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The Dodd-Frank Act:

Can Banks Survive the Cost and Complexity of Compliance?

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The passage of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank) and the ongoing promulgation of related regulations have created high anxiety in the banking industry. Some suggest that the increased burden associated with the new regulations could push banks to sell themselves to other financial institutions. While for some banks this may be true, this article lays out how banks can achieve prudent implementation without causing the complexity and costs of compliance to become an impediment to remaining independent.

For almost as long as banks have been in existence, they have been managing the changes prompted by evolving regulations. The critical issue is how the potential impact on the institution is evaluated and how the changes are managed. Savvy financial institutions recognize that the key is aligning the necessary adjustments with their business models and processes. By integrating Dodd-Frank compliance within business-as-usual processes, banks can cope with the new demands and often even extract greater value from their business processes.

A Climate of Uncertainty

Compliance officers across the country are struggling in the wake of the continuing regulatory edits being made under the auspices of Dodd-Frank. The torrent of questions about, for example, the *Real Estate Settlement Procedures Act* (RESPA) guidelines on disclosures in good-faith estimates and the HUD-1 settlement statement illustrate well the uncertainty in the industry. Even HUD's online FAQs for the new RESPA rule[1] that came out of Dodd-Frank are in flux, meaning question-and-answers that were available several months ago, and relied upon by institutions in understanding RESPA rules, might no longer be there today.

Banks also don't know what to expect in future regulatory examinations. Where will examiners put their focus? It could be on asset quality, fair lending, the *Bank Secrecy Act* (BSA), or elsewhere. And how will thrifts – previously regulated by the Office of Thrift Supervision (OTS) and now regulated by the Office of the Comptroller of the Currency – feel the impact of this change in oversight agency? A thrift that has been subject to OTS supervision might find that the exam's areas of emphasis have shifted away from those it was accustomed to. For now, the focus of the exam questions remains a moving target for many.

Questions also linger about the purview of the Consumer Financial Protection Bureau (CFPB). With the creation of the CFPB, banks must deal with another regulatory agency that will have examiners in the field conducting exams and assuming responsibility for certain compliance regulations. All banks will be directly or indirectly affected by CFPB rulemaking and enforcement. The CFPB is in the process of bringing its new employees up to speed on the agency's mission, and yet it has not provided banks with any clear direction about matters such as when the examination process will begin and how the new agency will function (particularly how it will interact with other authorities like state attorneys general).

Still in the early stages of Dodd-Frank implementation and interpretation, financial institutions will be forced to contend with an uncertain environment for quite some time. Banks can, however, take some measures that will allow them to successfully manage their way through this changing environment.

Model for Success

The conditions described above are simply the reality that banks face. As a result, a bank has two options: It can pack up and go home, or it can make the reality work for it.

If history is any indication, most banks can indeed successfully swing the second option. After all, banks have effectively implemented new compliance regulations, including the cascade of rules and regulations generated by the *Sarbanes-Oxley Act*, the enhanced BSA, and the *USA PATRIOT Act*, for years. There's little reason to think that well-run banks will not be able to adapt to future regulatory requirements. Successful adaptation comes down to taking a reasonable and systematic approach to integrating the requirements with normal processes, often using enhanced technology.

It's important to recognize, however, that a bank should not saddle the compliance officer alone with responsibility for adapting to the new reality. A silo approach to compliance is unlikely to succeed; success requires that critical management throughout the organization be on board. For example, line-of-business managers will need to help determine how to make Dodd-Frank compliance part of what they do, and information and technology managers will need to be aligned to implement new or adjust existing technology platforms to integrate new processes that facilitate compliance.

A similar approach was necessary to make the most out of the Know Your Customer (KYC) and customer identification programs required by BSA regulations, which required banks to familiarize themselves with their customers' normal activity and identify suspicious activity. Some banks settled for a "bolt on" approach, creating checklists to gather the required information and then feeding that information into another system to create a profile.

The more effective approach, however, used redesign of process and technology platforms to gather information while simultaneously enhancing the customer experience by sending a message that the bank's inquiries are intended to understand each customer better in aligning them with a suitable bank product. The result of this approach was an improved client experience, quicker account openings, and increased cross-selling, along with a solid platform for efficiently and effectively complying with the regulatory requirements.

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The opportunities don't end with the account opening process. Once a bank obtains KYC – or, now, Dodd-Frank-related – data, the information can be used not only to comply but also to mine the data for marketing and other valuable types of information such as cross-selling. The essential step taken by the banks that most successfully adapted to KYC was ingraining the requisite activities in their existing processes rather than considering them additional and separate compliance activities.

Planning for the Impact of Dodd-Frank

Organizations should develop cross-functional teams to keep abreast of changes likely to be required by Dodd-Frank and begin to develop strategies for implementing new processes and technology that can facilitate compliance in an efficient and effective manner. The goal of these teams should be to include a client-focused experience, product development, and sustainable process improvement while complying with new regulatory requirements. An approach that focuses on developing an efficient, effective, and sustainable process for complying with new regulatory guidance and involves thought leaders from across the organization is more likely to be successful than an approach that is focused solely on implementing a new regulatory requirement on an individual basis.

Under Dodd-Frank, for example, mortgage originators will be required to act in the best interest of their customers and seek to ensure the customer has the capacity to repay the loan. Banks should consider developing cross-functional teams consisting of management representatives from the mortgage origination, regulatory compliance, IT, and marketing functions. These teams would monitor specific regulations that are promulgated, develop a strategy for creating products and processes for originating loans that educate customers on the organization's products, analyze the customer's fit with the product, and analyze the customer's capacity to repay.

Crisis or Opportunity?

Keep in mind that every financial institution will be affected by the new regulations. Only the banks that take an integrative approach to compliance, however, will be able to make a smooth transition to compliance while gaining a competitive advantage. With some forethought, banks can achieve compliance and advance their business at the same time.

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[1] http://www.hud.gov/offices/hsg/ramh/res/resparulefaqs.pdf