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When you have to be right

Financial Services

Rethinking Regulatory Change Management

WHITE PAPER

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Regulatory reforms are happening at an accelerated pace, on a global scale. Managing the volume and velocity of change is a significant challenge for compliance departments in banking, insurance and other financial services.

A multinational enterprise with a broad product offering is typically obligated to monitor hundreds of regulatory and standard-setting bodies across its markets. Even when new rules have successfully been integrated, these remain subject to change. In the US, for example, financial firms are keeping tabs on the evolving Dodd-Frank Act; while in the EU, the regulatory reforms introduced after the financial crisis are continually fine-tuned to ensure they're producing the intended outcomes.[1] On a global level, the Financial Stability Board (FSB) is also shifting its focus towards a post-implementation evaluation of the G20 financial regulatory package.[2]

Adding to this challenge are the cases where regulations contradict each other, such as the new accounting standards on credit losses set out by the International Accounting Standards Board (IASB) in its IFRS 9 Financial Instruments and the US Financial Accounting Standards Board (FASB)'s "current expected credit losses" (CECL). While both IFRS 9 and CECL put forward an impairment approach that requires banks to recognize expected credit losses, these standards diverge in key areas – including the degree to which losses are established over an asset's lifetime, and the manner in which income is recognized on problem loans.[3] These conflicting approaches have a broad business impact.

Addressing these challenges

When regulatory reforms were introduced post-crisis, some financial institutions responded with interim measures to manage compliance and risk. Now, however, these firms need to assess the strategies, systems and processes they have in place – and ask whether these are adequate in the current regulatory environment.

Today, a strong regulatory change management program, supported by enterprise-wide collaboration and intelligent technology, can build business resilience. Ideally, financial institutions need to go beyond reacting to specific regulatory developments and take a more holistic view on compliance and risk. Having the resources available to efficiently manage the global and volatile nature of regulatory change can be a true competitive advantage.

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[1] https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-reforms-and-their-progress/financial-services-policy_en

[2] https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/financial-services/lu-deloitte-regulatory-outlook-2018-24012018.pdf

[3] https://www.bis.org/publ/qtrpdf/r_qt1703f.htm

Managing Regulatory Change Today: Key Focus Areas

Reducing risks

The most obvious reason for effective regulatory change management is to reduce the risk of business disruptions and loss if a law renders business models or practices illegal. Another primary goal is to mitigate the risk of violating a law or regulation due to human error or insufficient controls. In addition to the financial consequences of these risks, they can also lead to significant reputational damage and a loss of customer trust. Should a violation occur and be investigated, the financial institution will also have to deal with increased regulatory scrutiny going forward as corrective measures are carried out. All these events can reduce the economic value of the organization.

The Advantages of a Strategic Regulatory Change Management Program:

- Reduce compliance and regulatory risk
- Protect against a loss and reputational damage
- Optimize the cost of compliance
- Enhance the customer experience
- Manage conflicting rules more efficiently
- Manage increased volume and velocity of data

Controlling costs

With new market entrants arriving from every direction, financial institutions are under pressure to work smarter, faster and more cost-effectively. This means that compliance teams need to use their resources wisely, and if they get this right, it can be a way to address increased competitive pressures. A well-organized and streamlined regulatory change management strategy can help firms to achieve these goals.

Protecting customers and market integrity

In addition to safeguarding their own organizations, compliance departments must also protect their customers. One regulatory trend worldwide is a growing focus on financial culture and conduct, with the goal of ensuring fair outcomes for customers and protecting market integrity. The key impetus here is for banks to place customers' best interests at the core of their business and compliance models.

In Canada, financial institutions are now monitored by the Financial Consumer Agency of Canada's (FCAC's) new Supervision Framework, in effect from 1 October 2018. This aims to ensure that regulated institutions "continuously assess and improve their internal controls to meet their obligations to financial consumers."[4]

In an environment where conduct and culture are subjects of regulatory, media and public scrutiny, some firms may need to take a more holistic approach to managing this evolving risk category, because – ultimately – the behavior of everyone in the firm impacts conduct and culture.

Managing conflicting regulations

One major roadblock for financial institutions is the lack of harmony between some of the rules they must comply with across multiple legal systems. This includes differences in national regulatory regimes as well as divergent methodologies put forward by various global standard setting bodies.

Financial services firms that operate globally need to be prepared to handle contradictory regulatory frameworks, such as the different approaches to modelling credit impairment set out in IFRS 9 and CECL, as discussed earlier. This calls for a regulatory change management program that clearly flags the gaps, but also focuses on finding overlaps so that efforts can be synergized, and resources optimized.

Dealing with data and documentation challenges

Demands for financial information are growing and evolving. Regulated firms must produce much larger, more granular datasets – pulling information from multiple sources, which then needs to be standardized, verified and organized.

As regulatory demands change, the compliance team needs to carefully manage any issues that may arise around data quality, availability, collection and management to ensure that their firms can generate detailed, accurate and timely reports while responding swiftly to new regulatory demands.

It's also important for management to be able to defend all the steps taken during the regulatory change management process, providing clear rationales for decisions made. A full audit trail will help to inform a better audit process and address any questions that regulators may ask.

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[4] https://www.canada.ca/en/financial-consumer-agency/news/2018/10/fcacs-new-supervision-framework-now-in-effect.html

How To Stay Ahead of Risk

A compliance department needs to thoroughly understand all the regulatory developments that affect the business. However, there's such a vast lake of content to wade through. Regulators constantly publish new rules, updates to existing standards, guidance, information on enforcement and disciplinary actions, and much more. It's also often necessary to follow news stories to learn the additional details that help firms to interpret the law.

Reading and extracting actionable insights from this content is an incredibly labor-intensive task when this is done manually. It's also prone to human error, which exposes your organization to compliance risk. You could end up working with an incomplete or out-of-date picture of the laws, rules and standards that govern your firm.

The tools to manage change

Today, many financial institutions are taking a more innovative approach to handling these challenges by introducing technologies that provide them with up-to-date access to regulatory developments, modern data management tools, and the ability to improve key control processes through automation. This can substantially reduce manual workloads – and the associated risk.

Simultaneously, this regulatory change management technology needs to be scalable and agile enough to meet both current and future compliance requirements. This will enable financial institutions to adapt to the onslaught of regulatory developments – including large-scale changes such as Brexit and the updated Markets in Financial Instruments Directive (MiFID II) – an extensive package of reforms that have a significant impact right across the EU's financial industry.

As a provider of compliance software to financial services at Wolters Kluwer, we have certainly seen a need for technology that supports holistic regulatory change management, providing risk intelligence from around the globe and streamlining the flow of data. This enables firms to assess the impact of change throughout the organization – a centralized approach that helps to close compliance gaps and maintain a full audit trail.

Even in financial institutions that have managed core risks well to date, the pace of regulatory change is not expected to lose steam. Going forward, it's critical for firms to plan carefully for new and emerging risks in a regulatory, economic and business environment that is in constant flux. Having technologies that are agile and scalable enough to achieve this, while simultaneously managing current obligations, is the key to building business resilience.

About Wolters Kluwer Governance, Risk & Compliance

Wolters Kluwer Governance, Risk & Compliance (GRC) is a division of Wolters Kluwer which provides legal, finance, risk and compliance professionals and small business owners with a broad spectrum of solutions, services and expertise needed to help manage myriad governance, risk and compliance needs in dynamic markets and regulatory environments.

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CS-18-5030 287931516 Reg Change White Paper