

**Deloitte.**



**Navigating the year ahead**  
2018 banking regulatory outlook

United States  
December 2017

CENTER *for*  
**REGULATORY  
STRATEGY**  
**AMERICAS**

This publication is part of the Deloitte Center for Regulatory Strategy, Americas cross-industry series on the year's top regulatory trends. This annual series provides a forward look at some of the regulatory issues we anticipate will have a significant impact on the market and our clients' businesses in 2018. The issues outlined in each of the reports provide a starting point for an important dialogue about future regulatory challenges and opportunities to help executives stay ahead of evolving requirements and trends. For 2018, we provide our regulatory perspectives on the following industries and sectors: banking, securities, insurance, investment management, energy and resources, life sciences, and health care. For a view of the other trends impacting banking in 2018, we encourage you to read the Deloitte Center for Financial Services companion paper.

We hope you find this document to be helpful as you plan for 2018 and the regulatory changes it may bring. Please feel free to contact us with questions and feedback at **[CenterRegulatoryStrategyAmericas@deloitte.com](mailto:CenterRegulatoryStrategyAmericas@deloitte.com)**.

# Contents

Global foreword	2
Introduction	6
A pivot from building to sustaining	8
Regulatory divergence	10
Governance	12
Resolution planning: Where do we go from here?	14
Data quality and integrity in regulatory reporting	16
Financial crimes risk	18
Consumer protection	20
Navigating “Year Two”: Regulatory landscape and challenges for foreign banks and their IHCs	21
Other important regulatory considerations	23
Taking decisive action in uncertain times	27

# Global foreword

## **Another year has passed, so what has changed?**

This time last year, we expected 2017 to be a period of uncertainty for financial services regulation. Financial services firms were challenged by the continuing lack of clarity over the final shape of post-crisis reforms, the implications of Brexit, and a new US political administration. We also saw significant pressures on the banking and life insurance sectors from sluggish economic growth and low interest rates in Europe and the US, as well as from competition from new entrants (particularly fintechs).

Looking ahead to 2018, most of these challenges and uncertainties remain.

## **Economic growth, but how robust?**

Global growth prospects improved through 2017 and continue to be broadly positive, albeit more subdued than in the period before the financial crisis. China, Europe, and Japan have all been outperforming expectations, and although India's economy has slowed lately, the long-term outlook is upbeat. There are now signs that the extraordinary monetary easing of the last ten years is starting, slowly, to unwind in Europe and the US, although this stands in contrast to the situation in China and Japan.

There are reasons for caution. Asset markets and prices have seemed impervious to the prospect of tighter monetary conditions and geopolitical tensions. This has left many commentators worrying that markets are in the grips of a bout of irrational exuberance. There are also signs of price bubbles in commercial and residential property markets, as well as leveraged finance markets, and of elevated levels of consumer indebtedness, particularly in the advanced economies.

Supervisors across the globe are very alert to the financial stability risks posed by the political and economic climate, and we expect them to focus on the ability of financial institutions in all sectors to deal with the downside risks of an abrupt shift in market sentiment and any increase in asset price volatility, irrespective of the trigger. Boards are expected to keep their risk appetites under review, and will also need to engage closely with stress testing, whether prompted by supervisors or carried out internally.

## **What does this mean for the regulatory agenda?**

Last year we predicted that there would be no wholesale rolling back of the post-crisis regulatory framework, and this continues to be our view. The consensus in the US is that there will be some meaningful adjustments to the Dodd-Frank Act, but no large-scale repeal or rewrite. In the EU there remains a considerable volume of legislative work ongoing; and even where there is no new legislation, there is a great deal of "fine tuning" of existing rules. The Asia Pacific region faces a long tail of implementation work, and must also deal with the impact of regulation from outside the region.

At the international level, the Financial Stability Board (FSB) has shifted its primary focus toward a post-implementation evaluation framework, which will be "progressively applied" in the coming years. This is part of a

rebalancing away from introducing new rules and toward assessing the effectiveness of what has been done over the past decade. Boards will need to be ready to demonstrate to supervisors that they have embedded change and that this is leading to the desired outcomes.

One major area where a number of significant unanswered questions remain is bank capital requirements. Although the Committee on Banking Supervision (BCBS) has until now been unable to complete the Basel III package, final agreement on the open issues seems within reach. We do not see any major economies as being in a hurry to introduce yet-more legislation, and we also see those economies being more willing to depart from the letter of global standards where they conclude it is in their interest to do so.

As a consequence, financial services firms need to be prepared to deal with the challenges of diverging regulatory frameworks. At a minimum they will need globally coordinated approaches to understand overlaps, incompatibilities, and potential synergies.

### **Supervisors are turning more attention to long-term structural issues**

Technological innovation, aging populations, and climate change have all caught the attention of the regulatory and supervisory community as emerging risk areas. We expect some supervisors to begin to challenge boards, risk committees, and senior management to demonstrate that they understand the impact on their customer bases, business models, and risk profiles—and that they are set to take effective mitigating actions where needed.

- **Fintech:** While new technologies present opportunities, regulators want to understand the potential risks and the likely impact on incumbents' business models. The FSB has a clear interest in the subject. The European Commission is expected to deliver a fintech "action plan" in January. Similarly, US regulators are considering the implications of new technologies, including third-party relationships among fintechs and banks. They're even exploring special purpose bank charters for fintechs.
- **Climate change:** The FSB has taken the lead internationally with its Task Force on Climate-Related Financial Disclosures, which made its final recommendations in June 2017. A number of regulators in the Asia Pacific region are instituting policies to encourage green finance. The Bank of England (BoE) is also researching climate change, and the EU recently proposed to integrate environmental risks into the mandates of the European Space Agency (ESA) as part of its action plan on sustainable and green finance.
- **Aging populations:** Aging populations worldwide will create a widening pool of potentially vulnerable customers and influence demand for different types of financial services. They will also affect how financial institutions engage with their customers. At the international level, the International Organization of Securities Commissions (IOSCO) is taking forward work on aging populations.



## Leadership changes

Finally, we note that by the end of 2018, the most senior leadership of many of the world's leading regulatory bodies will be starkly different from what it has been for the majority of the post-crisis regulatory reform era. Mark Carney's term as chairman of the FSB has been extended through to December 2018, lending some additional continuity to reform efforts. But this will be his final year at the top of the FSB. We expect Stefan Ingves to stand down as chair of the BCBS in the near future. There's also a great deal of change in senior leadership across national and regional regulatory bodies, particularly in the US. It remains to be seen how far new leaders will uphold the key tenets of the international supervisory agenda of the last decade, particularly its emphasis on cross-border coordination, or whether supervisory priorities will tilt more toward promoting the competitiveness of individual jurisdictions.

On balance we think that these new leaders will emphasize practical supervisory initiatives over (new) rule making, as well as the need for firms to demonstrate that they're financially and operationally resilient to a range of threats, both old and new. New leaders will be keen to consolidate the outcomes and achievements of the prudential policy agenda that has dominated the last 10 years and focus their tenures on continuing structural challenges as well as emerging risks and issues.

## Acting in the face of uncertainty

While we expect some greater clarity about the regulatory outlook to emerge in 2018, the overriding challenge for firms remains coping with uncertainty, including from the global impacts of Brexit and how markets in Europe and elsewhere will be reshaped by Markets in Financial Instruments Directive (MiFID) II. This will put a premium on firms maintaining strategic flexibility, while they also adopt new technologies to react to the threat from "challengers," improve their customer service and outcomes, better manage their risks, and help control costs. With yields, income levels, and return on capital still under severe pressure, cost control will continue to be extremely important. Even though interest rate rises are underway, they will be neither quick enough nor big enough to alleviate pressure on incumbents' business models.

### David Strachan

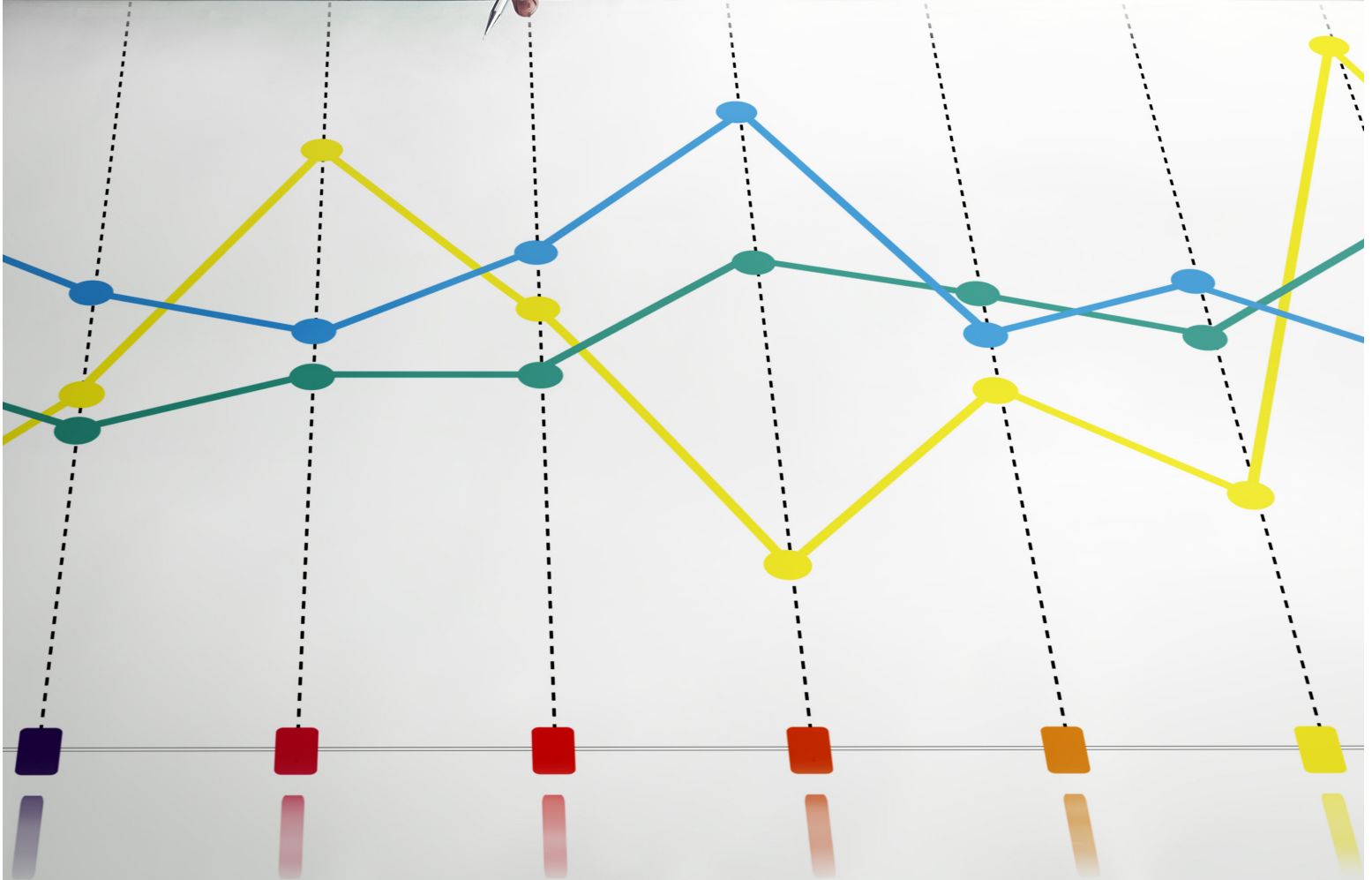
Centre for Regulatory Strategy,  
EMEA  
Deloitte UK

### Kevin Nixon

Centre for Regulatory Strategy,  
APAC  
Deloitte Australia

### Chris Spoth

Center for Regulatory Strategy,  
Americas  
Deloitte US



# Introduction

Most banks are forging ahead with their risk and compliance initiatives, even as regulatory uncertainty will likely remain a significant and ongoing challenge. Even if lawmakers and regulators make certain definitive changes, banking organizations should continue to drive effectiveness and efficiency of their risk and compliance programs so they meet applicable laws, regulations, and supervisory expectations. And in most cases, they don't have the time or luxury of waiting to see how things will shake out. Fortunately, many of the changes banking organizations are making to achieve compliance are useful improvements that are worth doing from a risk and business perspective.

Here's a look at the key regulatory trends banks will likely need to monitor and address in 2018. By embracing regulatory complexity, organizations can accelerate performance and stay ahead of changes so they can better navigate the regulatory landscape.

To stay on top of the latest regulatory news, trends, and insights, we invite you to visit our website at [www.deloitte.com/us/about-dcrsamericas](http://www.deloitte.com/us/about-dcrsamericas).



# “Core Principles” Report: Treasury Department’s recommendations

On June 12, 2017, the Treasury Department released the first of four reports pursuant to President Trump’s executive order setting forth the Administration’s “Core Principles for regulating the US financial system. The report covers regulations governing insured depository institutions and holding companies, and offers recommendations for Congress and the regulatory agencies (approximately two-thirds of which could be enacted by the agencies without Congressional action).

Although the report provides President Trump’s nominees a roadmap for enacting the Administration’s policy priorities, it remains unclear which of the recommendations will be implemented, or how quickly. However, the recommendations may inform the regulatory and supervisory agendas of the FRB, FDIC, and OCC, and may also have significant implications for the FSOC’s work going forward. Notably, several of the recommendations for Congress were included in a bipartisan legislative proposal recently introduced by Senate Banking Committee Chairman Mike Crapo (R-ID).

Below are several of the report’s most significant recommendations:

## Recommendations for Congress

- Raise the enhanced prudential standards (EPS) threshold from \$50 billion in assets (no recommended asset threshold provided)
- Raise the threshold for submitting resolution plans from \$50 billion to match the revised EPS threshold
- Raise the Dodd-Frank Act stress test (DFAST) threshold from \$10 billion to \$50 billion

- Apply EPS to foreign banking organizations (FBOs) based on US risk profile and assets (using revised EPS threshold)
- Consider establishing an “off-ramp” from capital and liquidity requirements for well-capitalized banks
- Eliminate the mid-year DFAST cycle and the adverse scenario (i.e., only retain the baseline and severely adverse scenarios)
- Reform the structure of the CFPB
- Create a Volcker Rule “off-ramp” for highly capitalized banks
- Exempt banks with less than \$10 billion in assets from the Volcker Rule
- Broaden FSOC’s statutory mandate to mitigate regulatory overlap
- Assess how the Community Reinvestment Act (CRA) could be improved

## Recommendations for federal regulatory agencies and states

- Raise the Comprehensive Capital Analysis and Review (CCAR) threshold from \$50 billion to match the revised EPS threshold
- Consider changing CCAR to a two-year cycle and improve transparency (including by subjecting models to public comment)
- Eliminate qualitative component of CCAR for all firms
- Change the resolution planning process to a two-year cycle and subject guidance to public comment
- Amend the supplementary leverage ratio (SLR) to allow the following items to be deducted from the denominator: (1) cash on deposit with central banks, (2) US Treasury securities, and (3) initial margin for centrally cleared derivatives

- Revisit US “gold-plating” of the global systemically important bank (G-SIB) surcharge, total loss-absorbing capacity (TLAC) requirements, and the enhanced SLR
- Narrow the scope of full Liquidity Coverage Ratio (LCR) to US G-SIBs (subject internationally active banks to modified LCR)
- Raise Single Counterparty Credit Limits (SCCL) threshold to match the revised EPS threshold
- Delay adoption of the Net Stable Funding Ratio (NSFR) and Fundamental Review of the Trading Book (FRTB)
- Recalibrate internal TLAC requirements for FBOs
- Seek public comment on 2013 leveraged lending guidance and reissue with clearer definitions
- Reassess the volume and nature of matters requiring attention (MRAs) and consent orders
- Perform cost-benefit analysis on significant regulations





# A pivot from building to sustaining



The banking sector as a whole has largely transformed itself over years of post-crisis repair, design, and implementation. While there are still some reform initiatives to be proposed by regulators and completed by industry, the vast majority of the post-crisis reform blueprint has now been built, including the most impactful components. There is, however, a realization that the largest banks are at varying stages of maturity in their journey to transformation under the enhanced standards and broader governance, risk, and compliance expectations. Most have nearly completed the build phase and have entered, or will soon enter, the critical phase of rationalizing and sustaining what they have built.

The build phase had a vast scope that covered everything from enhancing resiliency through capital adequacy and liquidity risk management to resolvability, governance, and risk management. Also, the build phase was cross-business, cross-functional, and undertaken rapidly, usually involving disparate parts of the bank, including risk, compliance, finance, treasury, and key business lines. The imperative was to get the build done quickly, yet specific features, minimum standards, and key concepts were sometimes only broadly laid out by regulators. Over time, it became apparent that the optimal target destination could only be achieved through an iterative trial-and-error process as both regulators and the industry learned by doing. In that light, it's not surprising that the build phase often involved first stage solutions rather than more strategic solutions with typical transformation projects.

Now, looking back at what they have built, banks are realizing there are many opportunities to rationalize, streamline, and increase efficiency through people, process, or technology. The expected benefits of these efforts are lower costs, increased efficiency, enhanced quality, sustainability, and perhaps better morale by shifting processes away from repetitive tasks to higher-value activities.

A key outcome of these efforts is to efficiently integrate what was once regulatory "project" work into business-as-usual, day-to-day activities. Designing these new activities into normal business workflow has the benefit of integrating regulatory considerations into strategic and daily business planning and decision making, providing better visibility into constraints and opportunities in the marketplace. Moving from "fire drill" mode on regulatory initiatives to fuller integration should help to align financial, capital, IT, and human resources in ways that can ensure sustainability over the longer term.

In our experience, there are five key levers that can help a firm effectively *pivot* from build to *sustain*:

- 1. Simplify.** Eliminate or reduce low-value, redundant activities to streamline key processes. Rationalize between first- and second-line responsibilities and activities, and between second-line control functions. Streamline reporting, governance, and management routines to increase efficiency and cut out non-critical activities. Prioritize or risk-rank execution activities to shift employee focus to high-value activities.

## Getting sufficient organizational traction to use these levers in modernization efforts can be a daunting task.

**2. Centralize.** Reallocate activities and relocate people and responsibilities. Establish Centers of Excellence (CoEs) or capability center(s) in key areas to enable a flexible resource model and increase operational effectiveness. Implement a centralized technology strategy and architecture to enable consolidation and coordination of compliance risk activities (e.g., case management).

**3. Standardize.** Implement standard frameworks and processes. Rationalize frameworks, policies and procedures, methodologies, and approaches. Optimize and standardize activity execution and oversight (e.g., risk assessment, taxonomies). Standardize supporting tools and technology and deployment.

**4. Automate.** Harness the power of enabling and innovative technologies to automate repetitive, manually intensive tasks. Use robotic process automation (RPA) to increase efficiency and effectiveness and decrease costs over time. Employ cognitive intelligence technologies—including natural language generation, natural language processing, and artificial intelligence—to take automation to the next level.

**5. Enhance.** Develop continuous improvement capabilities to increase value and decrease costs. Leverage data analytics to enable real-time metrics and reporting that help proactively quantify risk. Consider alternative delivery models and “workforce of the future” initiatives (e.g., managed services, enhanced offshore/nearshore capabilities). Optimize visualization tools, processes, and case management.

Getting sufficient organizational traction to use these levers in modernization efforts can be a daunting task. To make the pivot easier, it helps to break larger efforts into smaller, bite-size components. But whether the project scope is broad or narrow, the critical steps to a successful journey are essentially the same:

- Gain a full understanding of the current-state process, including its origins, strengths, and weaknesses
- Challenge how the process is done, including responsibilities and governance
- Imagine a future state involving fewer steps, greater automation and quality, and fuller integration into day-to-day activities

- Experiment with pilot programs to prove that modernization concepts deliver real-world benefits and then rapidly scale up on programs that succeed

It’s becoming clearer that living with current-state capabilities and processes built in the regulatory transformation isn’t a viable long-term option for banks that wish to lower costs, improve efficiency, enhance quality, and gain sustainability. Rather, banks that pivot well from the build to sustain mode can realize those goals and also be positioned to have the flexibility to take advantage of market opportunities.



# Regulatory divergence

One headwind for the pivot from build to sustain is regulatory divergence—both in substance and timing—across the global landscape. For banks with a global presence, this divergence creates uncertainty, complexity, and an uneven playing field. To effectively navigate the many associated challenges, banks need a disciplined approach that recognizes regional tailoring of regulatory and compliance initiatives as a fact of life.

The growing divergence in regulatory standards is a reversal of previous post-crisis trends. Since 2009, banking regulators around the world have generally been committed to strengthening the capital, liquidity, and leverage standards for banks. Those efforts led to an equally strong commitment to address the unevenness and complexity of the global capital framework for internationally active banks, with regulatory convergence initiatives such as Basel III and the FSB's focus on resolution regimes setting the tone for an increasingly consistent banking rulebook in most jurisdictions.

Recently, however, governments have begun asking whether banking reforms are unduly impeding economic growth. In particular, several countries are questioning the need to adopt common global regulatory standards for the banking sector. Furthermore, the European Union has recently shown an increased willingness to deviate from the rules set out by the BCBS. At the same time, host countries have been trending toward stricter regulatory measures for foreign banks. Examples include the US requirement





for foreign banking organizations (FBOs) to establish intermediate holding companies (IHCs) and the recent proposal by the EU for separate holding companies (i.e., independent parent undertakings (IPUs)).

Overall, the global regulatory landscape for banking looks set to become increasingly divergent and fragmented—a trend that, if left unchecked, could have significant implications for banks with substantial operations in multiple jurisdictions. The potential impact is particularly great for current efforts to create a regulatory, risk, and compliance infrastructure that's more streamlined and sustainable. As decision makers grapple with having “too many regulators to manage,” they should adopt new approaches and invest in tools and strategies that can help them efficiently navigate the new complexity. Otherwise, they could face strategic paralysis as the cumulative impact of regulatory complexity—and the resulting binding constraints on how a bank operates—become harder to understand.

As decision makers grapple with having “too many regulators to manage,” they must adopt new approaches and invest in tools and strategies that can help them efficiently navigate the new complexity.

The challenges associated with regulatory divergence give rise to three types of questions that management and boards of internationally active banks should consider:

- 1. Strategic.** Does divergence impact the sustainability of cross-border business models and the ability of managers to plan and make well-informed regulatory and commercial decisions?
- 2. Operational.** Will divergence increase the complexity of regulatory processes, and are bank governance structures, controls, and regulatory capabilities up to the task of coping with this fragmentation?
- 3. Technological.** Will divergence increase the pressure on banks' data management systems to a point that strategic IT capability investments will be required?

To prosper in a divergent regulatory environment, global banks that answer “yes” to these questions may need to invest in a number of core capability enhancements, including:

- An agile **central strategy group** to provide leadership when evaluating the impact of shifting and diverging regulations on business strategy and profitability—identifying opportunities from both relaxing and tightening standards and helping shape budget decisions for reallocating scarce resources to the areas of highest need
- **Tailored regional compliance, risk, and governance capabilities** to address rising complexity and unevenness in standards and expectations by region
- **CoEs** that provide resources, coordination, and global consistency, while at the same time allowing regions to tailor solutions for unique local needs
- **Advanced analytic capabilities** to detect and prevent regulatory noncompliance before significant issues emerge
- **Simplification and rationalization** of risk and compliance systems, using increased automation and controls to enable a more sustainable approach to running the bank
- **Investments in technology and data** to support all the above activities

Proactively addressing the emerging trend of regulatory divergence could provide a competitive advantage by enabling a firm to more nimbly respond to regulatory constraints and the associated market opportunities.

# Governance

Effective governance remains a top focus for regulators, with a strong emphasis now being placed on sustainability, accountability, holistic end-to-end views, and conduct. Consistent with the pivot from building to sustaining, regulators have been assessing their rules, guidance, and supervisory approaches with an eye toward improving the effectiveness of outcomes. As a part of this trend, the Federal Reserve Board (FRB) is signaling a new age of governance and accountability<sup>1</sup> through recent proposals on board effectiveness, as well as a new rating system for large financial institutions (LFIs) that specifically rates governance and controls.

At the Office of the Comptroller of the Currency (OCC), governance and operational risk are primary focus areas in the 2018 Large Bank Supervision Operating Plan.<sup>2</sup>

Although adhering to existing governance requirements (such as the FRB's enhanced prudential standards (EPS) and the OCC's heightened standards) remains as important as ever, here are some other specific areas that will likely be a focus going forward.

## Rebalancing of board expectations

The FRB's proposed supervisory expectations for boards of directors would outline attributes of an effective holding company board, rescind or revise existing FRB expectations for boards, and change the Fed's policy on supervisory communications by directing more supervisory letters to management. This significant rebalancing of board expectations is a result of the FRB's post-

crisis reviews of board effectiveness at the largest banking organizations, as well as its improved understanding of the unintended consequences of past guidance and rules. The FRB's key findings include recognition that many board requirements in existing guidance and rules have contributed to blurring the lines between boards and senior management, leading to diluted accountability. The proposed guidance would apply to all holding companies and nonbank companies designated as systemically important, but it wouldn't apply to FBOs or their IHCs, at least for now.

As it pertains to the largest holding companies (i.e., those with \$50 billion or more in total assets), the proposed guidance describes five key responsibilities for effective boards:

1. Set clear, aligned, and consistent direction regarding the firm's strategy and risk tolerance
2. Actively manage information flow and board discussions
3. Hold senior management accountable
4. Support the independence and stature of independent risk management and internal audit
5. Maintain a capable board composition and governance structure

The FRB indicated that it will evaluate banks against these five attributes through its supervisory process, but it suggested that larger banks also perform self-assessments for their own improvement and share results with the FRB. The focus on these five attributes represents a noteworthy

Consistent with the pivot from building to sustaining, regulators have been assessing their rules, guidance, and supervisory approaches with an eye toward improving the effectiveness of outcomes.

<sup>1</sup> Recent Developments, Board of Governors of the Federal Reserve System, updated November 27, 2017, <https://www.federalreserve.gov/default.htm>.

<sup>2</sup> OCC Releases Bank Supervision Operating Plan for Fiscal Year 2018, News Release, September 28, 2017, Office of the Comptroller of the Currency, US Department of the Treasury, <https://www.occ.treas.gov/news-issuances/news-releases/2017/nr-occ-2017-113.html>.

shift away from a “process-oriented” view of the board’s responsibilities. The FRB also appears to have somewhat shifted its focus away from culture and toward increased management accountability.

One development of note is that the FRB also proposed a new rating system for these large companies with individual ratings for three components:

1. Capital planning and positions
2. Liquidity risk management and positions
3. Governance and controls

The ratings would be satisfactory, satisfactory watch, deficient-1, and deficient-2, and there would be no composite rating.

For companies with less than \$50 billion in assets, the FRB didn’t change its expectations for boards. Rather, it referred to existing guidance about approving business strategies and significant policies, understanding the company’s risks, having information about risks, providing guidance about acceptable risk exposures, and overseeing management.

### Independence of risk management and internal audit

Consistent with the OCC’s heightened standards, the proposed guidance solidifies the role of the chief risk officer (CRO) and chief audit executive (CAE). The FRB expects that the board reinforce, support, and enable the independence of the risk management and internal audit functions. This guidance reinforces the expectation that a board’s risk and audit committees should communicate directly with the CRO

and CAE, boards should provide these independent functions with unrestricted access to their committees, and boards should ensure that these functions have adequate budget and other resources.

### Accountability of senior management

Under the FRB’s proposed guidance, supervisory findings—which include Matters Requiring Immediate Attention (MRIAs) and Matters Requiring Attention (MRAs)—would generally be addressed by senior management. A particular MRA/MRIA would only be sent to the board if it involved corporate governance responsibilities, if there were issues with oversight and accountability of senior management, or if senior management failed to take appropriate remedial action. This approach further supports the regulatory emphasis on accountability and distinguishing between the board’s role and the role of senior management.

While the OCC hasn’t said much publicly on this issue, it has indicated agreement with the FRB’s approach. The OCC is also undertaking its own reviews of guidance and supervisory communications to better distinguish the role of the board from that of management.

### Rationalizing the flow of information

With these expected revisions to regulatory views on board governance, 2018 will likely be a good time to rationalize the flow of information between management and the board (and board committees). We have found that board members generally want management to provide more analysis

and deep-dive discussions of business lines and control functions. Often, board packages contain exceedingly large volumes of information but too little synthesis and quality analysis.

### Action items for 2018

Here are some steps that boards can consider to improve their effectiveness:

- Confirm that it’s setting a clear and consistent direction to management regarding the bank’s strategy and risk tolerance
- Review and revise materials to eliminate unnecessary information flows, with an increased focus on quality analysis and deep-dive discussions of topical areas
- Enforce accountability at the senior management level through such measures as balanced incentive plans, an emphasis on self-identification and issue resolution, and appropriate personnel actions when necessary
- Foster a culture of controls into key areas, such as governance, risk management, and compliance programs, with appropriate monitoring, reporting and escalation, and disciplinary actions
- Safeguard the independence and stature of the CRO and CAE and ensure that they have unfettered access to board members
- Conduct self-assessments in line with the proposed guidance with a scope that includes capabilities and governance structure



# Resolution planning: Where do we go from here?

Over the past several years, the FRB and Federal Deposit Insurance Corporation (FDIC) have shifted the focus of resolution planning, now emphasizing the capabilities that banks must demonstrate in order to have a credible plan. Feedback letters to institutions—as well as issued guidance and FAQs—have been the main drivers of recent resolution planning activity, and all emphasize plan execution rather than conceptual strategy. The global systemically important banks (G-SIBs) benefited from one-on-one meetings with the agencies prior to their recent July 1, 2017, submissions, where the discussions focused on specific capabilities and how the G-SIBs are addressing these capabilities.

The agencies are considering formally extending the cycle for resolution plan submissions to once every two years (as opposed to the current annual requirement). They already announced a one-year extension (until July 1, 2019) for the eight US G-SIBs to file their next plans, thus creating an opportunity to focus on assessing and evolving their capabilities to support resolution planning strategy and execution activities. The regulators also provided a one-year extension to covered FBOs, including the four FBOs in the Large Institution Supervision Coordinating Committee (LISCC) portfolio (until July 1, 2018), the 19 large non-LISCC FBOs (until December 31, 2018), and the 82 FBOs with limited US operations (until December 31, 2018). Currently, 16 US non-G-SIB banks are required to file their next plans by December 31, 2017.

At the same time, the agencies are continuing their horizontal reviews of 2017 resolution plans and having discussions with the banks about core capabilities.

While institutions wait for the next round of feedback and/or further guidance, what else should they be focusing on? A leading practice would be focusing on how to structure their ongoing recovery and resolution planning (RRP) activities, teams, and governance structure to embed the RRP process into their business-as-usual (BAU) activities. Although the focus publicly has been on resolution plans, the requirements surrounding recovery plans and other regulatory guidelines naturally lead to an internal shift toward a broader RRP structure and holistic view of these requirements and their implications.

An organization geared toward quickly responding to regulatory developments will likely be in a stronger position to address opportunities and mitigate risks that arise in the future. This perspective can also enable institutions to consider adjustments to spending costs and better adapt to emerging challenges. Institutions should take this opportunity to review their organizational RRP operating models, focusing on the ability to efficiently and accurately fulfill submission requirements and adapt to regulatory changes that could affect whether their operations can deal with different recovery and resolution scenarios. During this evaluation, institutions should consider several key questions, including:

- 1. Organizational structure.** What is the optimal structure for the resolution planning office from an activity perspective?
- 2. Alignment with the broader enterprise.** How are resolution planning activities aligned to individual functions within the organization?
- 3. Embedding resolution planning into everyday processes.** How are resolution planning initiatives managed, and to what degree are those initiatives integrated into BAU activities within operating functions?

## Organizational structure

Institutions have typically used either a centralized or federated governance model for RRP. These two primary approaches differ in terms of required full-time resources and ownership of developing and exercising RRP capabilities, and each has advantages and disadvantages. Institutions should evaluate their current structure of resolution planning ownership and then determine if there's an opportunity to improve by transitioning to a different model or adopting a hybrid approach. Regardless of which model is selected, it's essential to maintain strong resolution planning governance and oversight from a centralized body that can provide ongoing institutional planning, reporting, and resourcing assistance.



### Alignment with the broader enterprise

As institutions consider potential adjustments to their organizational models, they should understand how RRP-related activities align with the current resolution planning office and individual functions, and if potential realignment is necessary or beneficial. Institutions should also seek to increase the maturity of their RRP capabilities, moving up from mandatory tasks—such as updating playbooks and plans—to more systemic operational activities, such as event planning scenarios/simulations and ensuring all staff across functions are trained on RRP implications. Recovery plan guidance includes testing of the recovery plan, and we expect that the execution capability of the resolution plan will become a topic of discussion among the agencies.

### Embedding resolution planning into everyday processes

To fully embrace the spirit of the “living wills” regulation, institutions should consider how to integrate RRP requirements into everyday operational business processes and operations, including control and risk management. To do this, an institution should assess the impact of requirements across the enterprise, looking for key points that could affect its RRP capabilities. At a basic level, this might include ensuring that all staff with a central role in playbooks receive continual training about what’s expected of them in a resolution scenario. At a more mature level, this might include incorporating calculations for Resolution Capital Execution Need into the firm’s risk management decision making when an external event occurs.

To derive the most value from the RRP function, institutions should look beyond complying with prescriptive regulatory requirements and instead focus on how to use the function to tackle broader operational risks. For example, by establishing more mature capabilities, such as an impact management office, an institution may be better equipped to understand how internal and external events could affect RRP issues such as capital and liquidity requirements.

Uncertainty continues to surround potential changes to RRP regulations. But institutions can benefit from a brief pause to evaluate their ability to quickly and efficiently react to a changing legislative environment while continuing to support resolution planning activities in BAU. Banks that have already thought about an optimal resolution planning office model for this streamlined regulatory environment may be better positioned to shift to a more operationally efficient structure that fits their strategic goals while maintaining a focus on cost and risk.





# Data quality and integrity in regulatory reporting

Regulatory expectations continue to rise for improved governance, controls, and data infrastructure to ensure data quality. Significant improvement is expected to remediate issues discovered after several horizontal reviews at domestic banks and FBOs.

Key trends in this area include:

- General slowdown in introducing new reporting requirements
- Reduction in reporting burden as an objective of all agencies
- Increased expectations across all lines of defense, with a focus on data quality/integrity, related controls, and accountability

Domestic LISCC banks are expanding their capabilities around chief financial officer (CFO) attestation in advance of the first full-year compliance requirement. FBO IHCs that are part of the LISCC portfolio are gearing up for the first CFO attestation submissions in early 2018. Meanwhile, large US banks are pivoting toward transformation of their reporting processes across functional and business domains, with a focus on efficient and effective operating models. Also, many IHCs are building on their first year of filings and following up on feedback from initial horizontal examinations.

## Higher expectations for data quality

Although new requirements have slowed, regulator expectations for data quality and controls have been elevated. Given banks' past issues, the rollout of CFO attestation and materiality policies, and the amount of work yet to be accomplished, regulators are

expecting to monitor and challenge banks' reported progress. In addition, over the past several years, remediation efforts by banks around data issues and improvements in their governance and systems has created an expectation that material data issues will be self-identified, documented, and remediated through both tactical and strategic solutions.

As in other parts of the business, robotics and cognitive technologies in regulatory reporting can greatly streamline existing activities that are highly labor-intensive and time-consuming.

Regulators have stated their expectations for banking institutions to have a data environment that's integrated and supports external and management reporting across financial, legal entity, liquidity (Comprehensive Liquidity Analysis and Review (CLAR)), capital (Comprehensive Capital Analysis and Review (CCAR)), and resolution planning reporting. In addition, many banks are beginning to move from report-centric solutions to coverage across products and risk domains (e.g., commercial loans, counterparty, liquidity, and derivatives). Such an approach may provide a foundation for cross-report integrity and the capability to meet future data demands quickly with a high level of data quality.

These higher expectations call for an alignment of enterprise data governance and data quality initiatives with existing

reporting governance and controls frameworks, coupled with effective use of data stewardship programs to exchange data precisely and consistently between systems and to reuse data-related resources. The increased exchange of information creates a need for standardized data requirements and definitions for all critical reporting data elements,

further defining "sources of truth" across business systems. From these sources, the documentation of data lineage provides a specific audit trail over end-to-end reporting data flows, with data validation and quality checks at data handoffs. This improves alignment, minimizes inconsistencies in how data is used, and provides a greater understanding of the data assets.

Regulatory reporting, similar to financial and risk reporting, can't be optimized without effective programs to manage the underlying data. Many banks have begun to transform from a culture where data is independently managed and stored in each business line without regard to downstream uses. Change in culture is leading to an environment where data is viewed as enterprise assets that are being managed from a C-suite perspective. The first step in

the shift to this new culture is defining roles and responsibilities for data throughout the organization. As the chief data officer (CDO) role matures, the setting of policies and monitoring of compliance with these policies will be the center of the CDO role. This includes establishing data quality standards. The CDO position in each organization varies. But the need for independence and focus on standard data policies are critical.

Beyond the challenges of changing the culture of organization, the data architecture of large banks may require significant work to implement an integrated data infrastructure. Overcoming legacy systems (many cases were a result of past merger and acquisition activity) and implementing the necessary target architecture will take several years. Therefore, tactical approaches to manage data are necessary.

### Data controls

Institutions are now expected to implement an effective internal controls framework over reported data that may leverage the firm's COSO controls, with a well-documented understanding of the controls that directly affect end-to-end data flow, especially at the source (e.g., loan onboarding, transaction initiation) and at each point of hand-off and/or transformation. Internal controls over reported data are expected to be prioritized based on risk and materiality and supported by the enterprise-wide governance structure with appropriate accountability by senior management, the board, and lines of business. The integrity of the framework is expected to be validated through monitoring and testing activities (for both data and controls) performed by quality assurance and data integrity teams, as well as the internal audit function.

Meanwhile, the expectation of the internal audit function in regulatory reporting continues to elevate. The audit program is expected to include risk assessment of reporting processes based on both qualitative and quantitative inputs. In addition to the traditional approach of evaluating the regulatory reporting control environment through a review of policies, procedures, and submitted reports, internal audit is expected to incorporate end-to-end transaction data testing into its audit program. To effectively address the most critical areas, banks should conduct risk assessments. This work should leverage its partnership with the second line. To achieve tangible results, internal audit groups have begun investing in data analytics and automation capabilities, as well as a new talent pool of regulatory reporting subject matter experts (SMEs).

### Training program

An effective data governance framework is expected to include a robust and formalized training program that provides coverage across lines of business and corporate functions and report-specific roles, such as report preparer, data provider, and data owner. The training is expected to focus on key products, systems, data lineage, and reporting logic. The program is expected to address changes to key data elements, accounts, interpretations, and reporting requirements and to play a role in the firm's attestation/certification process. In addition, offshore and nearshore resources have broadly been used in baseline report preparation and monitoring activities, where success primarily depends on consistency in approach and well-documented policies and procedures. With inherent concern about head-office accountability and

information security issues, the regulators' stance is that the books and records should be readily available. Increased offshoring/nearshoring by banks can increase the risk of inaccurate regulatory reporting unless an effective staffing and training program can be developed.

### Automation and efficient use of data

Moving forward, banks should continue their efforts to streamline and automate reporting processes and to rationalize operating models across reporting functions and data providers. This includes evaluation of strategic uses for data across various reporting disciplines and linking data architecture to enable delivery of on-demand, streamlined, granular reporting.

As in other parts of the business, robotics and cognitive technologies in regulatory reporting can greatly streamline existing activities that are highly labor-intensive and time-consuming. This can boost efficiency and productivity, enabling a shift of resources to forward-looking strategic initiatives that better prepare the institution for internal and external operations and data quality reviews. Similarly, operational efficiency gains from having tactical solutions covered in the near term enable an institution to use the data infrastructure and underlying data for internal and external reporting.



# Financial crimes risk

Financial crimes risk management continues to support national security objectives and focus on preserving the integrity of the financial system, domestically and across the globe. Over the past few years, the number of civil and criminal enforcement actions related to anti money laundering (AML) has increased around the world. Rising compliance expectations have been driven by various factors, including acts of terrorism, the follow-on impacts of effectiveness tests conducted by the Financial Action Task Force (FATF), and additional regulatory requirements. Pressures on certain jurisdictions to augment activities within their AML regimes have increased due to deficiencies identified through the FATF mutual evaluation process.

AML enforcement in the US is unlikely to recede. Office of Foreign Assets Control (OFAC) sanctions have expanded and increased during 2017, far exceeding the 2016 total. In August 2017, the President signed into law the Countering America's Adversaries Through Sanctions Act (CAATSA), which significantly expands US sanctions against Russia while enacting new sanctions on Iran and North Korea. The Russia measures tighten existing sanctions and impose new sanctions, including "secondary sanctions" that could significantly affect US and non-US companies. Sanctions compliance is no longer solely the name filtering process of years ago. It now requires greater leverage of customer due diligence information, in-country or regional expertise of first line management, internal collaboration to achieve optimal holistic client and sanctions risk management, and—at times—enhanced agreements with clients. In one recent

enforcement case, OFAC, after evaluating the financial institution's sanctions controls and its specific agreement with a client, directly fined the client, not the financial institution, for initiating the violations in question. In 2018, OFAC sanctions will likely continue to be a vital part of US national security and foreign policy objectives—and their use, pace, and compliance complexity are unlikely to diminish.

In 2018, two new substantive regulatory requirements will take effect: the Financial Crimes Enforcement Network's (FinCEN) Customer Due Diligence/ Beneficial Ownership Rule (implemented by May 2018), and the New York State Department of Financial Services (DFS) Rule 504 requirements and certification. Supplemental guidance on operationalizing these requirements has been slowly emerging. However, implementing these new requirements will likely include adjustments and enhancements across all three lines of defense.

Other continuing challenges are due to the complexity of addressing front-line employee training, beneficial ownership collection methodologies, IT system integration, data maintenance and distribution, customer updating, and records retention of legal entity beneficial ownership information—all of which stress both operations and risk management systems. Institutions chartered in New York State have been actively assessing the quality and effectiveness of their transaction monitoring and (sanctions) filtering systems in light of the detailed Rule 504 requirements, and importantly, the annual certification requirement due April 15, 2018.

Looking ahead, institutions should stay abreast of evolving crime threats; new regulatory requirements; and, for global institutions, higher compliance expectations. Specific actions that can be taken to strengthen AML and sanctions compliance programs include:

- **Augment AML/sanctions governance through improved monitoring and reporting.** Regulators continue to concentrate on the comprehensiveness of AML/sanctions governance and the integration of financial crimes compliance within the overall risk management framework. This program should include more frequent and robust board and/or management training, such as biannual training sessions and quarterly updates on the regulatory environment/horizon as well as enforcement trends.
- **Establish a robust and quantifiable risk assessment process, particularly a documented risk coverage matrix that directly links identified risks to suspicious activity monitoring scenarios.** This is a key area of regulatory focus that provides evidence of appropriate risk coverage by the transaction monitoring systems. Risk assessments continue to form the foundation for development of a risk-based Bank Secrecy Act/AML compliance program. Expectations include a consistently repeatable risk assessment process with quantifiable risk exposures (enterprise-wide; by department; and, if necessary, at the business unit level), documented mitigating controls, and identification of residual risks.





- **Leverage and invest in technologies and expertise.** The technology lever continues to pay dividends through increasing efficiencies and consistency. Strategic deployment of technology—whether focused on client onboarding; centralizing customer due diligence; or advanced suspicious activity monitoring, reporting, and fraud systems—can augment operational efficiencies. Although AML/sanctions knowledge has increased over the past decade, the need for well-seasoned experts continues unabated. The value added to operational efficiency, risk management, and strategic leadership through acquiring deep financial crimes expertise across all three

lines of defense is immense. Recruitment strategies focusing on financial crimes leadership and middle management may provide institutions with a strategic advantage.

- **Prioritize compliance program performance.** Program improvement may become a strategic advantage by establishing a robust governance process, integrating compliance within the overall risk management framework, and leveraging innovative technologies and recruitment strategies to gain efficiencies and control increasing compliance costs.

# Consumer protection

Despite proposed legislative changes and pending litigation that could alter the structure of the Consumer Financial Protection Bureau (CFPB), as well as the recent and prospective leadership changes at all the banking agencies, the topic of consumer protection isn't going away. When operational breakdowns cause real or perceived consumer harm, a firm's reputation can suffer materially from negative press, social media attacks, and enforcement actions and fines, as well as bipartisan condemnation from Congress.

Although the CFPB has continued to advance its rulemaking agenda, many of its proposed rules have come under Congressional scrutiny. For example, after the CFPB finalized a rule in July banning most arbitration clauses that prevent the consumer from joining in class action suits, Congress overturned the rule pursuant to the Congressional Review Act. The CFPB also recently finalized a rule to regulate payday lenders and has a rule in process to regulate debt collection, although these rules may also be targeted by Congress.

From a supervision standpoint, the CFPB continues to examine for compliance with existing laws and regulations. In particular, the agency continues to find problems in a number of areas, including credit card account management, auto loan servicing, debt collection, deposits, and mortgage loan origination and servicing.

In the credit card area, problems found by the CFPB include the inappropriate marketing of credit card add-on products, as well as failures to comply with billing error resolution rules. In the auto servicing area, the agency found issues with lenders failing

to stop repossessions after consumers had made catch-up payments or had otherwise entered into an agreement to avoid repossession. In the debt collection area, issues include unauthorized communications with third parties, false representations made to authorized credit card users regarding their liability for debts, false representations regarding credit reports, and communications with consumers at inconvenient times. Deposit issues include fee misrepresentation, inadequate error resolution practices, and deceptive statements about overdraft protection products. In the mortgage area, the agency determined that most supervised institutions had effectively complied with the "Know Before You Owe" mortgage disclosure rule. However, some problems were still found in the mortgage area, including violations relating to the timing and content of loan estimates and disclosures. Servicing issues were primarily related to loss mitigation efforts.

Most of these issues aren't really new. Rather, consumer protection problems are often caused by operational breakdowns in existing compliance programs and processes, including complaint management, training, testing, and monitoring. In some cases, compliance issues have arisen in programs that are decentralized and inconsistently managed throughout the enterprise.

As noted previously in this year's regulatory outlook, compliance management systems at most banks could benefit from a pivot in the overall approach, from building to sustaining. Now is a good time for banks to conduct end-to-end reviews of their compliance processes.

Here are some specific actions that can strengthen a bank's compliance management systems:

- Inventory the bank's compliance management processes, prioritize them by risk, and then implement a program to review each process end to end. This isn't a "once and done" exercise, and it will likely take years. But the ultimate result should be a stronger compliance program.
- Implement a robust process to aggregate, categorize, and analyze customer complaints, whistleblower comments, fraud investigations, social media comments, and other "voice of the customer" channels. Regulators, especially the CFPB, use complaints and related information to guide their supervisory activities, so banks should know what their data is telling them.
- Monitor regulatory publications (e.g., the CFPB's Supervisory Highlights and the OCC's Semiannual Risk Perspective) to identify industry issues, so they can be proactively addressed.
- Consider RPA to improve compliance outcomes and drive effectiveness and efficiency.





# Navigating “Year Two”: Regulatory landscape and challenges for foreign banks and their IHCs

While the key milestone of July 1, 2016, has passed for FBOs to establish US IHCs and implement the FRB’s EPS, the long road to operationalizing run-the-bank (RtB) functions has just begun. Heading into Year Two, IHCs and FBOs’ broader combined US operations (CUSO) are contending with the reality that there is still much work to do in a regulatory environment focused on local/jurisdictional implementation that challenges the global model.

## Four key focus areas underpinning the supervisory strategy

### 1. Capital planning and stress testing.

For the first time in the seven-year history of the CCAR program, the FRB didn’t object to any of the capital plans or capital distributions of participating banks. However, recently formed IHCs didn’t participate in the full CCAR process in 2017. Instead, each submitted a capital plan that was subject to a confidential review process. When preparing for their first public CCAR filings in 2018, these banks should carefully consider the feedback they received during their non-public CCAR and then strive to create remediation plans that are materially improved for 2018 and beyond. As longer-term CCAR filers have learned over time, remediation efforts generally take more than one planning cycle to fully complete. Consequently, providing the board with a fair accounting of the

strengths, weaknesses, and limitations of the current state of remediation efforts and results is crucial.

**2. Liquidity.** As the FRB continues to emphasize issues related to FR 2052a (Complex Institution Liquidity Monitoring Report),<sup>3</sup> FBOs should address data quality concerns and data infrastructure issues related to their regulatory reporting submissions. In addition, they should continue to integrate liquidity risk management and stress testing into their BAU capabilities.

**3. RRP.** Resolution planning remains critically important for FBOs. The extended submission cycles and the detailed guidance certain FBOs have received for their next submissions suggest the FRB and FDIC will expect thorough plans supported by credible assumptions.

**4. Governance and controls.** FBOs must demonstrate the ability to operate with sufficient decision making and accountability across CUSO, with clear delegation of authority from parent companies. It will be critical to demonstrate legal-entity decision making and cross-functional execution against strategy, risk appetite, and day-to-day operations.

One additional theme serves as a

foundational element for the IHCs and CUSO going forward:

- **Booking model and overall business strategy.** As the financials and performance of US IHCs begin to normalize—and as additional trend/performance data becomes available via FR Y-9C (Consolidated Financial Statements for Holding Companies) and FR Y-15 (Banking Organization Systemic Risk Report)—shareholders, analysts, and parent banks will further critique the level of profitability and business model choices of large FBOs operating in the US, particularly those that are subject to the IHC requirements. This will likely prompt a closer look at cost/income ratios, staffing expenses, and revenue sharing between the IHC and other legal entities.

FBOs should reassess the sustainability of their US business strategies and booking models across IHC/branches, as well as global impacts. FBOs should then identify the markets and business lines across CUSO that will continue to be profitable to support the IHC. Furthermore, FBOs should strive to improve the rationale and documentation of what’s originated, booked, and managed from CUSO, and to better understand inbound and outbound business flows.

## Year Two focus

<sup>3</sup> FR 2052a, Board of Governors of the Federal Reserve System, updated December 30, 2016, <https://www.federalreserve.gov/apps/reportforms/reportdetail.aspx?sOoYj+5BzDbpqbklRe3/1zdGfyNn/SeV>

It's critically important to understand that the Year Two focus needs to extend beyond simply remediating regulatory feedback not fully addressed during Year One. IHCs should strive to go much further in fully operating as an integrated IHC structure with a more proactive and forward-looking approach.

Overall, the following leading practices should be near-term focus areas for management of CUSO, the IHC board, and parent governance processes:

- Assess the effectiveness of newly designed processes and compliance with the requirements, especially for capital planning and liquidity and given regulatory feedback
- Evaluate business strategies and models in light of financial performance data available from IHC data in order to operate with a sustainable model
- Continue to build regional management capabilities for self-identifying, remediating, and monitoring risk and compliance issues
- Prepare for a regulatory reporting examination that holistically reviews reporting capabilities as a follow-up to the management information systems (MIS)/reporting reviews
- Maintain momentum on resolution plans
- Demonstrate results—don't just start from scratch, move forward with plans, and meet regulatory commitments; management needs to focus on continuing the momentum and building sustainability

FBOs should reassess the sustainability of their US business strategy and booking models across IHC/branches, as well as global impacts.







# Other important regulatory considerations

## Liquidity

For US BHCs and FBOs with total combined assets of \$50 billion or more, the past year has seen continued implementation of liquidity requirements such as FR 2052a liquidity reporting, where third wave filers have submitted their first submissions in August of 2017. Initial submission deadlines were T+15 calendar days for prior month end as of date, and average approximately 10 business days. Starting with submission for January 2018 month end, the submission timeline will be shortened to T+10 calendar days, and average approximately 7 business days. In addition to the shortened reporting timeframe which these institutions have, FRB scrutiny will be heightened due to the increased volume of data to which the FRB has access. The past year has also seen both implementation of enhancement programs, sometimes described as “Day 2” enhancements, established during the overall readiness planning and Day 1 implementation process; and reactive remediation activities in response to direct FRB findings specific to particular institutions.

On the rulemaking front, the final key liquidity rule outstanding, the Net Stable Funding Ratio (NSFR) has an uncertain future. Although the FRB, FDIC, and OCC proposed the rule for large US banks in May 2016,<sup>4</sup> the industry has expressed significant objections about the unintended adverse effects the rule may have. As new leadership at the banking agencies review the proposal and industry comments, the form, content, and timing of the final rule is unclear.

Through horizontal reviews and examinations, regulatory agencies have continued to escalate their scrutiny of liquidity-related to EPS and other requirements. Regulators also continue to focus on—and expect improvement in—such areas as Treasury data, the three-lines-of-defense model, intraday liquidity, collateral management, and governance, just to name a few. In addition, institutions continue to implement Day 2 enhancements and find ways to incorporate requirements into their standard operating procedures as BAU processes. Living with the requirements has introduced a new and heightened focus on certain areas for financial institutions: intercompany transactions, high-quality liquid asset (HQLA) management and reporting, deposit versus wholesale funding strategy, and automation of analytic tools.

In the current environment, mandates instilled and enforced by institutions’ management are expected to focus on cost reduction. Consequently, Treasury and liquidity management will continue to face pressure to manage costs through streamlined and efficient processes while still meeting regulatory mandates. Both objectives can be achieved by applying the right governance model across each line of defense and across each risk category. In addition, managing liquidity costs by establishing and implementing an allocation of the costs (and benefits) across users (and providers) can more effectively steer business decisions.

Governance is a topic that affects both change-the-bank and RtB BAU processes. Satisfying the new requirements demands an effective governance model both at the functional level and overall organizational level. This should include establishing better data capabilities and more precise metrics (e.g., those related to limits, targets, and setting the overall risk appetite) along with building a clearly defined framework for roles and responsibilities related to data and metrics, including well-documented escalation procedures.

Treasury data is at the heart of liquidity due to granularity requirements, particularly for FR 2052a liquidity reporting, which ultimately drives liquidity reporting and should also drive monitoring and management. Data should be sourced and built from the same underlying data sets to help ensure consistency, quality, and accuracy across different uses.

Intraday liquidity and collateral consistently come up as regulatory agenda items. Non-US-driven requirements and guidelines, such as BCBS 248, have—in several instances—been seen as a basis for intraday liquidity reporting, since US-specific requirements haven’t been codified. Institutions continue to contemplate and develop internal capabilities to hone their liquidity monitoring, management, and reporting capabilities and to anticipate regulatory scrutiny in the near and long term.

<sup>4</sup> Agencies propose net stable funding ratio rule, Joint Press Release, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, May 3, 2016, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20160503a.htm>.

Funds transfer pricing, as well as capital and liquidity integration, are on the radar for increased regulatory agency scrutiny as institutions continue to mature their liquidity risk management activities, leading to greater precision in product pricing and deployment of consistent and integrated frameworks across functions and risk types.

Financial institutions should continue to address regulators' inquiries on their requirements' implementations and overall operating models, while at the same time making a proactive effort to build and enhance their long-term capabilities. This includes focusing on business and operational cost optimization by efficiently managing and allocating liquidity costs, automating processes and applying advanced analytics, and monitoring regulatory developments both in the US and globally.

In 2018, financial institutions should focus on several items, including:

- Demonstrating sustained compliance with regulatory requirements
- Addressing enhancements and incorporating them into BAU processes
- Tightening up the plans for remediating regulatory findings
- Communicating status on plans to senior management and regulators

### Capital and CCAR

For the first time since the CCAR program was instituted seven years ago, the FRB didn't object to any bank's capital plan or proposed capital distributions. However, as discussed in the FBO section above, recently formed IHCs didn't participate in the full

CCAR process in 2017. So it's important that these institutions fully address the feedback that was provided on a confidential basis by the regulators.

The FRB has indicated that additional changes to the program are forthcoming. Some of the proposed changes likely will be welcomed by the industry, while others may well pose additional challenges for the largest banks. These changes can be implemented by FRB through its rulemaking authority.

First, as they have already done for noncomplex banks, the FRB may eventually eliminate the assessment of qualitative factors as part of CCAR for all banks, and such considerations would revert to the FRB's ongoing supervisory process. The exclusion of qualitative factors from directly constraining a firm's dividend and stock buyback decisions would be a matter of significant relief to industry.

Second, the FRB is considering making assumptions around balance sheet growth and capital distributions that are less conservative. However, according to FRB Governor Jay Powell—President Trump's nominee to be the next FRB chair—such adjustments would be made in conjunction with:

1. The integration of the risk-based capital buffer for G-SIBs into the CCAR post-stress capital requirements
2. Replacement of the Basel III capital conservation buffer (CCB) with a new buffer based on an annual calculation of peak-to-trough stress (the so-called "stress capital buffer" (SCB))

While these changes have offsetting impacts, the overall impact of these changes is likely to be negative for several G-SIBs and somewhat positive for the other CCAR participants.



The FRB also plans to enhance the transparency surrounding its CCAR and stress testing processes, and it expects to seek public feedback on possible forms of enhanced disclosures. The FRB may also disclose more information about risk characteristics that contribute to the loss estimate ranges. However, according to FRB Chair Janet Yellen, the FRB doesn't intend to make its models public.

Despite the trend toward de-emphasizing the qualitative component in the CCAR process itself, policy and processes around capital planning and measure will remain a focus for regulators. It's important that banks continue to integrate these processes into a sustainable BAU environment.

### Credit

Although it sometimes appears that credit risk has dropped off the radar as a major regulatory focus, regulators are articulating some increasing concern in this area. Couple this with the fact that some downturns in the credit cycle have been relatively unexpected and severe, and credit is still a risk that deserves the full attention of management.

Both the OCC and the FRB have noted a trend in loosening credit underwriting standards over the past couple of years, from relatively conservative to an increasing risk appetite to spur loan growth. The OCC recently noted an increased tolerance for underwriting exceptions and easing in pricing, guarantor requirements, loan covenants, collateral requirements, and debt-to-income requirements. Asset classes that are causing some concern include commercial real estate (CRE), retail auto lending, and agricultural lending.

The OCC also has noted increasing CRE concentrations in some banks. CRE remains a particular focus because the construction and development portion of CRE tends to exhibit high loss volatility in downturns.

In leveraged lending, the Government Accountability Office (GAO) recently determined that the March 2013 guidance on this topic from the FRB, FDIC, and OCC constitutes a "rule" for purposes of the CRA. Furthermore, because the guidance hasn't been submitted to Congress, it may not be considered valid. While the practical effects of this development are unclear at this time, it does represent a double-edged sword. On one hand, it appears to ease regulatory restrictions on lending into this asset class. On the other, it may increase inconsistency when regulators evaluate leveraged loans, and it heightens the need for the industry to maintain sound risk management in a highly competitive loan class.

At the same time, as banks built lending processes over time, they have often become burdensome and duplicative without materially improving credit outcomes. Now is a good time to look at end-to-end credit practices with the goal of simplifying the process by cutting out unnecessary requirements, rationalizing the roles of the first and second lines of defense, and using automation where it makes sense.

The bottom line? Lenders should keep this comment in mind: "The worst of loans are made during the best of times." The time has come to streamline lending processes without damaging the sound credit disciplines put in place when economic conditions weren't so good.

### Cybersecurity

Cyber threats continue to increase, including a growing sophistication of attacks. Phishing is a common method for breaching data systems and is often the entry method used to perpetrate other malicious activities. These include obtaining confidential information, installing ransomware, initiating unauthorized payments, conducting espionage, and disrupting online systems.

Strong governance and employee awareness is critical to help protect from damaging attacks. Cyber events are often made possible by preventable acts or omissions, such as failure to make a timely patch or a careless click by an employee.

Regulatory requirements include the Interagency Guidelines Establishing Standards for Safeguarding Customer Information issued in 2001 by the federal banking agencies. In addition, in 2016 the federal banking agencies issued an advance notice of proposed rulemaking (ANPR) regarding enhanced cyber risk management standards. The outcome of this ANPR is uncertain at this time, although there is some indication that the new leadership at the agencies may not go forward with this rule in favor of coalescing around an existing standard, such as the National Institute of Standards and Technology (NIST) Cybersecurity Framework. Future exam work and potential guidance may focus more on bank preparedness and resiliency in the aftermath of a cyber incident.

At the state level, the New York State DFS recently finalized a rule containing several fairly prescriptive cybersecurity requirements.<sup>5</sup> A number of other states are in stages of cyber rulemaking as well. On a global level, there are also various cyber requirements, such as the Monetary Authority of Singapore Notice on Technology Risk Management.

Fortunately, the similarity of requirements among global regulators makes the global compliance challenge more manageable than it seems. Regardless of jurisdiction, many cyber regulations focus on the same or similar types of threats and vulnerabilities and require banks to adopt similar mitigating requirements.

To address these various regulatory requirements and to help protect from cyber threats, here are some practical steps that can be taken:

- **Think globally.** Build a framework that addresses the commonalities of regulatory requirements and expectations, then tailor them to conform to specific jurisdictional requirements.
- **Leverage standards.** Because regulations are often aligned to established standards (e.g., NIST), those standards can be a valuable source of insights and synergies.
- **Ensure good “cyber hygiene.”** Implementing timely patches, sound controls, strong risk-based authentication, and robust employee awareness programs.
- **Be prepared.** Should a breach occur, the firm should be able to activate an existing cyber recovery plan within its crisis contingency framework, laying out key steps to contain the intrusion, protect customers, and resume normal operations.



<sup>5</sup> Governor Cuomo Announces First-in-the-Nation Cybersecurity Regulation Protecting Consumers and Financial Institutions from Cyber-Attacks to Take Effect March 1, Press Release, February 16, 2017, New York State Department of Financial Services, <http://www.dfs.ny.gov/about/press/pr1702161.htm>.



# Taking decisive action in uncertain times

Regulatory uncertainty remains a fact of life. But in most cases, waiting for absolute certainty isn't a viable option. Instead, banking organizations need to keep moving forward as planned, with deliberate linkage between regulatory strategy; business strategy; and building infrastructure for governance, regulatory reporting, and risk management that scales and is flexible. Senior management will need to take decisive action while also paying close attention to emerging regulatory developments and staying as flexible as possible. The good news is that many of the changes banking organizations are currently implementing make good sense from a business perspective—not just a regulatory perspective—and are worth doing no matter how the future unfolds.

# Contacts

## Leadership

### **Nicole Sandford**

Regulatory & Operational Risk Leader  
Partner | Deloitte Risk and Financial Advisory  
Deloitte & Touche LLP  
nsandford@deloitte.com

### **Alok Sinha**

Advisory Financial Services Leader  
Principal | Deloitte Risk and Financial  
Advisory  
Deloitte & Touche LLP  
asinha@deloitte.com

### **Monica O'Reilly**

Advisory Banking & Securities Leader  
Principal | Deloitte Risk and Financial  
Advisory  
Deloitte & Touche LLP  
monoreilly@deloitte.com

### **Chris Spoth**

Executive Director, Center for Regulatory  
Strategy Americas  
Managing Director | Deloitte Risk and  
Financial Advisory  
Deloitte & Touche LLP  
cspotth@deloitte.com

## Authors

### **Bala Balachander**

Principal | Deloitte Risk and Financial  
Advisory  
Deloitte & Touche LLP  
lbalachander@deloitte.com

### **Mike Bolan**

Managing Director | Deloitte Risk and  
Financial Advisory  
Deloitte & Touche LLP  
mbolan@deloitte.com

### **Craig Brown**

Managing Director | Deloitte Risk and  
Financial Advisory  
Deloitte & Touche LLP  
cbrown@deloitte.com

### **Michele Crish**

Managing Director | Deloitte Risk and  
Financial Advisory  
Deloitte & Touche LLP  
mcrish@deloitte.com

### **Matt Dunn**

Managing Director | Deloitte Risk and  
Financial Advisory  
Deloitte & Touche LLP  
matdunn@deloitte.com

### **John Corston**

Independent Senior Advisor to  
Deloitte & Touche LLP  
jcorston@deloitte.com

### **Irena Gecas-McCarthy**

Principal | Deloitte Risk and Financial  
Advisory  
Deloitte & Touche LLP  
igecasmccarthy@deloitte.com

### **Dmitriy Gutman**

Managing Director | Deloitte Risk and  
Financial Advisory  
Deloitte & Touche LLP  
dgutman@deloitte.com

### **Ed Hida**

Partner | Deloitte Risk and Financial Advisory  
Deloitte & Touche LLP  
ehida@deloitte.com

### **Marlo Karp**

Partner | Deloitte Risk and Financial Advisory  
Deloitte & Touche LLP  
mkarp@deloitte.com

### **Julia Kirby**

Managing Director | Deloitte Risk and  
Financial Advisory  
Deloitte & Touche LLP  
jukirby@deloitte.com

### **Ken Lamar**

Independent Senior Advisor to  
Deloitte & Touche LLP  
kelamar@deloitte.com

### **John Wagner**

Managing Director | Deloitte Risk and  
Financial Advisory  
Deloitte & Touche LLP  
johnwagner@deloitte.com

### **Dave Wilson**

Independent Senior Advisor to  
Deloitte & Touche LLP  
daviwilson@deloitte.com

### **David Wright**

Managing Director | Deloitte Risk and  
Financial Advisory  
Deloitte & Touche LLP  
davidmwright@deloitte.com

**The Center wishes to thank the following Deloitte professionals for their insights, contributions, and support for this report:**

**Aaron Bhardwaj**, Senior Manager | Deloitte Risk and Financial Advisory, Deloitte & Touche LLP

**William Brown III**, Senior Manager | Deloitte Risk and Financial Advisory, Deloitte & Touche LLP

**Lara Burkhart**, Senior Manager | Deloitte Risk and Financial Advisory, Deloitte & Touche LLP

**Zach Dressander**, Senior Marketing Specialist, Deloitte Services LLP

**Krisztina Geosits**, Senior Manager | Deloitte Risk and Financial Advisory, Deloitte & Touche LLP

**Alex LePore**, Senior Consultant | Deloitte Risk and Financial Advisory, Deloitte & Touche LLP

**Ryan Press**, Senior Marketing Specialist, Deloitte Services LLP

**Richard Rosenthal**, Senior Manager | Deloitte Risk and Financial Advisory, Deloitte & Touche LLP

**Pierre Whatley**, Senior Consultant | Deloitte Risk and Financial Advisory, Deloitte & Touche LLP

# CENTER *for* **REGULATORY STRATEGY** **AMERICAS**

## **About the Center**

The Deloitte Center for Regulatory Strategy provides valuable insight to help organizations in the financial services, health care, life sciences, and energy industries keep abreast of emerging regulatory and compliance requirements, regulatory implementation leading practices, and other regulatory trends.

Home to a team of experienced executives, former regulators, and Deloitte professionals with extensive experience solving complex regulatory issues, the Center exists to bring relevant information and specialized perspectives to our clients through a range of media including thought leadership, research, forums, webcasts, and events.

# Deloitte.

This publication contains general information only and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor.

Deloitte shall not be responsible for any loss sustained by any person who relies on this publication.

As used in this document, "Deloitte" means Deloitte & Touche LLP, a subsidiary of Deloitte LLP. Please see [www.deloitte.com/us/about](http://www.deloitte.com/us/about) for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2017 Deloitte Development LLC. All rights reserved.