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Silver Linings Playbook: Compliance Edition

Strategies for turning compliance into a competitive advantage

By Amber Seitz

Compliance is a level playing field in the banking industry. While recently passed regulatory reforms (such as those included in S. 2155) will allow for a more tailored approach once implemented, most Wisconsin banks must play by the same rules. "When it comes to compliance, I'm not competing against another bank," said **Kristen Gagliano**, vice president – BSA and compliance manager at North Shore Bank, Brookfield. "We all have essentially the same set of rules to follow and do our best to comply with those rules." So, how can banks transform their compliance processes into a competitive advantage? It comes down to finding the silver lining, the unique knowledge and experience bankers can use to deepen customer relationships, build and sustain a culture of compliance, and participate in constructive conversations with regulators.

Grow Deeper Relationships

In today's long-term low-rate environment, customer loyalty (and their deposits) is an essential component for bank success. Compliance can help achieve that loyalty by providing added value to retail and commercial clients.

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Constructing a System for CRE Risk Management

Five tactics to mitigate risk as concentrations rise

By Amber Seitz

Bank regulators frequently shift the focus of their examinations to address specific areas of concern, as they should. An appropriate level of scrutiny to high-risk practices can help prevent industry-wide risk levels from becoming unmanageable, as they did in the mortgage lending sector in the early aughts. Today's "hot topic" is commercial real estate (CRE) lending. Fueled by market forces, many banks—in Wisconsin and nationwide—are holding more of these loans and in higher dollar amounts than in the past.

Generally, this increase in CRE concentrations is being driven by "expectations of loan growth in a very competitive environment," said **Nicholas Hahn**, director of risk advisory services at RSM US LLP. "Many banks are more comfortable with the underlying collateral in CRE loans, so they've become very attractive." Tying compensation to loan growth has magnified the problem, as has intense competition for commercial and industrial (C&I) loans.

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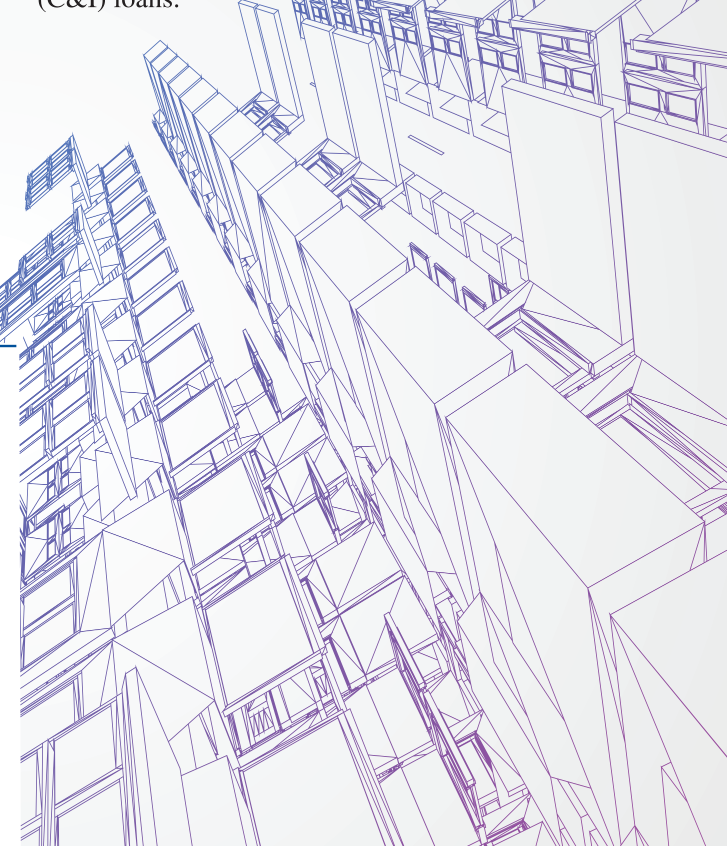

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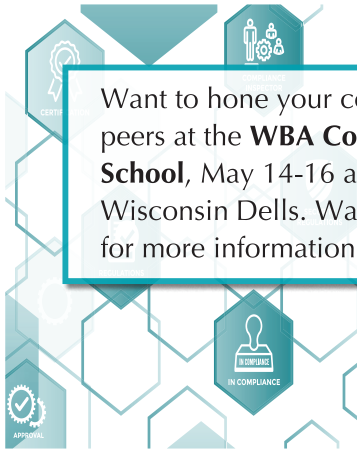
One way is through increased transparency and trust. Interactions with customers—such as a meeting to provide and explain disclosures—are opportunities for transparency beyond what is required by regulation. "Going above and beyond has allowed us to improve our customer relationships," said Gagliano, who sees it as a way to build trust and help eliminate frustrating surprises down the road. "Transparency with the customer is what builds that trust as the cornerstone of the relationship," she continued. "If you lose trust with your customer, you've lost that customer. It's a long-term investment."

Bankers can also use their compliance knowledge to add value as expert advisors for their clients, for example by helping a business establish sound fraud-prevention policies or walking a customer through the steps needed to amend the FEMA map and remove their property from a flood plain. "In compliance, there's really no competition," said **Scott Nolan**, CRCM, assistant vice president – compliance officer at The Bank of New Glarus, who suggests sharing the bank's BSA policies and procedures with commercial clients. "We all have the same rules. We're not jeopardizing any trade secrets when we share what we're doing." In addition, the due diligence BSA requires can reveal opportunities for additional services, such as ACH origination, merchant processing, and remote deposit capture.



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Finally, banks can deepen their customer relationships by demonstrating they have a culture of compliance. "We see that consumers have become more aware of concerns within the banking industry and want to work with banks that have established a culture of compliance," said **Heidi Wier**, managing director at CrossCheckCompliance. Banks that do this well have identified where to invest their compliance resources to get the highest return. "While several regulations present hard rules which must be abided by, not every regulation and rule we work under presents an absolute 'yes' or 'no' option," explained **Jay Jesberger**, CRCM, vice president – compliance officer at The Equitable Bank. One way to identify areas to invest resources in is to review the

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bank's annual compliance risk assessment. "Most banks should be—and many already are—performing an annual compliance risk assessment to help them identify their priorities," Wier explained. "When you know your high-risk areas, you can focus your resources there rather than spending time and money on low-risk areas." Take into account the Board's risk appetite and areas that could cause consumer harm when determining the bank's specific areas of focus. This often includes advertising, disclosures, and fees. Other common areas of focus are new or changed regulations and rules with large penalties attached.

Build a Culture of Compliance

A culture of compliance has many direct and indirect benefits to the bank's bottom line, but building and sustaining one can be difficult. Key components include efficient staff training, a regulatory change management system, and a proactive attitude toward compliance. "Training of frontline and backroom staff is essential for success," said Gagliano. "Their knowledge of compliance prepares them to help educate customers, making them easy to do business with while building trusted relationships." Banks can stretch their training resources by carefully identifying which employees need training on specific topics. For example, by identifying the two frontline staff who need additional BSA training rather than spending the time and money to train all 20 people in that area.

Establishing an effective regulatory change management system in addition to the bank's compliance management system is also critical, according to Wier. "We always talk about compliance management systems, but having a process to not miss anything and ensure that everything gets communicated to all affected parties is important." According to Wier, a sound regulatory change management system utilizes a committee approach to identify all operations areas that will be impacted and includes a formalized process with a timeline and targeted deadlines. Internal communication is essential, as well, particularly when the compliance department discovers an issue with the bank's current procedures. "If you review a finding, don't sit on it until you go to committee at the end of the quarter," said Nolan. "The board of directors and senior management can't change yesterday, so you have to tell them what happened and what you're doing to correct it immediately."

Ultimately, the best way to turn compliance pressure into a benefit is an attitude more than a strategy.

Finally, banks with a strong compliance culture tend to take a proactive approach. "In today's environment, it is important that compliance not sit back and wait to be approached," said Jesberger. "Compliance needs to be proactively approaching management and the business units and showing them where we can help." For example, Nolan says he works with the bank's marketing staff to get involved in campaigns during the "napkin stage," rather than when the ad is ready to print. That proactive approach gives the bank a competitive edge, according to Jesberger. "By involving compliance at the front end of a process, we can provide a competitive advantage for the bank by providing insight, consideration, and direction throughout the development process and thus expedite the delivery of the product or initiative that will deliver the desired return for the bank," he said.

Disagree Constructively

A third strategy for turning compliance into a competitive advantage is to strive for constructive conversations with regulators, especially when disagreements arise. With all of the recent regulatory changes, times when bankers and examiners interpret a rule differently have become more common. Those differences can be a positive—or at least less of a negative—if the bank takes the time to show their work and keep the conversation respectful rather than defensive. "Stay calm and stick to the facts," Gagliano advised. "Seek to understand the examiner's concern and then do your research to prepare your response. Supporting documentation of how you came to your interpretation will be especially important in defending your bank's position." The bank's compliance management system should include that documentation, including the thought process, internal discussions, and the guidance of any outside resources used, according to Jesberger. "If the examiner can understand how you came to your conclusions, I believe that will make a marked difference on how the tone of the conversation progresses from there, whether that is to affirm the bank's reasoning or to gently redirect the bank in another direction," he said.

In addition to the appropriate documentation, the tone of the conversation is also key. Nolan, who was an examiner for nine years, says the best thing to do is be reasonable and respectful. "Most times, if you can support your logic and they can see how you reached your conclusion, you'll get a better result," he explained. "They might still write you up, but the tone will be more favorable." According to one banker who experienced this during a recent examination, one of the most effective strategies for constructive disagreements is to have a pre-established relationship with your regulator. When disagreements arise and the bank needs to make changes, build rapport by requesting input from your regulator on those changes. Wier recommends understanding where the regulators are focused and what areas may be in the spotlight. "Being well-prepared can make the difference between satisfying the examiner's questions or requiring additional follow-up and scrutiny," she said.

Ultimately, the best way to turn compliance pressure into a benefit is an attitude more than a strategy. "We can demonstrate our value by utilizing our risk assessments and internal monitoring to help the bank identify opportunities for growth, either through showing how the existing controls may be limiting growth prospects in one area, or to illustrate where a framework exists that enables expansion in another," Jesberger explained. When compliance becomes the "gotcha" department, those opportunities for collaboration and growth dwindle. "I view compliance as a resource, not a hindrance," said Nolan. "To make compliance work, you have to treat it as a positive. It's a *corrective action*, which means we're changing something to be right."

Seitz is WBA operations manager and senior writer.

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