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Featured Article

Record-Breaking Quarter of Regulatory Changes Leads to Sky-High Costs

By Pam Perdue, EVP, Regulatory Operations, Continuity

SUMMARY: The BCI finds that an avalanche of new rules, larger than anything seen in the last twenty years, leaves community financial institutions struggling to keep up while inspiring industry innovation.

When it comes to keeping up with regulatory change, over the past few years the average community financial institution has relied on a few assumptions. Each quarter it will take at least 1.5 full-time employees just to keep up with changes. There will be around 70 new regulatory changes and it will cost, on average, $37,000 to comply.

Consider those assumptions shattered.

According to the Q4 2015 Banking Compliance Index™ (BCI), the average community financial institution spent $52,317 to manage regulatory changes in the fourth quarter—the most since the BCI began tracking this expense. Complying with regulatory changes took 968 hours, or the equivalent of 2.23 additional full-time employees—the greatest number in more than two years. Overall, the financial services industry spent more than $328 million simply keeping up with regulatory change in the fourth quarter.

One reason for the heightened costs was the astounding 125 regulatory changes—compared to an average of 50 to 75 issuances per quarter over the past 20 years. It's too early to say whether this will become a trend, but it is an alarming development.

Where are these rules coming from? It's a combination of factors. Some of it is leftover housekeeping from Dodd-Frank. This includes Fed updates to capital planning and stress testing rules as well as CFPB amendments to the definitions of "small creditor" and "rural or underserved" for mortgage-related rules affecting HPMLs, qualified mortgages, and HOEPA loans. Also included were the typical year-end updates to indices and various thresholds.

The passage of the Fixing America's Surface Transportation Act (FAST Act) in December also added new rules to the mix. The Act contained several provisions for the banking industry, including some regulatory relief. It eliminated annual privacy notices for many institutions and extended the examination cycle to 18-months for well-capitalized, well-managed banks with assets up to $1 billion versus the former $500 million threshold. It's a sign that the industry is seeing the impact of its lobbying efforts, but any changes—even positive ones—add to the regulatory change management workload.

Enforcement Actions

After two quarters of record-breaking numbers of enforcement actions (EAs), the fourth quarter saw EAs decline six percent to 159—consistent with the traditional fourth quarter slowdown. EAs are also looking slightly less complex with the average number of items in an EA down to just four—compared to five or seven in previous quarters.

The overall enforcement climate remains hot. BSA/AML, consumer protection and safety and soundness remain focal points—the result of a convergence of a heavy global focus on anti-terrorism

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and regulators looking to protect consumers and avoid another crisis. If enforcement continues at this rate, more than 10% of the industry could find itself under an enforcement action in the coming 12 months.

Expect this trend to continue. The agencies issued 13 final rules dealing with safety and soundness in the fourth quarter and issued a statement reminding institutions of prudent risk management for commercial real estate lending. Meanwhile new rules keep coming, including FinCEN's proposed due diligence requirements for identifying the beneficial owner of accounts, which are expected to be finalized this winter.

The Year Ahead

Despite the distraction of an election year, the pace of regulation is unlikely to slow down. The FAST Act demonstrated Congress's appetite to modify rules, even outside the context of clearly-identifiable legislation, and especially in areas where Dodd-Frank went too far. Hearings on complex rules are likely. More executive orders are possible.

Regardless of what happens, there will still be plenty of work. Implementing HMDA rules will require hundreds of hours. Same-day ACH rules take effect in September, while the Military Lending Act will apply come October.

Meanwhile, the CFPB plans to tackle payday and auto title loans in the first quarter of 2016 followed by prepaid accounts, mortgage servicing rules and arbitration later in the year. There is not an end in sight...at least not in 2016.

The Regulatory Matrix

The BCI demonstrates that the volume of regulatory change—and the resulting fluctuations in staffing needs—continues to be a tremendous challenge and expense for financial institutions. Institutions that use manual approaches to manage regulatory compliance are left at a disadvantage as compliance becomes not only more voluminous, but more complex.

Compliance is no longer limited to the compliance department—it touches every aspect of an institution from lending and marketing to credit risk and safety and soundness. This interdependency creates a matrix of action, touching multiple departments simultaneously and making it more complicated than ever to execute and track compliance efforts.

Creating and maintaining this matrix has become such an overwhelming struggle that it's led to a new and quickly expanding branch of the FinTech industry, RegTech. RegTech is a field dedicated to replacing outmoded manual approaches to regulatory compliance with streamlined, automated and efficient processes.

There's no way of knowing what the next quarter might hold. The only solution is to be prepared for anything and everything. If you're not already using one or more components of Continuity's Compliance Core™ and enjoying the benefits of a RegTech leader, now is the time to evaluate your institution's compliance management system to find ways to take the guesswork out of compliance costs and streamline the adoption of new rules—no matter how many.

About Continuity

Continuity is a leading provider of Regulation Technology (RegTech) solutions that automate compliance management for financial institutions of all sizes. By combining regulatory expertise and cloud technology, Continuity provides a proven way to reduce regulatory

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burden and mitigate compliance risk. Our Compliance Core™ is an ecosystem of solutions designed to automate all aspects of compliance management, from interpretation of regulatory issuances through to intuitive task delegation, vendor management and board reporting. Continuity serves hundreds of institutions across 40 states. For more information about Continuity, visit www.continuity.net.