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VIEWPOINTS

Take a Business Approach to Compliance



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Banks need to treat compliance with regulation like a separate business line.

In the past five years regulation has increased tremendously. Though intended to protect consumers, fight financial terrorism, and enhance corporate governance, the extra regulation can also produce migraines and hit the bottom line.

Regulatory scrutiny and resulting enforcement actions have increased in each of the last three years, and 2006 should be no exception.

Since 2003 more than 800 banking institutions and affiliated parties, including officers, directors, and employees, paid \$492 million in fines in connection with more than 2,500 publicly announced regulatory actions. If an equal number of institutions were subject to regulatory actions that were not made public, almost one in five was affected.

And fines are just the tip of the iceberg. Consultants, lawyers, additional auditors, and public relations firms are often hired. Stock prices suffer. And management, instead of pursuing strategic and day-to-day business objectives, spends time talking to the invest-

ment community about regulatory issues and assuring it that the next exam will be better than the last.

All this can mean big expenses that do little to further the bank's competitive position.

Until recently there was less need for management teams to meet often to discuss regulatory requirements.

Management knew roughly when examiners would arrive, would engage them when they were on-site, and would not see them again for a year.

This has changed. Examiners now identify areas of concern or violations of law and stay in contact to monitor the bank's response, so management must drop everything to comply.

One bank with which I am familiar let junior management handle compliance in an area that became the focus of an examination.

These well-intentioned people had not adequately reviewed regulatory requirements. When examiners found deficiencies, the resulting regulatory orders impeded the bank's pursuit of important acquisitions. Senior management and board members had to spend significant time and resources addressing the issues. Outside advisers were hired.

All this caused the bank to miss external financial targets and internal growth objectives. Its stock price and profitability suffered.

The old model of managing regulatory issues as an aside to the business of banking is no longer viable.

Compliance absolutely affects the bottom line; if you are out of compliance, your costs are going to rise.

So banks should treat compliance exactly as they do a business line: by dedicating a management committee to the job.

Members should include an executive from each significant business line and control area, who should identify regulations relevant to it and develop processes to assess

compliance (or seek third-party assistance).

To anticipate where regulators will focus, they should also think strategically about how their businesses intersect with regulatory themes.

Internal teams should work ahead of exam teams to address weaknesses, not just those identified in past exams but those that may come under scrutiny in future exams.

This isn't as difficult as it seems. All regulators publish exam manuals that can easily be divided among senior managers.

Each such manager should read trade journals and publications and attend conferences to learn from experts. Each should reach out to peers at other banks to compare notes on regulatory matters.

Banks with over \$1 billion in assets should consider appointing a chief regulatory officer or adding the duties to an existing position.

Is this really necessary? Yes. Governance, and specifically regulatory governance, is changing.

Most banks with good ratings have never had regulatory problems and don't expect to. But where ratings have declined, the management teams generally didn't see it coming.

Furthermore, many regulatory issues arise not because law or regulation was violated, but because processes were out of date.

Beyond saving hundreds of thousands or even a few million dollars, the hard work of treating compliance as a business line may gain you your examiners' trust.

That could change the dynamic of future exams and make it easier to expand into new businesses, acquire the troubled bank next door, even make the transformative acquisition.

Ignoring regulatory matters is easy, but costly. Bankers should address regulatory issues before they become real problems.

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