance with changing regulations	Ability to demonstrate compliance to regulators	Ability to manage risk across all lines of business
2019	55%	58%	54%	58%
2020	54%	56%	53%	55%
2021	53%	56%	52%	55%
2022	55%	58%	54%	59%

Among the looming regulatory measures that are magnifying 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.

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.

Emerging regulator priorities: More aggressive rulemaking and oversight

As weak risk management has prompted both federal and state regulators to increase rules and oversight, these trends are converging in the loan transaction layer, where the spotlight on data collection and reporting are creating additional regulatory and operational risks for banks. With robust regulatory oversight further heightening the importance of compliance risk management, intelligent technology partnerships become even more pivotal to automating regulatory compliance and lending operations excellence.

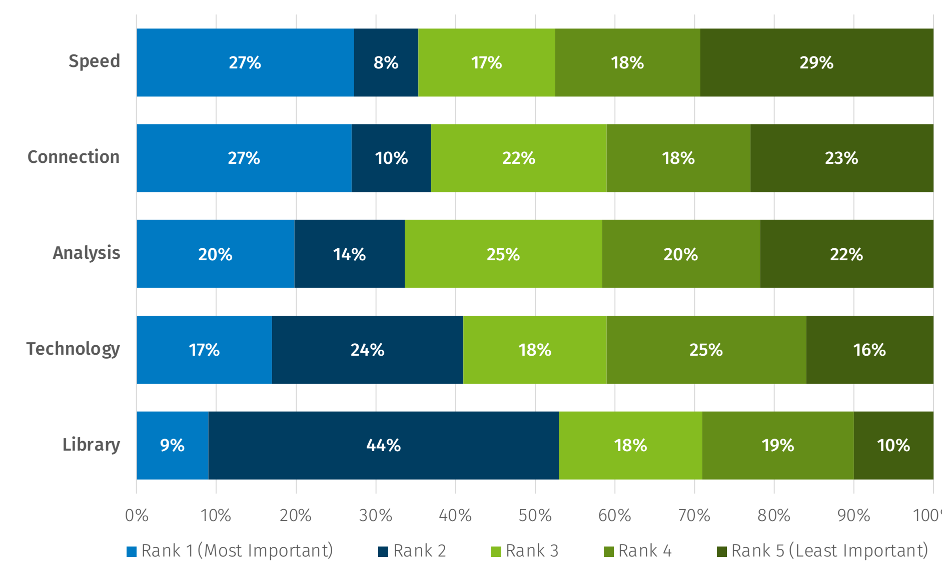
Compliance is Critical to Every Phase of Lending Lifecycle

	Application	Disclosure	Underwriting	Closing	Post-Closing
Description	Consumer application inclusive of key financial, demographic and sociographic indicators	Lender disclosure of key data sources, methods and reporting requirements	Lender evaluation and decisioning related to loan financing amount and loan structure	Loan document execution by borrower and creation of legally binding contractual agreement between FI and borrowing entity	Management of post-closing life-of-loan activities including reporting, servicing, transfer and loan sale
Current Regulations	ECOA HMDA S.A.F.E. Act TILA/RESPA - TRID	TILA/RESPA - TRID ECOA	ECOA HMDA Fair Lending UDAAP	ESIGN / UETA TILA/RESPA - TRID GLBA	SEC Reg AB
New Regulatory Requirement: 1071	Loan application design changes to support collection of additional data elements	Additional borrower disclosure of incremental data collection	Systems and processes blocking use of collected data for loan decisioning	No material change	Submission of 81 new data elements to CFPB in standardized format for covered credit transactions by eligible entities

Without question, there is an incredible amount of work for lending organizations to keep up with; from the Federal Reserve considering tougher rules and oversight for midsize banks, to 29 proposed rules and 15 rules in the final stage from four federal regulators, to heightened activity across individual states. The flow of new or changed state laws and regulations has gone from steady but manageable to overwhelming, evidenced in the chart below.

Ranking important of regulatory change management process automation

In considering the automation of your regulatory change management program, please rank the following features as to their importance to your institution



As of 6.14.23: https://assets.contenthub.wolterskluwer.com/api/public content/3d91a35e24f544698e9499fd760dab9c

Indeed, states are proactively engaging in the regulation of more products, services, and areas of risk than ever before, including cybersecurity, privacy, and digital assets, among others. While regulators' near-term focus is on safety and soundness, any violation or deficiency is likely to receive more attention than in the past and be given a shorter runway to resolve.

Operational risk has been elevated as cyber threats persist and digitalization of banking products and services continues to expand, especially as banks increasingly utilize third parties. At the same time, compliance risk has magnified amid the current dynamic environment and rapidly changing regulations. Further amplifying risk is a laser-focus on lenders to ensure they are providing fair access to credit and fair treatment of applicants and borrowers.

Consider how the following agencies have weighed in recently on regulatory change management:

OCC oversight

In the Office of the Comptroller of the Currency's (OCC) semi-annual risk perspective for spring 2023, four key risk themes were identified: liquidity, credit, operational and compliance. While much is being discussed about liquidity and credit risk, lenders must give significant attention to operational and compliance risks. The OCC report points out the need for lenders to effectively implement changes and update their cash management services, while emphasizing the importance of ensuring sufficient resources and subject matter expertise to implement critical controls to manage fair lending risk. This includes measures such as monitoring, testing, and self-evaluations. Additionally, the report stressed that fair lending controls should include systems and processes for evaluating loan applications — from origination through the life of the loan — in order to assess whether the bank is marketing, soliciting applications, offering, and extending credit on an equal basis. Many of these concerns can be addressed by introducing automation techniques.

DFPI oversight

Also evaluating the impacts of the SVB collapse — and potential regulatory changes required as a result — is the Department of Financial Protection and Innovation (DFPI). In the section of its report titled "Next Steps," the organization highlighted immediate enhanced monitoring to prevent further failures and supervisory enhancement, as well as increased supervision — indicating that they intend to coordinate with federal regulators to develop stronger and more effective systems to promptly remediate deficiencies.

Federal Reserve

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. The organization concluded that the SVB's board not only neglected to properly manage its risks, but failed to recognize what was happening and did not address the problems quickly, resulting in the bank's collapse. Going forward, banks will be expected to understand the risks of their institution and to provide the resources needed to manage them. Compliance, risk, and audit personnel must address problems quickly with a more assertive supervisory approach.

We're living in a changed world where state and federal banking regulators will be increasing supervisory scrutiny in large part due to recent bank failures. At the same time, fresh challenges have been created by the wide scope of new compliance requirements resulting from regulatory changes. As a result, it is imperative to strengthen compliance defenses through advanced techniques that manage higher-risk compliance obligations and regulatory changes more effectively, in order to reduce or avoid violations. Translating complex requirements into defensible operations through automation and other tools will be key for the lending community to be successful — helping to manage or eliminate compliance risks that can result in fines, sanctions, or hinder growth and competitiveness.

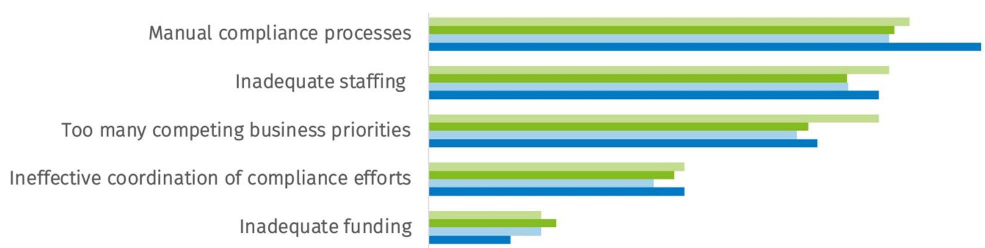
Harness the right technology solutions to optimize regulatory management and compliance

Technology has long played a role in regulatory compliance, providing financial institutions with the necessary tools to navigate regulatory information and manage risk and compliance. Yet some lenders may be relying on ineffective, incomplete, or outdated processes and tools.

Although there are countless technological solutions available on the market today, the key is to select and implement fully automated, interconnected tools specifically designed for the financial industry. Coupled with a purpose-driven, holistic compliance strategy, the right technology solutions can significantly help lending organizations to manage regulatory change and compliance.

Despite the fact that today's regulatory environment is far too complex to effectively manage without the help of technology and automated resources, reliance on manual processes continues to be a stumbling block for lenders. In fact, respondents in the 2022 Wolters Kluwer Regulatory & Risk Indicator survey revealed that this challenge represents their chief obstacle to implementing an effective compliance program.

What are your biggest obstables to maintaining an effective compliance program



	Inadequate funding	Ineffective coordination of compliance efforts	Too many competing business priorities	Inadequate staffing	Manual compliance processes
2019	11%	25%	44%	45%	47%
2020	13%	24%	37%	41%	46%
2021	11%	22%	36%	41%	45%
2022	8%	25%	38%	44%	54%

“Because compliance is embedded within nearly every stage of the loan origination process, automation is essential to achieving success”

Even more, regulators are increasingly expecting enterprise-wide risk management programs to connect to different parts of an organization, especially in environments of remote supervision. Only in this way can banks ensure that the entire organization is moving forward to implement change in a consistent way.

In the OCC report, the organization emphasized that “delaying investments and failing to maintain technology infrastructure can lead to operational inefficiencies and reduced resilience.” The OCC also stressed that new, modified, or expanded products, services, and operational structures expose banks to heightened consumer compliance risk if they are not effectively implemented with appropriate changes and updates to compliance management systems. Additionally, fair lending controls should include systems and processes for evaluating loan applications, from originations through the life of the loan, to assess whether the bank is marketing, soliciting applications, offering, and extending credit on an equal basis.

Because compliance is embedded within nearly every stage of the loan origination process, automation is essential to achieving success — reducing both processing time and costs. When monitoring is automated, personnel are promptly alerted about changes, have the ability to generate valuable reports, and can access content from multiple sources that has been aggregated and analyzed. With these tools, banks can increase efficiency and respond to changes more quickly. Automated processes also help prevent critical information or requirements from falling through the cracks.

Organizations should also review their control processes and consider where automation can improve compliance. Ideally, an authoritative source library is linked to an internal function, process, risk and control. If a change is made to the authoritative source, banks can go directly to the control that must be adjusted, or directly to the process where a new control must be developed. Doing so builds more than just efficiencies in the handling of the day-to-day tasks of management; it decreases an organization’s compliance risk associated with operations and enhances compliance risk management.

Similarly, the regulatory library is a tool that can help lenders meet regulatory change with control, efficiency, and certainty. The solution not only helps banks manage the volume and complexity of regulatory changes, but can be instrumental in enabling them to understand the impact on the overall institution, and adapt compliance and business processes accordingly. Wolters Kluwer’s Regulatory Change Management Data Feed, for example, contains a comprehensive library of laws, rules, regulations and guidance for federal, state, and global regulatory bodies and agencies. Paired with enriched regulatory updates, it helps banks to expedite reviews and quickly assess the impact of new and changed regulations.

Understanding what laws, rules, and regulations apply to your organization — and mapping the regulatory library to internal policies, procedures, risks, controls, products, services, organizational units, and other elements of your compliance program — is critical and expected, regardless of the size of the institution. In this way, a regulatory library adds tremendous value as a critical feature of the regulatory change management process. In fact, when asked to rank the importance of regulatory change management process automation features, respondents in the Wolters Kluwer 2022 Risk Indicator survey overwhelmingly selected the regulatory library as the most important. A library helps banks to identify and analyze specific regulations, assess the impact, generate reports and much more.

Embracing new solutions can be instrumental in helping compliance professionals move beyond antiquated approaches that can put banks at risk. If implemented correctly, cutting-edge technologies such as Artificial Intelligence (AI) can help modernize and improve virtually any regulatory compliance program, driving better insights and business outcomes, as well as fostering a sustainable and accountable process.

AI platforms — which represent compliance enablers, not actual strategies — are geared toward solving sector-specific challenges, such as identifying regulatory requirements across different states and efficiently managing the pace of regulatory change. When planned and implemented effectively as part of a broader compliance program management tool kit, these solutions can serve as a key resource for a bank's compliance team, helping the institution to reduce operational costs and enhance overall risk management capabilities.

Conclusion

As the risk factors that threaten a bank's strategic competitiveness continue to proliferate, robust regulatory oversight is simultaneously increasing — magnifying the relative importance of regulatory and compliance risk management. Yet regardless of the changing landscape, banks must be keenly aware of compliance conditions at all times — and implement effective strategies to ensure that regulatory requirements are being met long-term.

By embracing the optimal strategies and implement holistic technological solutions, lenders gain the control, certainty, and efficiency to successfully mitigate risk and manage ongoing regulatory changes. Investing in the right purpose-driven tools can optimize a bank's ability to streamline, automate, and ultimately ensure compliance.