Driving efficiencies through a holistic approach to new banking regulations

Approaches to reduce overruns and costs that help financial institutions progress toward their strategic objectives

Today's expected compliance costs for newly finalized and pending regulations could adversely impact up to 3% of return on equity, according to a March 2014 report from Morgan Stanley.[1] These costs might easily increase unless banking organizations transform their risk, control and compliance framework from a patchwork of tactical responses to a more strategic, enterprise-wide approach. Given the considerable overlap among regulatory agencies and requirements for the same information from different parts of a bank, there are many opportunities to improve consistency and efficiency of treasury processes and reporting

In September 2014, the Liquidity Coverage Ratio (LCR) was finalized, creating a standardized minimum liquidity requirement for large and internationally active banking organizations for the first time. The LCR is but one of myriad new regulations that banks must address. To drive compliance with all of these, organizations must devote considerable time and resources from a number of institutional disciplines. While it is important to have the right systems and processes in place for each new regulation, it is also important to take a step back and look at the regulatory environment as a whole — and then deploy organizational resources in a more holistic and efficient way. Banks will need to rethink the operating model.

One function that is critical to this transformation is corporate treasury. This article highlights the fundamental model for financial institutions to consider.

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[1] "Mis-allocated Resources: Why Banks Need to Optimise Now," Morgan Stanley, 20 March 2014.

Building a better working world

The challenges

By far the biggest challenge to developing a holistic regulatory framework is data acquisition, which can account for 50% to 60% of the work. This is primarily because of the disparate nature of an organization with different functions collecting and managing data in different ways, as well as various interpretations of what type of data is needed.

Another significant challenge is the nature of evolving regulations that mandate new and changed requirements as they shift from proposed rules to final rules. This is a major reason for scope creep for regulatory projects, typically delaying implementation and contributing to cost overruns. Evolving regulations often defer critical decisions until the final rule in an attempt to better address industry commentary and feedback, which leads to alignment with industry practices. Ironically, this often contributes to an industry-wide scramble to comply with the final requirements when wholesale changes are made. A recent example of this challenge is the delays in issuance of the US LCR rule, which extended compliance deadlines for banks with less than $250 billion in assets. This led to many organizations having to quickly restructure delivery plans.

Typically, banks initially try to comply with new regulations through a tactical or interim solution that requires a large number of people and is heavily manual. This introduces human error and a lack of confidence in the results. Institutions do not have time to jump straight to a strategic solution, which creates an environment that leads to minimal controls. Again, this breeds a lack of confidence in the results.

Large and midsize financial institutions that have grown through acquisition typically use many technology applications that process similar financial products. Organizations are assessing the technology landscape in an effort to enhance data quality by reducing the number of redundant source systems. This will reduce the complexity of data sourcing projects and operationally identifying and remediating potential issues with data reducing cost in the long term. Rationalizing the data landscape coupled with robust business and data quality rules will give senior management and regulators comfort that the data is of the highest quality and reconciles with books and records. Finally, reporting has become more detailed and more frequent — sometimes daily. Data must be collected from across the enterprise, aggregated and vetted to be sure it is consistent with the organization's general ledger. Without a strong data management system in place, reporting will be time-consuming and possibly imprecise.

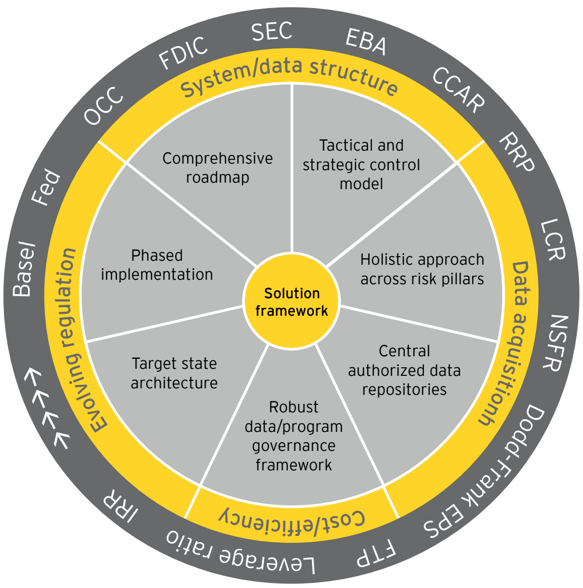
What banks can do

Banking organizations can take a number of steps to move from a patchwork approach that often results in inefficiencies and "throwaway" work to a more holistic and efficient institutional compliance strategy. These include:

- **Develop a comprehensive road map** so that when tactical solutions are required, you don't lose sight of your strategic target state objectives. This will minimize throwaway work and realize a more efficient and cost-effective framework.
- **Phase your implementation** to demonstrate measured progress to senior management and external regulators. This will highlight potential data and functionality issues early in the project life cycle and avoid project overruns.
- **Use a control model to impose checks and balances on tactical solutions.** Institutions must leverage their efforts from tactical solutions to enable a more robust strategic solution. Utilizing requirements and legwork from completed tactical solutions should reduce the overall costs and rework needed for strategic solutions if there is a clear target state vision.
- **Establish a holistic approach to address regulatory requirements across risk pillars.** This can be enabled by creating a unified team to solve for data and functionality rather than using multiple teams working toward the same deliverables, which increases project duration and overall cost. A holistic approach also allows the COO, CDO and CIO to leverage operational processes, controls and data from region to region.

- **Build toward central, authorized data repositories,** even if in the short term they need to be fed by controlled, manual processes so that data consumption is uniform across the organization.
- **Establish a robust data governance framework** aligned with Basel's principles for effective risk data aggregation and risk reporting.
- **Create a strategic control model** so that data, calculations, reporting and overall processes and procedures stand up to internal audit/compliance standards and regulatory scrutiny.
- **Design a target state architecture** with function-specific engines fed by strategic data repositories that the enterprise can drive toward in an efficient and unified manner. Without a target state architecture, significant rework will be required with each major program.
- **Streamline systems based on materiality and impact** in an effort to migrate systems with small balances and minimal transactions to target state strategic systems. This will reduce cost and decrease data quality issues and overall complexity for regulatory and management reporting and metrics. In addition, rationalize the technology landscape by eliminating different applications for similar products and financial instruments, to reduce the total operating cost.
- **Establish program governance** to empower the CFO and CRO to drive cost efficiency and engagement with stakeholders.

By adopting this approach, banks will be better prepared to navigate the continually changing regulatory landscape, meet frequent reporting requirements and provide data that is often quite granular in nature.



Conclusion

The continually changing regulatory environment, including many of the new regulatory mandates, presents unique challenges for banking organizations. Regulators are asking for an unprecedented amount of granular data with increasing accuracy, and on a more time-sensitive basis . But it is possible to comply with new regulations fully and efficiently by building a strategic framework to support tactical, interim and strategic reporting requirements. Banks that define a strategic architecture before building and leverage tactical and interim solutions aligned across the organization will find opportunities to reduce costs, increase efficiency, demonstrate measured progress and ultimately deliver a strategic, robust risk management framework.

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