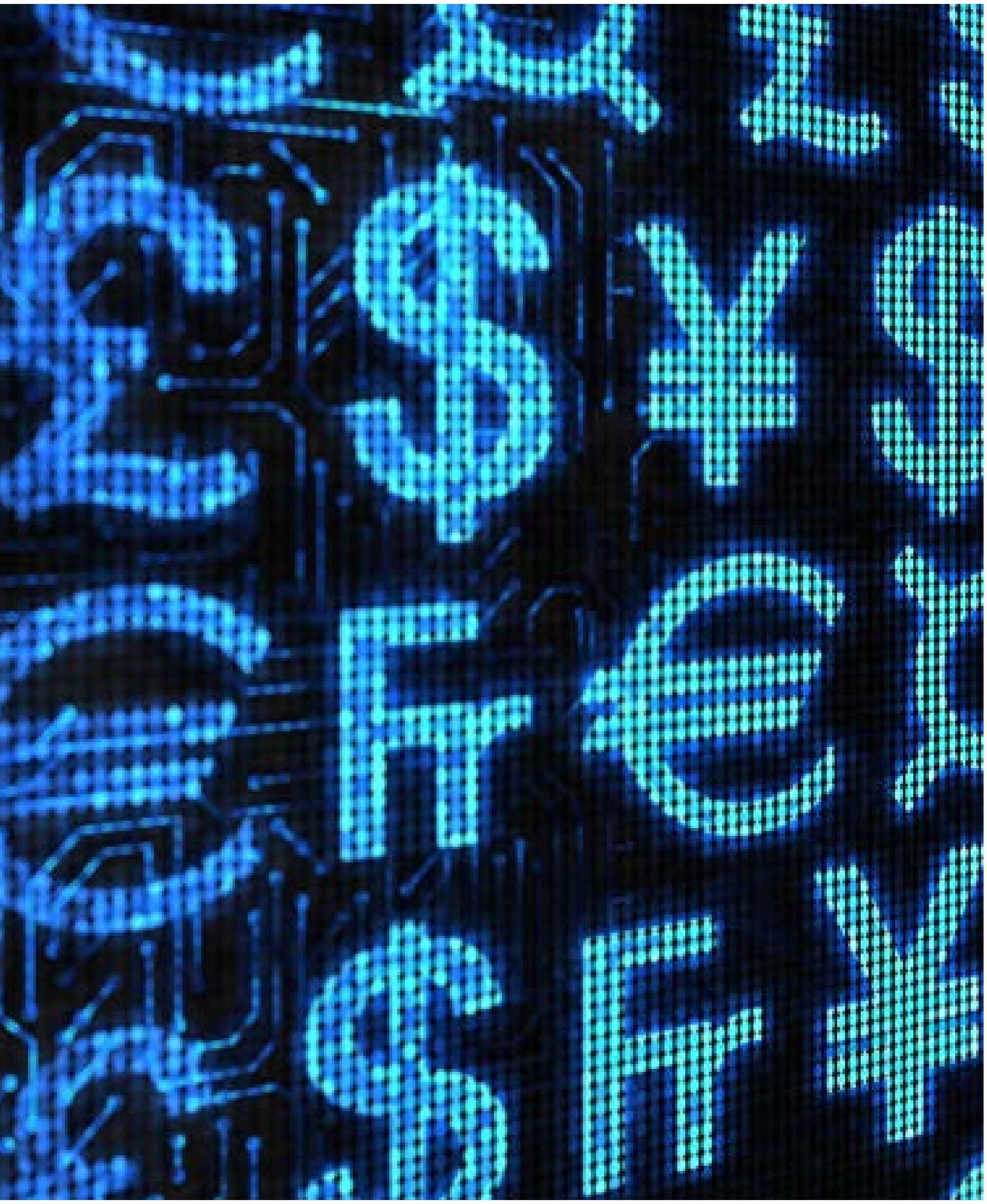
REGULATORY INTELLIGENCE BRIEFING — NOVEMBER 2017

FINTECH REGULATORY UNCERTAINTY:
A SPOTLIGHT ON MARKETPLACE LENDING

Capco Center of Regulatory Intelligence

CAPCO



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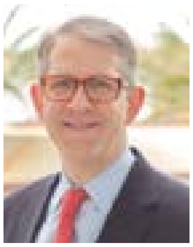
EDITORIAL NOTE FROM THE MANAGING DIRECTOR, CENTER OF REGULATORY INTELLIGENCE



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Peter has more than 16 years of government and consulting experience in advising clients on supervisory matters before the U.S. government and in the implementation of enterprise risk management programs. He is a thought leader in government affairs and regulatory strategies in support of banks' and financial institutions' compliance with the Dodd-Frank Act and Basel Accords. Prior to joining Capco, he served as a director of government relations at Clark Hill and in senior government positions, including serving as a deputy assistant secretary at the United States Department of the Treasury.

As technology grows, changes and improves, the pace of change only becomes faster and faster. A technological breakthrough in today's world is a harbinger of future breakthroughs. For fintech, this means that there are constantly new consumer financial products and services available. But, while more firms enter the market everyday with innovative technology creating new opportunities for stakeholders, it seems the more difficult questions come second. And one of the top concerns in today's fintech world is figuring out who is responsible for keeping these products legally safe for consumers.

This month's Regulatory Intelligence Briefing (RIB) discusses current regulatory uncertainty in financial institutions and fintech companies who partner or compete, with a highlight on marketplace lending. Our focus article begins by exploring how several regulatory bodies have been reacting to fintech in the past few years: some are simply attempting to garner a holistic understanding of the implications of this new technology, while others are taking more proactive or reactive steps to manage and mitigate unfair or deceptive practices in the space. We use marketplace lending as a case study to exemplify some of this regulatory confusion. Describing the different models of marketplace lending, we explore some of the recent legal and policy developments shaping this industry and what the implications of those developments might mean for the U.S. financial system as a whole.

Our congressional hearing summary starts the RIB with a review of recent developments regarding the Congressional Review Act (CRA). After years of inactivity before President Donald Trump took office, the CRA has returned to congressional attention with two new developments that could have a profound effect on the way Congress utilizes the Act to potentially shift guidance that federal banking regulators issued over the past two decades. In this article, we investigate these developments and the potential impact of increased CRA usage.

Our final article strategically follows the focus article on fintech regulation uncertainty: in this piece, we describe trends in regulatory change management (RCM) and steps your institution can take to keep abreast of developments in the regulatory field and ensure an effective RCM program. First, we outline the building blocks of a proficient RCM program. Then, we use the Department of Labor's Fiduciary Rule as an example of how to manage ongoing regulatory change, detailing what questions your institution should be asking and what steps it should be taking at every new development.

The recommendations regarding these issues continue to transform and develop as regulation and guidance change and grow. Capco's CRI team will keep you updated on all significant changes as they progress.

REGULATORY ROUNDUP

Regulatory and Compliance Alerts

FSB Publishes Report on Artificial Intelligence and Machine Learning in Financial Services

On November 1, 2017, the Financial Stability Board (FSB) published a report titled Artificial Intelligence and Machine Learning in Financial Services. The report covers the financial stability concerns of the growing use of artificial intelligence and machine learning in the financial services industry.

Banking Agencies Propose Revisions to Streamline the Call Report

On November 2, 2017, the Federal Financial Institutions Examination Council (FFIEC) proposed additional revisions to streamline the Call Report as part of efforts to reduce data reporting and other burdens for financial institutions. The latest proposal from the Federal Reserve Board (FRB), the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) will remove or consolidate a number of data items and adjust reporting thresholds in the three versions of the Call Report. Comments are due by January 8, 2018.

FinCEN Issues Advisory on North Korea's Use of the International Financial System

On November 2, 2017, the Financial Crimes Enforcement Network (FinCEN) issued an advisory to further alert financial institutions to North Korean schemes for evading U.S. and United Nations (UN) sanctions, laundering funds and financing the North Korean regime's weapons of mass destruction and ballistic missile programs.

OCC Issues Guidance on CRA Ratings' Impact on Licensing Applications

On November 8, 2017, the Office of the Comptroller of the Currency (OCC) issued guidance to provide transparency regarding its framework for evaluating certain types of licensing applications when an applicant bank has an overall Community Reinvestment Act (CRA) rating of "Needs to Improve" or "Substantial Noncompliance" (i.e., a less-than-satisfactory CRA rating), or a similar rating in one or more geographic rating areas.

CFPB Approves Language Preference Update to URLA

On November 20, 2017, the Consumer Financial Protection Bureau (CFPB) issued an official approval of the final redesigned Uniform Residential Loan Application (URLA), which will include a question about mortgage applicants' language preferences. The approval notice confirms that a financial institution's use of the URLA does not violate specific provisions of Regulation B (Equal Credit Opportunity Act).

NCUA Publishes Final Notice of OTR Methodology

On November 22, 2017, the National Credit Union Administration (NCUA) issued a final notice to outline and discuss the comments received on a notice and request for comment from June 2017 related to proposed changes to the NCUA's Overhead Transfer Rate (OTR) methodology. This final notice sets forth the new OTR methodology the NCUA has chosen to adopt after considering the public comments.

CONGRESSIONAL HEARING SUMMARY: CONGRESSIONAL REVIEW ACT DEVELOPMENTS

Federal agencies have a variety of methods to impact the way the financial sector interprets and executes laws. These methods include, among others: regulations, amendments, clarifications, formal guidance, informal guidance, speeches, frequently asked questions (FAQs), technical assistance and enforcement actions. From these, regulation, in which federal regulators have the power to promulgate rules from federal laws, is the most powerful way for federal agencies to impact change. Based on this, the Congressional Review Act (CRA) was enacted in 1996 to give Congress review power over federal rules and regulations. However, a recent ruling from the Government Accountability Office (GAO) could expand Congress' pre-conceived ability to challenge agency releases, all hinging on the CRA's definition of a "rule."

CRA in 2017

When the 2016 elections solidified Republican control of Congress and the presidency, the CRA re-entered the spotlight after ostensible dormancy since President George W. Bush's first term in office. Most of the focus in the beginning of 2017 was on the CRA's ability to overturn Obama-administration rules and regulations issued during the last 60 legislative days (midnight rules) of the 114th Congress. By utilizing the CRA, the new administration overturned 14 Obama-administration midnight rules. Two recent developments have shifted the conversation over the CRA, opening the possibility that the impact goes well beyond the ability to overturn midnight rules.

1. **House Joint Resolution 111 Passes Both Houses of Congress and Trump Signs Off, Repealing the CFPB's Arbitration Agreements Rule:** On November 1, 2017, President Donald Trump approved a joint resolution repealing the Consumer Financial Protection Bureau's (CFPB) rule regarding arbitration agreements.

2. **GAO Report States Leveraged Lending Guidance is Subject to Congressional Review Act:** The GAO published a report on October 19, 2017, regarding the 2013 interagency guidance that federal banking agencies issued on leveraged lending. The GAO stated they consider the guidance a general statement of policy and therefore a "rule" under the CRA.

Overview of the Congressional Review Act

At its core, the CRA establishes expedited procedures for Congress to disapprove regulatory rules that federal agencies issue. To do so, a joint resolution of disapproval must pass both houses of Congress by a simple majority and the president must sign off. Once a joint resolution of disapproval has successfully passed, the agency-issued rule shall not take effect. Further, an agency may not issue a rule in "substantially the same form" as the disapproved rule, unless it is specifically authorized by subsequent law.

The CRA requires federal agencies promulgating rules to submit a report on the rule to Congress and the Comptroller General. The report must contain:

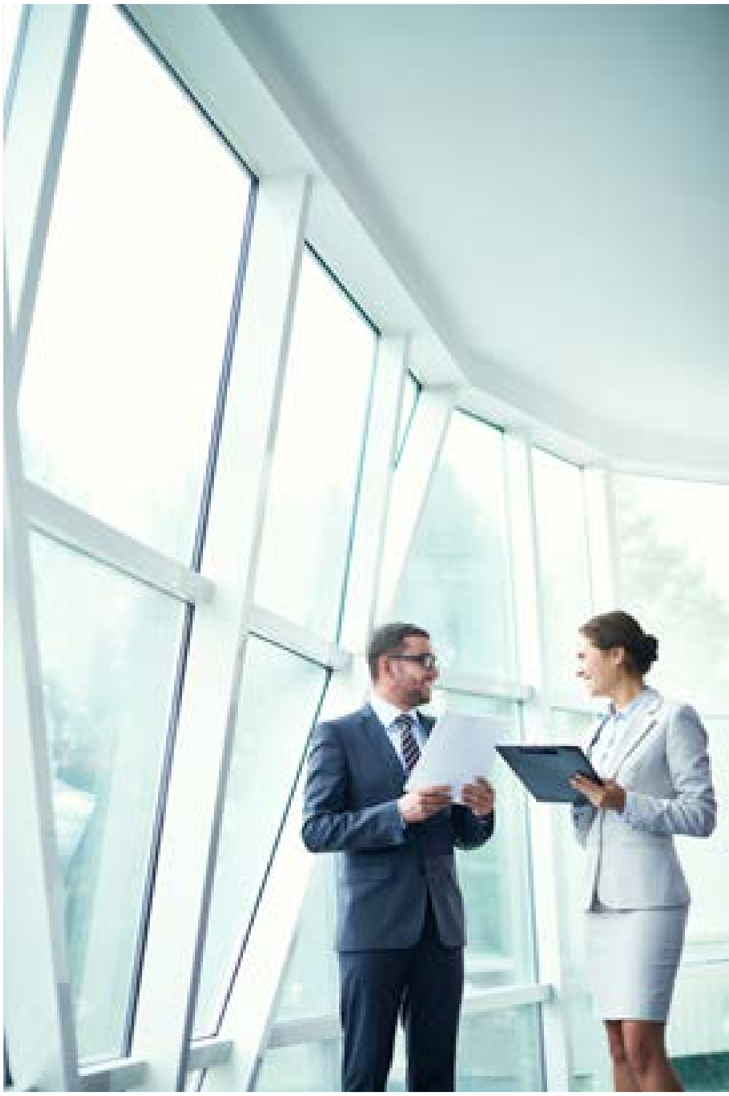
- A copy of the rule
- A concise general statement relating to the rule, including whether it is a "major rule" *
- The proposed effective date of the rule

5 U.S.C. § 801(a)(1)(A).

The CRA also states that "major rules" take effect on the later date of:

- 60 days after Congress receives the report required by 5 U.S.C. § 801(a)(1)(A) (described above)
- 60 days after the rule is published in the Federal Register

5 U.S.C. § 801(a)(3).



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A "major" rule is defined as "any rule that the Administrator of the Office of Information and Regulatory Affairs of the Office of Management and Budget finds has resulted in or is likely to result in – (A) an annual effect on the economy of $100,000,000 or more; (B) a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or (C) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic and export markets."

Traditional Use: Congress Uses CRA to Dismantle the CFPB Arbitration Rule

As one of the few remaining executive agencies with a Democrat-appointed director, the CFPB faced challenges to advance its rulemaking agenda due to its rules' vulnerability under the CRA. On July 19, the CFPB's final rule on arbitration agreements was published in the Federal Register, beginning Congress' 60-legislative-day review period under the CRA. The House wasted little time, passing House Joint Resolution 111, which provided for congressional disapproval of the arbitration agreement rule, on July 25.

On October 24, the Senate voted 50 to 50 on the rule's disapproval and Vice President Mike Pence cast the deciding vote to overturn the rule. On November 1, Trump signed legislation approving the joint resolution and repealing the CFPB's arbitration agreements rule.

Infrequent Use: GAO Finds Leveraged Lending Interagency Guidance is a "Rule" under the CRA

On March 31, 2017, Senator Patrick Toomey (R-PA) sent a request to the GAO to determine whether a joint guidance on leveraged lending that the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB) and the Federal Deposit Insurance Corporation (FDIC) issued in March 2013 constitutes a "rule" for the purposes of the CRA. Under the CRA, a "rule" is defined as:

"[T]he whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency and includes the approval or prescription for the future of rates, wages, corporate or financial structures or reorganizations thereof, prices, facilities, appliances, services or allowances therefor or of valuations, costs, or accounting, or practices bearing on any of the foregoing." 5 U.S.C. § 551(4).

As laid out in 5 U.S.C. § 804(3), the three exceptions to the definition of a rule are:

A any rule of particular applicability, including a rule that approves or prescribes for the future rates, wages, prices, services, or allowances therefor, corporate or financial structures, reorganizations, mergers, or acquisitions thereof, or accounting practices or disclosures bearing on any of the foregoing;

B any rule relating to agency management or personnel; or

C any rule of agency organization, procedure, or practice that does not substantially affect the rights or obligations of non-agency parties.

On October 19, 2017, the GAO issued a report concluding "that the Interagency Guidance is a general statement of policy and is a rule under the CRA." In getting to that conclusion, GAO considered, among other things: an agency's characterization of its issuance, previous GAO rulings, the CRA's legislative history and whether the interagency guidance fit any of the exceptions to the definition of a "rule" outlined above.

A Timeline of Leveraged Lending

March 21, 2013

Leveraged Lending Guidance is Finalized

June 12, 2017

Treasury Recommends 2013 Leveraged Lending Guidance be Re-issued for Public Comment

March 31, 2017

Senator Pat Toomey Issues Request to GAO to Determine if Leveraged Lending Guidance a Rule under CRA

October 19, 2017

GAO Determines Leveraged Lending Guidance a Rule Under the CRA

Consider This

Should banks have relied on this guidance if the agencies never submitted to Congress and the Comptroller General?

What happens to a bank that was cited in a matter requiring attention or an enforcement action for noncompliance with the guidance?

Will there be redress?

To start, the Board issued a letter to the GAO Assistant General Counsel in July 2017, specifying that the joint agencies explicitly stated the interagency guidance was not a rule. And while considering this fact, the GAO stated in its report that the agency's characterization is not "determinative."

In determining that the leveraged lending guidance was a "rule," the GAO first determined that the guidance was a "general statement of policy." The report cites a U.S. D.C. Circuit Court decision:

"A general statement of policy … does not establish a 'binding norm.' It is not finally determinative of the issues or rights to which is has addressed. The agency cannot apply or rely upon a general statement of policy as law because a general statement of policy as law because a general statement of policy only announces what the agency seeks to establish as policy."

Pacific Gas and Elec. Co. v. Fed. Power Comm'n, 506 F.2d 33, 38 (D.C. Cir. 1974).

According to the GAO report, the joint agency guidance expresses the "regulators' expectation regarding the sound risk management of leveraged lending activities" and does not establish a "binding norm" nor determine the outcome of any institution's examination. Therefore, it is a "general statement of policy."

With that in mind, the GAO has previously determined general statements of policy can be considered "rules" under the CRA. Examples of this include:

- B-287557: On May 14, 2001, the GAO determined the Fish and Wildlife Service's Record of Decision entitled "Trinity River Mainstem Fishery Restoration" is a "rule" under the CRA.
- B-316048: On April 17, 2008, the GAO determined a letter that the Centers for Medicare & Medicaid Services issued to state health officials concerning the State Children's Health Insurance Program is a "rule" under the CRA.

The GAO decision also references the Congressional Record from 1996 during final consideration of the CRA, where a sponsor of the CRA pointed out that rules subject to the CRA include agency general statements of policy.

Finally, in making its determination, GAO concluded that the interagency guidance does not fall within any of the three exceptions in the CRA (outlined in the previous section).

Implications Moving Forward

With rules and regulations issued in the future, the CRA's impact does not change. Executive agencies must be sure to submit reports on new rules to both Houses of Congress and the Comptroller General before it can take effect. Once an agency submits these reports, the clock for CRA-disapproval begins.

As for the GAO report, the precise implications are not yet known. While the GAO has determined that a specific past guidance is a "rule" under the CRA, and if all rules must be submitted to Congress and the Comptroller General, there are a series of questions that can be asked:

Was the leveraged lending interagency guidance ever submitted to Congress and the Comptroller General, accompanied by a report as required under the CRA? If it was found to not have been submitted, it leads directly into the next question…

Can the 2013 guidance be reviewed under the CRA in 2017? An opinion piece in the Wall Street Journal suggested that, according to the Senate parliamentarian, the GAO's ruling "counts as the official report, and so the [CRA] clock is now ticking…" on the 2013 interagency leveraged lending guidance.

Can the GAO review any agency guidance from the past to determine whether the guidance constitutes a "rule" under the CRA? If so, this could broadly expand the scope of the CRA's reach to almost unimaginable levels.

If an agency pronouncement is considered a "rule" under the CRA, and was never formally submitted with a report to Congress and the Comptroller General, what impact does that have on enforcement actions, examinations and other negative findings for financial institutions? This question is particularly important, especially for major rules. Essentially, is something really a rule if it was not submitted the proper way?

FOCUS: FINTECH REGULATION UNCERTAINTY

A SPOTLIGHT ON MARKETPLACE LENDING

Over the past few years, fintech has surged well past a fad and into a staple for the financial services industry, However, as we see more and more activity in the field of fintech regulation, stakeholders — including regulators and fintech firms themselves — still face issues with understanding which laws and regulations apply.

With a recent increased focus on fintech, there has also been an increased focus on how to ensure accountability in keeping fintech products and services safe for consumers. A large part of the confusion surrounding these potential regulations is just how many regulatory bodies could have a role in fintech supervision.

A GAO report from April highlighted the following federal agencies as likely having some responsibility over the fintech industry: Federal Reserve Board (FRB), Federal Deposit Insurance Corporation (FDIC), National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), the Consumer Financial Protection Bureau (CFPB), the Department of the Treasury (Treasury), Financial Crimes Enforcement Network (FinCEN), Federal Communications Commission (FCC), Federal Trade Commission (FTC), Securities and Exchange Commission (SEC), Commodity Futures Trading Commission (CFTC), State banking regulators and State securities regulators.

Some of these regulators have made concerted efforts to understand fintech and begin the process of welcoming it into their regulatory purview. Examples include:

CFPB

In February 2016, the CFPB announced the introduction of its no-action letter (NAL) policy, which allows companies to apply for a CFPB statement to reduce regulatory uncertainty surrounding new products or services that might offer consumer-friendly innovation. In September 2017, the CFPB issued its first NAL to a fintech company that uses alternative data to make credit and pricing decisions; the letter requires the company to report lending and compliance information to mitigate consumer risk and aid CFPB's understanding of the impact of using alternative data for lending decision-making.

OCC

In January 2017, after over two years of research into the matter, the OCC announced its intentions to provide an option for certain fintech companies to apply for Special Purpose National Bank (SPNB) charters. The charter would be available to companies involved in money lending or check payment, but not to those that take deposits.

FTC The FTC has conducted workshops and published reports regarding fintech and the benefits and risks to consumers. Starting in June 2016, the FTC began hosting a series of fintech forums, with the first forum concerning marketplace lending. The FTC has also also brought law enforcement actions against fintech companies under the FTC Act and other applicable laws.

FDIC The Winter 2015 edition of the FDIC's Supervisory Insights featured an article on marketplace lending, describing different types of models and the risks involved with partnerships, and in July 2016, the agency issued guidance on third-party lending.

Case Study: Marketplace Lending

Today's consumer operates in a world of technological advances that allow for timely and efficient solutions through online offerings. With consumers conducting many aspects of personal finance and business operations online, there has also been a rise in online marketplace lending, with a Congressional Research Services report citing the market could potentially be as big as $90 billion by 2020.

Consumers seeking quick and easy access to credit work with marketplace lenders to access individuals and institutions willing to participate in less traditional models of lending. To underwrite loan products such as consumer or small business loans or lines of credit, marketplace lenders may supplement traditional credit data (e.g., credit score or debt repayment history) with alternative consumer data (e.g., monthly cash flow, online customer reviews and credit algorithms). The divergences from conventional lending make marketplace lending an attractive solution for many consumers and lenders alike.

Types of Marketplace Lending

The market has traditionally been defined by two types of marketplace lending models:

Direct Lending

In the "direct lending" model, the operator originates loans in its own name. Direct lenders, sometimes known as balance sheet lenders, acquire funds from outside sources and use this money to finance loans and often hold loans on their balance sheets. This type of lending requires the originator to obtain necessary licenses in each jurisdiction of loan origination, and is subject to applicable state lending laws, including usury prohibitions. Because of the high expense to ensure and maintain applicable licensure and proper compliance, direct lending is more difficult for a loan originator.

Platform Lending

In the "platform lending" model, otherwise known as the "bank partnership" model, the loan originator partners with a depository institution. This institution originates loans and sells them to marketplace operators. Through this model, originators may be able to take advantage of federal preemption and rate exportation to avoid state licensing requirements and lending laws, but the operator may be subject to federal banking supervisory authority as a third-party service provider.

There has also been two sub-types of platform lending based on partnerships, as highlighted in the Congressional Research Service report:

In a “white label partnership,” a traditional bank establishes underwriting standards, originates the loan and holds the loan once issued, though the bank may use a marketplace lender’s technology services for origination.

In “referral partnerships,” banks refer customers to a marketplace lender if the customer requires services the bank does not offer or if the customer does not meet the bank’s underwriting standards.

Policy Considerations

Because this is a relatively new field, the onus of certain legal obligations is difficult to discern. There have therefore been a number of court cases revolving around the issue of bank partnerships in lending. Two policy considerations that have added to the complexity around online lending are the “valid-when-made doctrine” and “true lender” theory.

“Valid-when-made Doctrine”

A loan that is valid at inception cannot become usurious upon subsequent transfer to another person.

Highlighting the confusion over the valid-when-made doctrine, in 2015, the U.S. Second Circuit Court of Appeals released an opinion concerning a case in which a consumer signed a credit card agreement under Delaware law and the bank that issued this card subsequently sold debt from this agreement to a third party. An affiliate attempted to collect the debt, which it calculated, under Delaware law in which there is no usury limit, at 27 percent. But, since the debtor lived in New York, which has a 25 percent limit, the debtor filed class action asserting claims under the Fair Debt Collection Practices Act and the New York usury statute.

Under the National Bank Act (NBA), a national bank can charge interest at the rate the state in which the bank is located allows, and the bank can use that rate for loans it makes to borrowers residing in other states (12 U.S.C. § 85). The NBA therefore protects national banks from state law claims for usury. In this particular case, the Second Circuit decided the third-party debt purchaser was: 1) not a national bank itself and 2) was no longer acting on behalf of the bank from which it had purchased the debt, and therefore could not assume the national bank’s state law preemption.

The issue with this decision is that, while it specifically concerns third-party debt buyers and limits the actions of such third parties within marketplace lending, the Second Circuit claims it will not “significantly interfere” with a national bank’s powers under NBA. But, the Court also recognized that this decision could serve as a warning for other national banks and might decrease the amount of interest a national bank charges in certain states. Some in the industry have also shown concern that the implications of this decision might interfere with lending overall in states with lower usury limits.

Uncertainty from this ruling has played a role in the creation of the white-label partnership model, where the bank maintains a more significant role throughout the life of the loan.

There have been fixes floated around Washington to address the valid-when-made doctrine, including S. 1642 and H.R. 3299. Both bills would require the rate of interest on certain loans to remain unchanged after transfer of the loan. Before stepping down from the position in November 2017, former Acting Comptroller of the Currency Keith Noreika supported these legislative approaches.

"True Lender Theory"

Determine which party has the predominant economic interest in the transaction.

The true lender theory continues to surface in marketplace lending partnership models. A decision from the Central District of California in a case the CFPB filed highlights this issue, when the court ruled a third-party small-dollar loan purchaser was the true lender, as it:

- Deposited enough money into the financial institution which was used to fund loans
- Purchased all of the financial institution's loans before the borrower made any payments on the loans
- Guaranteed a minimum payment and an administrative fee

The court found the third party "bore the risk of default as well as the regulatory risk."

Massachusetts federal court is also currently using the true lender theory in a case where a small business is filing suit against a fintech company, claiming that its partnership with a bank is set up to avoid state usury and consumer protection laws, and that the fintech company is merely "renting" the bank's charter to originate usurious loans.

Depending on the types of lending products offered, other regulations and legislation that may affect fintech companies and the financial institutions partnering with them in marketplace lending include:

- Bank Secrecy Act
- Bank Service Company Act
- Regulation E (Electronic Fund Transfer Act)
- Electronic Signatures in Global and National Commerce Act
- Regulation B (Equal Credit Opportunity Act)
- Regulation V (Fair Credit Reporting Act)
- Regulation F (Fair Debt Collection Practices Act)
- Investment Advisers Act of 1940
- Section 1036 of the Dodd-Frank Act (UDAAP)
- Section 5 of the Federal Trade Commission Act (UDAP)
- Securities Act of 1933 (Public Offerings and Private Offerings)
- Securities Exchange Act of 1934 Risk Retention Rule
- Servicemembers Civil Relief Act
- Regulation P (Title V of the Gramm-Leach-Bliley Act)
- Regulation Z (Truth in Lending Act)

Risks to Assess When Entering a Marketplace Lending Relationship

Contemplate making all consumer financial protection policies of the marketplace lender joint policies of the bank.	The bank should not overlook call monitoring of origination and servicing call centers as applicable.
Consider whether to require ongoing compliance monitoring and testing of the marketplace lender's origination and servicing processes match the bank's own internal monitoring and testing.	Continually review the marketplace lender's website to ensure timely updates are completed.
Become familiar with the marketplace lender's compliance training and consider involving the bank in the review and approval stages for training.	Consider having the bank receive and review all customer complaints to the marketplace lender.
Evaluate the marketplace lender's vendor risk management program.	Establish a suspicious activity capture and referral process before any loans are funded to enable the bank to file timely, accurate and complete SARs, as necessary.
Explore different required testing scenarios, including an annual independent audit of the marketplace lender's compliance management system, including risk-based transaction testing.	Create a separate oversight program within the bank's CMS for managing compliance risk from strategic partnerships with marketplace lenders.
	A previous issue of the FDIC's Supervisory Insights highlights further risks and advice for mitigating those risks.

Fintech and Online Marketplace Lending Moving Forward

With the focus on fintech from regulatory bodies and the numerous laws and regulations that may apply to a certain product or service, it is clear that fintech regulation is both rapidly changing and shaping the growth of fintech itself.

For marketplace lending, the valid-when-made doctrine and the true lender theory only serve as two of the issues that could transform the field. The further adoption of specific regulation and guidance for online marketplace lenders will also play a significant role in shaping the industry. With its significantly large projections, this is clearly a space that will continue to garner considerable regulatory attention.

Undoubtedly, regulators will continue to develop their approaches with respect to fintech over the coming months and years. At Capco Finance Risk and Compliance, we are positioned to help new entrants and those established in the space consider all of the regulatory and legal risks of their products and service offerings. For example, in the marketplace lending space, Capco can work with your compliance management systems, help with third-party risk management and improve consumer complaint management to help your financial institution meet regulator and investor expectations. We can also dive further into regulation-specific areas, like fair lending, to maximize your internal resources and remain compliant. The Capco Center of Regulatory Intelligence will monitor changes as they affect the fintech space, so please reach out to us at Capco.CRI@capco.com with any questions or concerns.

CONSIDERATIONS IN REGULATORY CHANGE MANAGEMENT

As a discipline, change management is a critical element for any business navigating into the future and hoping to achieve growth goals. The varying needs of internal and external stakeholders create decision points that require the right resources to ensure a balanced and effective outcome.

For the financial services industry, regulatory change, including rulemaking, guidance and enforcement actions, can have deep impacts on an institution's success. Failure to understand and respond to these changes could lead, at best, to inefficiencies that delay optimal performance. At worst, an institution may become the subject of severe supervisory actions that could ruin its reputation and result in financial losses.

This article provides an overview of an effective regulatory change management (RCM) program, and evaluates a recent regulatory change to highlight the criticality of following through on the RCM process.

Building Blocks for Regulatory Change Management Program

Regulatory Applicability

The foundation for any program is to dissect the organization's structure and define the universe of regulations applicable to each business unit, product or service, delivery channel and other internal program subject to regulatory oversight. The result of this exercise is a reference document that helps inform the other elements of the program, particularly as stakeholders determine action steps for emerging regulatory events.

Like an institution's risk assessment, a regulatory applicability document (sometimes called a map or matrix) is by its nature dynamic, and evolves through both internal and external forces. RCM stakeholders must have access to information from the compliance management, product development and other enterprise functions that could modify any facet of the way an institution does business.

Regulatory Tracking

Generally, individual RCM initiatives start with an instance of regulatory change that comes from a regulatory agency, such as a proposed or final rule, updates to examination procedures or topic-specific guidance. Based on the regulatory applicability document, an institution may be wise to implement a tracking program to ensure timely reporting of regulatory change events as they are announced.

Whether done internally or via a third party, the tracking element of the RCM program should ensure proper scope of coverage that mirrors the regulatory applicability document, and as a best practice, goes beyond the current applicability to improve awareness of peer and industry trends.

Regulatory Impact Analysis

Upon collecting the basic details of a new regulatory event, the appropriate personnel must determine if there is a real impact to the institution. The types of questions asked here include, but are not limited to:

- Are there new regulatory requirements that apply to our existing offerings or processes?
- Could this change how we do business?
- Are there other stakeholders that need to know this information and be involved in more in-depth analysis?
- Could this impact various components of the Compliance Management System (CMS)?
- What is the industry saying about this?

The end result of this initial impact analysis could range from an "all hands on deck" red flag to a simple and quick acknowledgment that no action is required. Additionally, it may be prudent to document each of these decision points to show how active and responsive the institution's RCM program is.

Institutional Response and Strategy

The next step in the RCM program is to conduct more in-depth analysis and develop a strategy as to how the institution will implement changes as a response to the regulatory change event. RCM stakeholders may need to engage resources throughout the organization, including project managers and other subject matter experts, to define the relevant requirements and project scope.

A critical part of this step of the program is to define a communication strategy that ensures the right people receive the right information at the right time. This includes not just internal communication regarding the strategy itself, but also training materials and, if necessary, regulatory and customer communication.

As part of this strategy, the institution should consider how a specific regulatory change could alter the institution's initial regulatory applicability document. The RCM program itself is not immune to the results of its own process.

Implementation of Changes

At this stage, the institution executes its strategy and implements the appropriate changes. As noted earlier, it is a best practice to clearly document what actions the institution took, who was involved and what the ultimate impact was for all involved parties (including customers).

Case Study:
Managing the Stages of the Department of Labor's Fiduciary Rule

Below is an example of how one regulatory change could result in multiple events over multiple years, and require RCM stakeholders to constantly re-evaluate the ongoing project to determine if new developments have an impact on the project plan. Something as basic as a delay in the effective date could wreak havoc on the project timeline, though the relief provided could prove invaluable. Every regulatory change will likely be different, so the RCM program must be attentive and nimble to be able to respond to the whirlwind of change in a timely manner.

April 20, 2015

DOL Proposes Fiduciary Rule

- Would anyone in our institution meet the proposed definition of "fiduciary" for employee benefit plans?
- Who needs to review the proposal to determine if our institution wants to submit a public comment?
- Who are the key stakeholders who would be involved in implementing the new requirements within the institution?
- To what extent shall stakeholders begin planning and developing a strategy to implement, assuming the rule eventually becomes final?

April 6, 2016

DOL Releases Final Fiduciary Rule

- Gather key stakeholders for an initial review session.
- How do the new requirements apply to the institution?
- Develop a strategy for implementation, including a timeline.
- Evaluate policies and procedures that will be impacted.
- Engage internal and third-party subject matter experts to help.

October 17, 2016

DOL Issues FAQs on Conflict of Interest/Fiduciary Rule Exemptions

- Did we interpret exemptions correctly?
- Do we need to refine the requirements in our project plan?

March 1, 2017

DOL Proposes Extension to Fiduciary Rule

- How would this impact our timeline?
- Is our project far enough along that a delay would cause problems?
- Shall we submit a public comment?

March 10, 2017

DOL Issues Bulletin in Fiduciary Rule Enforcement

- Add information to project requirements, as needed.

April 4, 2017

DOL Finalizes Exension of Fiduciary Rule Applicability Date

- How does this impact our timeline?
- Do we offer stakeholders any relief in delivering requirements?

May 22, 2017

DOL Issues Guidance on Fiduciary Rule

- Does this present any new information that would alter our project requirements?
- How do we memorialize this in our policies and procedures or training materials?

July 6, 2017

DOL Requests Information regarding the Fiduciary Rule and Prohibited Transaction Exemptions

- Shall we submit a public comment?

August 31, 2017

DOL Proposes Additional Extension of Transition Rule Period for Fiduciary Rule Exemptions

- How would this impact our timeline?

November 27, 2017

DOL Finalizes Proposed Exension from August

- How does this impact our timeline?
- Should we or can we roll back any processes that have already been implemented?

Conclusion

The RCM program components above represent a high-level overview of how an institution may establish a program. The fact remains that financial institutions have varying sizes, levels of complexity and regulatory oversight models. It is imperative that an institution cultivates a program that makes sense considering these variables.

Once established, the RCM program must be prepared for small-scale and large-scale shifts, and consider both internal and external forces in how to interpret, understand, prepare and execute. These activities could have enterprise-wide impact, so do not minimize or forget their importance.

ABOUT CAPCO

Capco is a global business and technology consultancy dedicated to the financial services industry, plus a dedicated energy division. Capco delivers innovative solutions in Banking & Payments, Capital Markets and Wealth & Asset Management, designed to withstand market forces, continual regulatory change and increasing consumer demand.

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