

# fs viewpoint

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## *Let's make a difference:*

Managing compliance  
and operational risk in  
the new environment



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## *Point of view*

**Banks have been managing compliance since the first loan application was signed. But today, expanding compliance expectations are pushing compliance programs to the brink.**

### **Soaring costs**

*Without a new approach to compliance and operational risk management, many banks will continue to face high costs and losses in the form of escalating litigation, penalties, and staffing needs.*

Today the scope of compliance is much broader and its impact on business far greater than ever before.

The scope and nature of compliance have evolved from a series of rules-based banking regulations to a much broader, grayer area that now includes operational and customer experience risk—areas that are more difficult for banks to monitor and control. This regulatory environment poses new challenges:

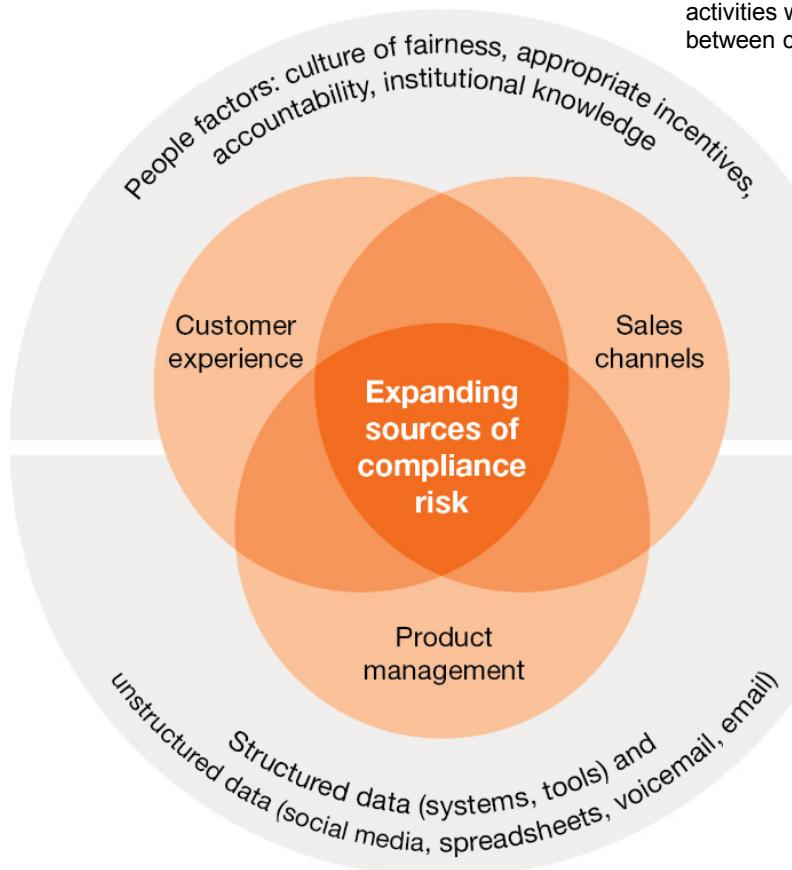
- Operational and compliance risks have become more complex and entwined, increasing the potential for failed processes that cause customer confusion and compliance control breakdowns (such as with mortgage foreclosures and payment stripping).
- Banks must identify unfair, deceptive, or abusive acts or practices (UDAAP), requiring:
  - New approaches to fair lending and disparate impact analysis.
  - Customer complaint identification, management, and analysis.
  - Control over vendors that have customer impact.
- An expansion of rules- and principles-based supervision is raising the level of overall risk.

Meanwhile, compliance functions at most banks haven't been built to cope with these emerging operational and customer experience risks.

In particular:

- The role of compliance in the customer experience continues to be limited. In the line of business (LoB) domain, we have observed a lack of resources, communication, and capabilities with which to meaningfully address compliance issues in these key areas.
- Lack of operational business expertise and talent is making it difficult for compliance groups to provide constructive input and “credible challenge” to the lines of business.
- Current “check-the-box,” rules-based testing processes do not provide adequate coverage over operational and customer risk—particularly since that risk is poorly defined, which requires a strong understanding of end-to-end business processes.

**For most of our clients, the current state of compliance has led to inconsistent application of compliance rules and a customer experience that is anything but seamless.**



We see examples of compliance challenges in three key areas—products, sales channels, and customers—due in part to a lack of ownership of compliance risks and responsibility.

The broader source of compliance risk now more than ever is embedded throughout business activities where customer experience, sales, products, and processes meet.

#### **Customer experience**

- Inconsistent customer sales and servicing experiences across channels.
- Products vary in how they utilize channel-specific features.
- Multiple handoffs or manual activities when transitioning between channels.

#### **Sales channels**

- Definition of primary characteristics, preferences, and behaviors for targeted customer segments differs between products in the same category.
- Limited tracking of usage and channel mix variations within and across products for each segment.
- Inconsistent fee treatment and product availability across customer segments, especially in comparison with demographic characteristics described in the Equal Credit Opportunities Act.
- Differing communications, sales, and service approaches for customer segments using similar products.

#### **Product management**

- Unclear or complex disclosures, terms, and conditions. Inconsistent fees and product availability across customer segments, especially when compared with characteristics described in the Equal Credit Opportunities Act.
- Overlapping products that meet the same customer need without clear differentiation.
- Differing communications, sales, and service approaches for customer segments using similar products.
- Large number of product variants, leading to errors in application processing and difficulties maintaining and managing changes.

**In our work with banking clients, we have witnessed first hand the challenges posed by the expanding scope of compliance.**

Our experience tells us that compliance requirements are supported by multiple groups across the bank, and at varying levels of maturity. Compliance processes, systems, and reporting are fragmented and in silos.

| Program elements    | Operational risk programs <sup>1</sup> | AML/BSA | Rules based compliance (Reg CC, Z, etc.) | Broader sources of compliance risk |
|---------------------|--|---------|--|------------------------------------|
| Policy              | ●                                      | ●       | ●  | ○                                  |
| Analytics reporting | ○                                      | ●       | ○  | ○                                  |
| Training            | ●                                      | ●       | ●  | ○                                  |
| Risk assessment     | ○                                      | ●       | ●  | ○                                  |

**Maturity Level** - represents typical state of development

● : High   ○ : Medium   ○ : Low

### Fragmented compliance groups

At most banks, compliance responsibilities are spread throughout the organization and have developed independently over time, leading to varying processes for risk assessment, testing, and reporting. Some program areas—notably compliance with the “alphabet” regulations (such as Regs CC and Z)—are very mature, but haven’t taken advantage of the newer analytics capabilities used by their peers working with the Anti-Money Laundering/Bank Secrecy Act (AML/BSA) to identify higher-risk areas and streamline testing.

### Inadequate focus on emerging talent needs

Several banks are already revamping their compliance systems and programs to address changing compliance expectations.

However, we’ve found that compliance enhancement efforts focus too narrowly on compliance functions (the second line of defense), often failing to cultivate new competencies needed to address emerging risks (such as customer impact risk).

### Unclear scope of roles and responsibilities

The most widespread obstacle we’ve seen is that the scope of the compliance function’s domain—versus that of the lines of business (the first line of defense)—has not been redefined. As a result, roles and responsibilities for managing emerging sources of compliance risk are not clear.

***The most widespread obstacle we’ve seen is that the scope of the compliance function’s domain has not been redefined. As a result, roles and responsibilities for managing emerging sources of compliance risk are not clear.***

<sup>1</sup> Operational risk programs typically are designed and implemented based on regulatory guidance. Examples include information security, business continuity planning (BCP), and vendor risk.

## ***Leading banks are rethinking their organizational structures, adopting new competency models, and taking a fresh look at new approaches.***

We see leading banks shifting from a narrow, rules-based, technical focus to one that extends to business acumen, improvement of the customer experience, and operational understanding.

Given today's higher stakes and broader sources of risk, industry leaders are now looking to the business to take on more responsibility for managing compliance risk.

Banks are also expanding the role of compliance to include collaboration with external stakeholders and a new focus on consumer interactions. In leading banks, that role may now include working with regulators, customers, the community, and advocacy groups to propose and support solutions and reduce product complexity.

**Leaders are leveraging analytics to do a better job of preventing compliance failures and to manage risk more efficiently and cost-effectively.**

The power of analytics includes both preventive control and providing management with trends and fact patterns that assist firms with more effective and cost-efficient risk management.

Financial institutions can use data mining and analysis software to:

- Monitor consumer risk and prevent UDAAP.
- Proactively manage compliance risk and inform business decisions.
- Drive efficiency and quality and better utilize forensic testing, by linking analytical platforms to compliance-testing programs.

**Banks are streamlining compliance processes and testing to reduce reliance on "brute force" and to enable smarter testing that leads to actionable insights.**

Leaders are standardizing compliance processes across the organization to boost productivity and promote greater cross-functional insights. Process standardization and design, utilizing an output-driven approach, limits waste and enables implementation of more value-added activities.

Technologies are being deployed to increase coverage and focus on anomalies through automated testing and forensic testing techniques. Shared platforms are also improving the efficiency of the compliance management process through automated issue tracking, streamlined reporting, storage and retrieval of work products, and knowledge management.

***Given the major changes in the compliance and regulatory landscape and the resulting long-term impact on banks, incremental adjustments will simply not be enough.***

Banks should design a new approach that integrates operational and compliance risk programs.

| Area of change | Current state  | New, integrated approach  |
|----------------|--|---|
| Approach       | <ul style="list-style-type: none"> <li>The operational and compliance risk programs operate individually and use separate system platforms for scenario assessments, risk and control assessments, issue tracking, and testing.</li> <li>Customer experience programs are generally disconnected from compliance risk programs.</li> <li>Efforts in implementing processes to address new compliance requirements are focused on initial compliance with less attention paid to sustainability, resulting in quick fixes that become “business as usual.”</li> <li>Reporting is primarily prepared at the enterprise level and focuses on historical events. Line-of-business (LoB) reporting is not standardized, limiting the ability to draw cross-LoB insights.</li> </ul> | <ul style="list-style-type: none"> <li>The operational and compliance risk programs are coordinated and follow a consistent standard and single platform. Integrated reporting and analytics provide compliance and LoB management with a more constructive, single view of risk.</li> <li>Products and channels are continually assessed from multiple perspectives—customer experience, business performance, operational, and compliance performance—and adjustments are made when needed.</li> <li>Compliance risk management processes are subject to continuous improvement and are evaluated based on aligning value (outputs and outcomes) with activities.</li> <li>Analysis of structured and unstructured data is forward-looking and shapes the compliance agenda for upcoming risk assessments, monitoring, and other framework components.</li> </ul> |
| Team           | <ul style="list-style-type: none"> <li>The organizational structures supporting the compliance and operational risk programs are separate and siloed and not consistent across LoBs. Roles, competencies, and level of focus also are variable. The current level of resources committed is not sustainable.</li> </ul>  | <ul style="list-style-type: none"> <li>Operational risk and compliance organizations are rationalized, and roles and competencies are defined and filled. A more efficient and effective team delivers improved results.</li> <li>The LoB leads the compliance risk management effort, with centralized compliance functions providing support and oversight. The end-to-end compliance risk team includes operational and customer experience competencies.</li> </ul>   |
| Scope          | <ul style="list-style-type: none"> <li>Centralized compliance functions often have a narrow view of compliance risk that is disconnected from the broader operational risk picture.</li> <li>Compliance testing is siloed within individual lines of business, and as a result, provides inconsistent application of compliance policy and procedures.</li> </ul>  | <ul style="list-style-type: none"> <li>Teams and tools may be integrated to obtain a broader view of sources of operational and compliance risk, including business practices, customer interactions, and products and channels.</li> <li>Standardized compliance testing allows the bank to gain greater insight into compliance issues and increase productivity of compliance efforts.</li> </ul>  |

**Relying on “business as usual” just doesn’t cut it anymore. In our view, banks need to incorporate fresh thinking, new systems, and innovative approaches to produce the expected results.**



We recommend that banks take a look at these six innovative approaches to drive change and meet the game-changing requirements of today’s operational and compliance risk environment.

| Approach                       | What is it?   | Benefits   |
|--------------------------------|---|--|
| Integrate risk                 | Integration of operational and compliance risk functions to address gaps in risk coverage emerging from different products, channels, and customers.  | <ul style="list-style-type: none"> <li>• Addresses rising regulatory expectations.</li> <li>• Integrates current operational risk silos and improves coverage of emerging sources of compliance risk.</li> </ul>   |
| Simplify products & channels   | A proactive, customer-centric approach to simplify products/channels and improve the customer experience while easing compliance burdens.   | <ul style="list-style-type: none"> <li>• Facilitates compliance with regulations through standardized products.</li> <li>• Reduces potential compliance issues arising from product development, sales team, and customer confusion.</li> </ul>                          |
| Leverage analytics             | The use of new technology and data analysis techniques to provide an improved understanding of business practices and activities across product/channel features, how they impact customers, and how they compare to peers. | <ul style="list-style-type: none"> <li>• Prevention of UDAAP and disparate treatment.</li> <li>• Improved reporting and transparency to stakeholders.</li> <li>• Better understanding of regulatory impacts and ability to influence future changes.</li> </ul>          |
| Standardize compliance testing | Standardizing compliance testing processes across the organization while boosting return on investment and quality through new forensic testing techniques.   | <ul style="list-style-type: none"> <li>• Reduces time spent manually searching for compliance exceptions, enabling more focus on deriving insights.</li> <li>• Supports banks’ ability to meet growing regulatory requirements with a more sustainable model.</li> </ul> |
| Adopt lean principles          | Lean principles create a mindset of continuous improvement and eliminate non-value-added activities/outputs across compliance activities.   | <ul style="list-style-type: none"> <li>• Improves quality and effectiveness by focusing efforts on increasing value and eliminating unnecessary work.</li> <li>• Reassesses organizational structures and capabilities to boost productivity.</li> </ul>                 |
| Manage change                  | A set of program and project management methods that helps drive more sustainable results by making new compliance requirements “stick” in business operations.   | <ul style="list-style-type: none"> <li>• Meeting project and program objectives faster with improved quality.</li> <li>• Increased financial discipline to get more out of resources invested.</li> </ul>  |

**Change is not easy.  
Effective change  
management requires  
both transformational  
leadership and strong  
teamwork across  
the organization.**

Banks must overcome many hurdles in order to keep pace with an expanding volume of regulatory requirements while balancing impacts on people, processes, and technology.

Here are some of the most common issues we've heard from our clients, and how we've worked with them to overcome them.

“It’s difficult to get the buy in needed from multiple groups to integrate the risk functions and supporting processes.”

Because of the widespread impact of risk integration across the bank, it’s more important than ever to enlist broad executive-level ownership and support. The project team should include key individuals from the LoB, compliance, and operational risk.

“We don’t want to interfere with related in-flight projects that are already tackling changes to the compliance function.”

The compliance risk program should be managed holistically across the organization, with definition of scope as a priority. Current efforts should be properly planned and integrated with operational risk programs.

“We just don’t have the resources to make big investments in new tools and testing approaches now.”

Leverage and extend existing forensic tools set in place (such as those used for AML/BSA) to reduce initial investments. Once initial wins have been demonstrated, a business case can be developed to expand the analytics toolset as part of a larger compliance testing strategy.

***In a risk and regulatory environment that is constantly evolving, to stand still is to move backwards.***

**Banks that take a backseat approach face significant risks:**

- Inability to grapple with the continued complexity in complying with regulators' expectations.
- Continued rising cost of non-compliance, which is now measured in the billions of dollars, resulting from litigation, penalties, and the cost of remediation. This increasing cost is also reflected in increased staffing in first, second, and third lines of defense.
- Compliance failures continuing to increase reputational risk and threatening to impose a significant drag on overall business performance—both for individual institutions and the industry as a whole. Consider the business impact of:
  - Negative news on customer satisfaction and retention.
  - Higher opportunity costs and slower growth.
  - Heavily publicized non-compliance—fueling a cycle of public and legislative demand for enhanced regulation and enforcement.

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## *Competitive intelligence*



*Our observations of industry  
practices.*

**Most banks are not equipped to meet the expectations of today's regulatory environment in a sustainable way. There are many steps they can take to begin evolving their programs.**

|   | Current state  | Transition state   | Target state   |  |
|---|--|--|--|--|
| <b>Integrate risk</b>                   | <ul style="list-style-type: none"> <li>Compliance risk aggregation and reporting</li> <li>Risk assessment, monitoring, and testing</li> <li>New products</li> <li>Training</li> <li>Policies and procedures</li> </ul> | <ul style="list-style-type: none"> <li>Aggregating and reporting compliance risk in a meaningful way is a challenge. Most reporting is high-level, qualitative information based on underlying compliance activities.</li> <li>The second line of defense has assumed primary responsibility for designing the risk assessment, monitoring procedures, and testing approach, but has had challenges implementing these processes in the lines of business (LoB), where most compliance risk resides.</li> <li>The scope of compliance is being reshaped to cover new compliance risk sources and definitions (customer, product, and operations risk).</li> <li>Traditional compliance functions have been designed to detect non-compliance with rules, and are not equipped to detect broader risks emerging from operations and customer interactions.</li> </ul> | <ul style="list-style-type: none"> <li>The LoB take the lead in shaping the approach, setting priorities to focus on new sources of compliance risk, and implementing standardized compliance and risk management procedures in the business. The organization commits appropriate expertise to project teams.</li> <li>LoB leadership begins integrating compliance and operational risk programs. This includes organizational alignment as well as rationalization of the risk assessment, monitoring, and testing efforts.</li> <li>Compliance risk reporting is improved through enhanced qualitative information as well as the introduction of analytics to measure and monitor high-impact risks.</li> </ul> |  |
| <b>Simplify products &amp; channels</b> | <ul style="list-style-type: none"> <li>Multi-competency teams</li> <li>Product rationalization</li> <li>Simplification of channels and customer interactions</li> </ul>  | <ul style="list-style-type: none"> <li>A rules-based approach to product management and sales channels has focused on customer disclosures and transaction handling.</li> <li>New product compliance risk assessments have focused on rules-based compliance, with improving consideration of unfair, deceptive, or abusive acts or practices (UDAAP) and disparate treatment.</li> <li>The existing product portfolio has not been consistently assessed for compliance risk and is more reactive to emerging industry issues.</li> </ul>   | <ul style="list-style-type: none"> <li>The LoBs begin to prioritize products and channels with the greatest operational and compliance risk—those that are the most complex. They identify and plan for simplification efforts.</li> <li>A multi-competency team is formed to drive change for selected products and channels. A team with a winning strategy and early success stories demonstrates what can be achieved.</li> <li>A case for simplification change, supported by a project charter, is developed. The effort is backed by a proven approach: team, method, standards, and tools.</li> </ul>  | <ul style="list-style-type: none"> <li>A broad-based organizational team, made up of team members with competencies in operational risk, compliance, product, channel, and customer experience, collaborates to continually assess, plan, and drive simplification.</li> <li>Scenario-modeling capabilities are employed to monitor for potential compliance issues emerging from business operations and customer experiences.</li> <li>A bank-wide simplification program drives change through product rationalization and simplification, channel and customer interaction simplification, and technology simplification.</li> </ul> |

***Most banks are not equipped to meet the expectations of today's regulatory environment in a sustainable way. There are many steps they can take to begin evolving their programs (continued).***

|   | Current state  | Transition state  | Target state   |
|---|--|---|--|
| <b>Leverage analytics</b> <ul style="list-style-type: none"><li>• KRI dashboards</li><li>• Scenario modeling</li><li>• Predictive analytics</li><li>• Statistical analysis</li></ul>                              | <ul style="list-style-type: none"><li>• Most compliance reporting exists at the enterprise level and is non-standard at the LoB level. Reporting is qualitative in nature and is derived from a variety of compliance risk activities. Quantitative metrics and KRIs for compliance do not exist or are not widely used.</li><li>• Aggregation methodologies are largely judgmental and are not consistently applied across the organization.</li><li>• Reporting attempts to bring together a horizontal view for issues which cut across LoBs (such as Flood or Anti-Money Laundering).</li><li>• Scenario analysis of business impacts is not typically performed or is ad hoc in nature.</li></ul> | <ul style="list-style-type: none"><li>• Reporting mechanisms and KRIs are inventoried to identify the spectrum of aggregation methodologies and tools.</li><li>• Compliance risk reporting is improved through enhanced qualitative information as well as the introduction of analytics to measure and monitor high-impact risks.</li></ul>  | <ul style="list-style-type: none"><li>• A KRI dashboard provides compliance views by LoB and enterprise-wide. The dashboard has both vertical and horizontal drilldown capabilities.</li><li>• Quantitative information is available utilizing "big data" type methods to search and analyze structured and unstructured data sources.</li><li>• Analysis is forward-looking and shapes the compliance agenda for upcoming risk assessments, monitoring, and other framework components.</li><li>• Scenario modeling is utilized to identify the impact of emerging regulations and macroeconomic events in concert with stress testing and other initiatives.</li></ul> |
| <b>Standardize compliance testing</b> <ul style="list-style-type: none"><li>• Standard testing approach</li><li>• Integrate compliance and operational risk testing</li><li>• Increase forensic testing</li></ul> | <ul style="list-style-type: none"><li>• Compliance testing is non-standard across the enterprise and relies primarily on manual methods.</li><li>• Compliance and operational risk testing are performed in silos.</li><li>• Strong forensic testing capabilities are established in selected compliance areas (such as fair lending, call monitoring for suitability, Anti-Money Laundering/Bank Secrecy Act (AML/BSA) for transaction monitoring). Forensic testing is used on an ad hoc basis for most other areas.</li></ul>   | <ul style="list-style-type: none"><li>• A standardized and integrated compliance and operational risk testing framework is developed.</li><li>• The most critical compliance risks are identified and used to implement a proof of concept for forensic testing.</li><li>• Mid- and long-term transition plans are created for lower compliance risk areas to leverage a standard testing approach.</li><li>• Existing forensic technologies that can be leveraged (data sources, "big data" tools, case management workflow, electronic discovery/computer forensic tools) are inventoried to create a temporary center of excellence.</li></ul> | <ul style="list-style-type: none"><li>• A compliance testing center of excellence is maintained (approach, methods, tools, data sources) to support consistent testing standards bank-wide.</li><li>• The LoBs adopt forensic testing techniques to analyze structured and unstructured data. These techniques enable them to cover a much wider range of compliance and operational risks in a compressed timeframe.</li><li>• Compliance testing strategies are used to identify, plan, and execute testing in a more sustainable way by matching the scope, extent, and method of testing to the risks.</li></ul>   |

***Most banks are not equipped to meet the expectations of today's regulatory environment in a sustainable way. There are many steps they can take to begin evolving their programs (continued).***

|                              | <b>Current state</b>   | <b>Transition state</b>   | <b>Target state</b>   |
|------------------------------|--|---|---|
| <b>Adopt lean principles</b> | <ul style="list-style-type: none"> <li>Value-added activities and outputs</li> <li>Continuous improvement</li> </ul> <ul style="list-style-type: none"> <li>Compliance risk management processes have been built up over the years at the enterprise and LoB levels. These processes are often not standardized and a significant level of resources is needed to support them. Often, it is unclear how these activities align to compliance goals and how they create value.</li> <li>Efforts in implementing processes to address new compliance requirements are focused on initial compliance with less attention paid to sustainability, resulting in quick fixes that become "business as usual." Selected compliance processes may improve in subsequent years (such as AML/BSA processes).</li> </ul> | <ul style="list-style-type: none"> <li>Outcomes and outputs of compliance risk management are inventoried and defined at the enterprise and LoB levels. Activities are mapped to the organizational resources consumed to assess the cost of generating value.</li> <li>Focus is placed on the most critical, complex, and/or costly processes to provide immediate benefits. Key compliance risk processes are selected to pilot lean principles by aligning value (outputs and outcomes) with activities, and then rationalizing non-value-added activities.</li> </ul> | <ul style="list-style-type: none"> <li>Compliance risk management processes are subject to continuous improvement and are evaluated based on aligning value (outputs and outcomes) with activities.</li> <li>The operational impact of new compliance requirements is considered to manage critical path efforts, redeploy workflow, and reduce process variability.</li> </ul>   |
| <b>Manage change</b>         | <ul style="list-style-type: none"> <li>Program management</li> <li>Project management</li> <li>Organizational change management</li> </ul> <ul style="list-style-type: none"> <li>Enterprise project management approaches for compliance-related projects are utilized; however, a program management approach is less consistently applied.</li> <li>Project teams often do not have the requisite operations, customer, or sales channel experience to fulfill project goals.</li> <li>Projects have difficulty transitioning from implementation mode to sustainable operations. Organizational change management is considered but not consistently applied.</li> </ul>   | <ul style="list-style-type: none"> <li>Projects are assessed to determine whether teams have the right capabilities and are using effective program, project, and change management approaches. Issues identified are addressed on a prioritized basis.</li> </ul>  | <ul style="list-style-type: none"> <li>A business transformation approach helps to establish that compliance initiatives have given thorough consideration to operational and customer impacts. Operational sustainability is achieved on day one of project completion.</li> <li>Compliance programs are formally defined and managed as a portfolio. This enables better management of business impacts, interdependencies, timelines, and budgets.</li> <li>Organizational change management is leveraged to drive compliance initiatives and promote readiness for sustainable and effective operations.</li> </ul> |

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## *A framework for response*

*Our recommended approach  
to the issue.*

**New thinking is needed to design and implement the right approach to meet the challenge. Real change, not more of the same, is needed.**

### **Make the case for change**

*Based on our experience, a transformational strategy that incorporates the six approaches in this framework can most effectively drive meaningful change.*

Each of the six approaches discussed in this framework has the potential to make a significant impact alone or as part of a broader plan. Banks should assess their current capabilities and develop a tailored strategy.

Banks can position themselves for success by designing their strategy in the center and executing on opportunities in the business.

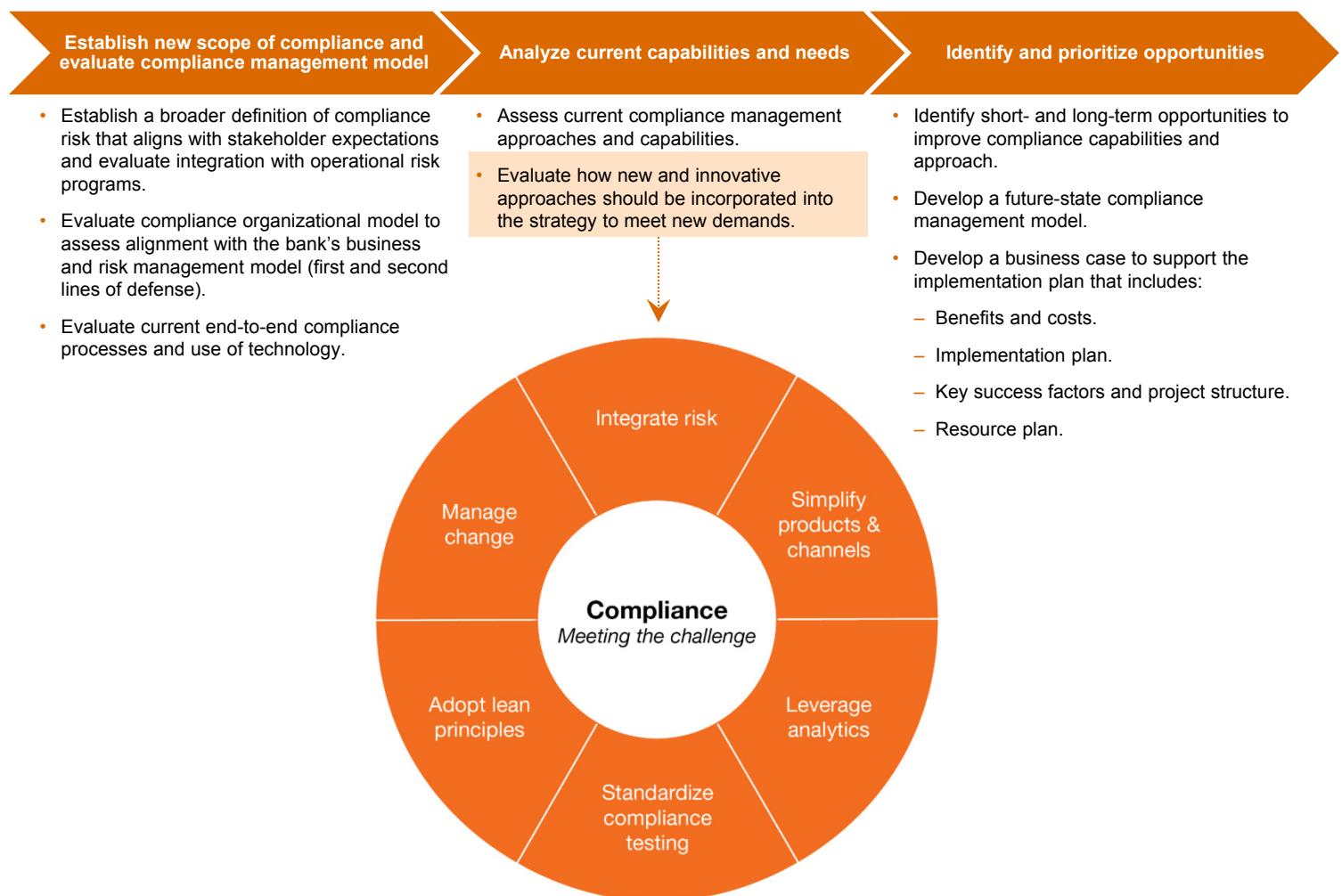


### **Key success factors include:**

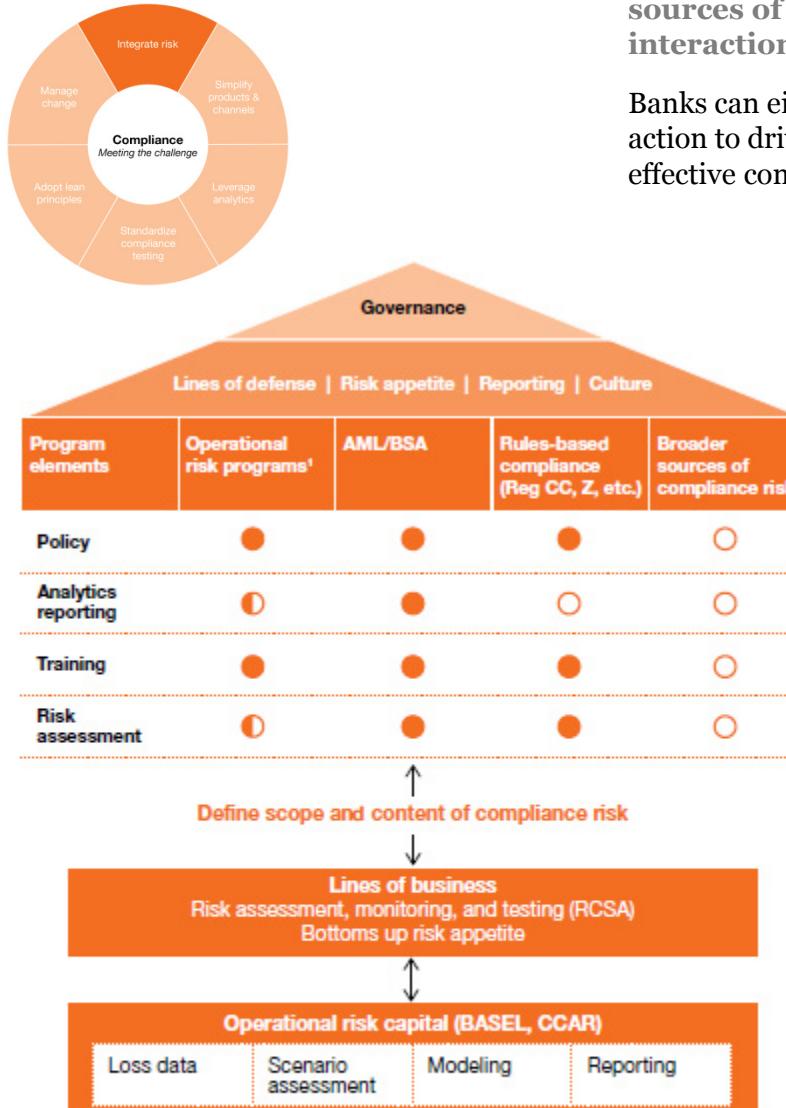
- Broad executive-level ownership and visible support for change, including leaders representing a cross-section of the organization committing time, resources, and subject matter expertise to the effort.
- A shared vision for stakeholders that includes organizational change and agreement on the new scope of compliance risks.
- A change in mindset and competencies within the compliance management function.
- An actionable plan that demonstrates a clear understanding of gaps, outlines a roadmap to the future state, and is supported by a sound business case.

## Moving to the future state

A clear roadmap can identify near-term improvement opportunities and set forth a longer-term strategy for developing an appropriate compliance capability with the tools, data, skills, and processes to support it.



## Integrate risk



The current fragmented approach to managing operational and compliance risks at most banks means that they are not well-positioned to address newly recognized sources of compliance risk emerging from products, sales channels, and customer interactions.

Banks can either drive incremental change to address risk coverage gaps, or view this as a call to action to drive top-down integration of operational and compliance risk, paving the way for more effective compliance and positioning banks for the future.

### Key risk integration principles

#### Getting the right risk coverage

- Line-of-business (LoB) management and operation and compliance risk functions should team to design an integrated approach that helps to establish risk coverage. LoB management should lead this effort, and the second line of defense should provide oversight and compliance expertise.

- Scope, content, and testing of LoB risk and control self assessments (RCSAs) need to be integrated, validated for risk coverage, and linked to the risk appetite cascade.

- Enhance current transaction-based process flows to include focus on customer interactions, third parties, and product variation.
- Form the right team—active participation by LoB management, operational risk, and compliance risk will help to establish that the right questions are being asked related to broader sources of risk.

#### Leveraging tools and data

- The approach and tools for managing operational and compliance risks should be standardized and designed to promote usability and focus.
- Utilize analytics to gain a fact-based understanding of compliance risk sources.

#### Reporting

- Integrated reporting and analytics should cover operational and compliance risks in a dashboard with federal, state, and local aggregation models.
- Operational and compliance risk programs will continue to have specific regulatory reporting requirements (such as compliance, information security, business continuity planning (BCP), vendor risk, etc.) that the integrated approach should support.

<sup>1</sup> Operational risk programs typically are designed and implemented based on regulatory guidance. Examples include information security, BCP, and vendor risk.

## Simplify products & channels



Banks are using a structured approach with a top-down assessment process that will enable them to implement a simplification program across multiple portfolios and product types.



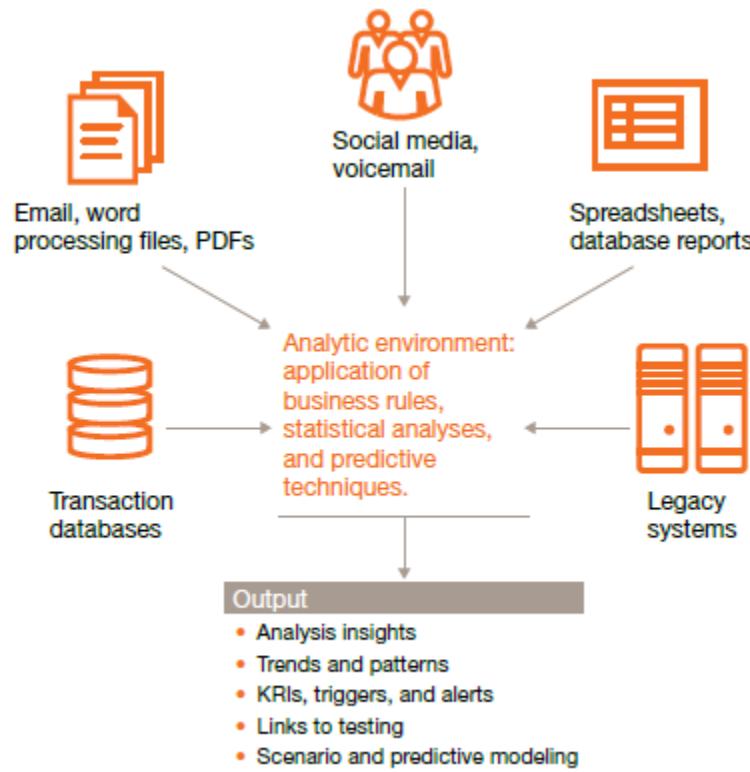
## Leverage analytics



Analytics should be designed to measure and model the sources of compliance risk for each business in which sales channels, product management, and customer experience meet.

The use of data analytics is not a new concept for banks. Compliance efforts to support fair lending, suitability, and AML/BSA have employed analytics for years, and these capabilities can be leveraged to extend to new sources of compliance risk.

The power of analytics includes both preventative control and providing management with trends and fact patterns that assist banks with more effective and cost-efficient risk management.



### Key analytics design principles

#### Compliance key risk indicators (KRIs)

- Promote an end-to-end design that includes risk assessment, analytics, research, and reporting.
- Create risk assessments that consider process and business rules, people interactions, sales channels, product management, and the customer experience.
- Use a broader definition of compliance and operational risk that focuses on business practices, customer impacts, unfair, deceptive, or abusive acts or practices (UDAAP), and disparate treatment.
- Enable the use of predictive and scenario analytics, along with detective analysis.
- Incorporate both structured and unstructured data sources as inputs to the analytic process.

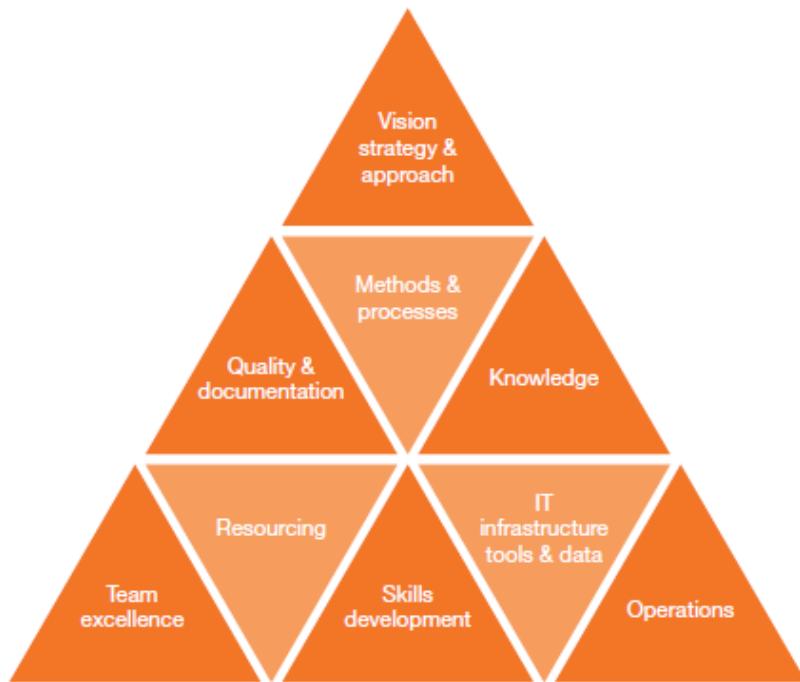
#### User experience

- Design a dashboard user interface with drilldown capabilities to support effective research and communication.
- Develop a federal, state, and county aggregation model to address governance, monitoring, and reporting needs across the first, second, and third lines of defense.
- Use an agile development methodology to address the evolving needs of stakeholders and continuously adapt analytics to future business needs.

## Standardize compliance testing



### Compliance testing framework



Banks should assess their compliance testing program to identify opportunities for expanding risk coverage, improving efficiency, and standardizing testing approaches organization-wide.

Enhancements to the testing program should address the components of the compliance testing framework. We recommend that the effort include several key activities:

#### Standardizing testing approaches

- Implement a robust compliance governance framework to promote bank-wide consistency and support the future-state compliance operating model.
- Assess current compliance testing practices against industry leading practices and adopt enhancements where needed.
- Consider developing a compliance center of excellence to drive adoption of approved testing methods and tools..

#### Integrating compliance and operational risk testing

- Bring together subject matter specialists across key groups (product, sales, customer experience) to share knowledge and enhance risk and compliance organization-wide.
- Conduct workshops and training to increase awareness of emerging sources of compliance risk for the LoBs, compliance, and operational risk groups.

#### Expanding the use of forensic testing

- Develop visual analytics dashboards and instruments to support enhanced data analysis and reporting.
- Assess the current technology environment and develop a business case for investing in the tools needed to support enhanced automation and analytics.
- Identify risk drivers through the development of risk segmentation models and seek opportunities to design a predictive model based on findings from root cause and trend analyses.

## Adopt lean principles



**How do we make our work easier, without sacrificing quality?**

Compliance processes, organizational structures, and supporting technology have accumulated over several years in a rules-based environment. We have found an output-driven analysis using lean principles is effective at identifying waste and designing and implementing more value-added activities.

To begin, banks should inventory and define outputs of compliance risk management processes at the enterprise, LoB, and business-unit levels. By focusing on the most critical, complex, and costly processes first, banks can increase near-term benefits.

| Stakeholder value   | Process efficiency  | Performance management   | Organizational capabilities  | Mindset and behavior   |
|---|---|--|--|--|
| <ul style="list-style-type: none"><li>Have a clear understanding of who the stakeholders are and what they value.</li><li>Inventory outputs from compliance management; estimate resources required to produce outputs and assess alignment of value and effort.</li><li>Determine outputs that can be eliminated, combined with others, or reduced in scope.</li><li>Identify entirely new approach to outputs (for example, using a top-down vs. bottom-up approach).</li></ul> | <ul style="list-style-type: none"><li>Design processes for new approaches.</li><li>Identify and remove non-value-added activities (for example, waste).</li><li>Verify that the work flows without interruption from obstacles or bottlenecks.</li><li>Design the system so that it reacts to changing demand and pulls work through the process (flexibility and agility).</li></ul> | <ul style="list-style-type: none"><li>Make results and defects easy to see, with performance tied to strategy.</li><li>Collaborate and foster an open discussion of business problems and solutions.</li><li>Assign clear roles and accountability for results.</li><li>Monitor meaningful key performance indicators, and revise improvement plans.</li></ul> | <ul style="list-style-type: none"><li>Rethink organizational structure, roles and responsibilities, and capabilities.</li><li>Empower process owners for continued improvement to owners' critical thinking skills and the ability to identify waste.</li><li>Align cross-functional teams around end-to-end value streams to see the big picture.</li></ul> | <ul style="list-style-type: none"><li>Shift mindsets and behaviors to embrace continuous improvement.</li><li>Create enterprise-wide ownership for improvement led by process stakeholders.</li><li>Develop intolerance for activities that do not add value.</li><li>Challenge the status quo by constantly asking: "Is this as good as it could be?"</li></ul> |

## Manage change



This new wave of compliance requirements and expectations needs to be met with efficient and effective methods to promote successful change.

Unprecedented levels of new compliance matters are being addressed concurrently, many of which have significant business model impacts. Volume, complexities, and interdependencies across several domestic and global compliance requirements require program-level and project-level management (such as Dodd-Frank, the Consumer Financial Protection Bureau, BSA/AML, and FATCA).

This degree of change requires program/project management methods commonly used in business transformation.

In addition, banks have an opportunity to drive more business value out of these costly compliance initiatives. When planning system and process changes needed to meet compliance requirements, banks should also consider the potential for revenue generation and cost-saving opportunities. Project teams should include an appropriate mix of business and compliance expertise to take advantage of these potential opportunities.

### What are the guiding principles of transformational change management?

- Senior level sponsorship and governance**
  - Assigning senior-level management ownership and responsibility for the program and creating a governance structure with the proper business and supporting function representation.
- Creating a strong project management function**
  - Creating the management discipline and reporting capabilities to support the execution of the effort in both the center and the LoBs.
  - Constructing strong implementation teams and applying financial accountability on a project-by-project basis.
- Utilizing proper project resources**
  - Helping to establish that there is the appropriate quantity of resources devoted to the project, the essential competencies are fulfilled, and the appropriate mix of compliance, operational, and business experience is on the project team.
- Intelligent use of information regarding rules**
  - Developing a framework matching the relevant rules, jurisdictions, etc. to the organization; monitoring and assessing the impact of rule changes on the business.
  - Determining where compliance efforts should use a global standard and where accommodations should be made for local rules.
- Managing key stakeholders throughout the process**
  - Addressing the needs and expectations of regulators and other key stakeholders from approach to execution.
- Helping to establish effective change management**
  - Focusing on the readiness to enact sustainable change in human capital and processes. The aim is to help to establish that the focus extends beyond just the build phase and into the future ongoing operating model.

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## ***How PwC can help***



*Our capabilities and  
tailored approach.*

## **What makes PwC's Financial Services practice distinctive.**

|   |  |
|---|--|
| <b>Integrated global network</b>              | With 34,000 industry-dedicated professionals worldwide, PwC has a network that enables the assembly of both cross-border and regional teams. PwC's large, integrated global network of industry-dedicated resources means that PwC deploys the right personnel with the right background on our clients' behalf whenever and wherever they need it.  |
| <b>Extensive industry experience</b>          | PwC serves multinational financial institutions across banking and capital markets, insurance, asset management, hedge funds, private equity, payments, and financial technology. As a result, PwC has the extensive experience needed to advise on the portfolio of business issues that affect the industry, and we apply that knowledge to our clients' individual circumstances.   |
| <b>Multi-disciplinary problem solving</b>     | The critical issues financial institutions face today affect their entire business. Addressing these complexities requires both breadth and depth, and PwC service teams include specialists in strategy, risk management, finance, regulation, operations, and technology. This allows us to provide support to corporate executives as well as key line and staff management. We help address business issues from client impact to product design, from go-to-market strategy to an improved economic model to proper functional practices across the organization. We excel at solving problems that span the range of our clients' key issues and opportunities, working with the heads of the business, risk, finance, operations, and technology. |
| <b>Practical insight into critical issues</b> | In addition to working directly with clients, our practice professionals and Financial Services Institute regularly produce client surveys, white papers, and points of view on the critical issues that face the industry. These publications—as well as the events we stage—provide clients new intelligence, perspective, and analysis on the trends that affect them.  |
| <b>Focus on relationships</b>                 | PwC US helps organizations and individuals create the value they're looking for. We're a member of the PwC network of firms with 180,000 people in more than 158 countries. We're committed to delivering quality in assurance, tax, and advisory services.  |

We look across the entire organization—focusing on strategy, structure, people, process, and technology—to help our clients improve business processes, transform organizations, and implement technologies needed to run the business.



| Client needs                         | Issues we help clients address   |
|--------------------------------------|--|
| <b>Manage risk and regulation</b>    | <ul style="list-style-type: none"> <li>Building a risk-resilient organization.</li> <li>Managing ERP investment and project execution risk.</li> <li>Safeguarding the currency of business; keeping sensitive data out of the wrong hands.</li> <li>Helping to establish capital project governance and accountability.</li> </ul> |
| <b>Build effective organizations</b> | <ul style="list-style-type: none"> <li>Establishing effective strategic sourcing and procurement.</li> <li>Realizing competitive advantage through effective sales operations inventory planning.</li> <li>Transforming the close and consolidation process to work for you rather than against you.</li> </ul>                    |
| <b>Reduce costs</b>                  | <ul style="list-style-type: none"> <li>Driving efficiency through shared services.</li> <li>Redesigning finance to realize efficiency and competitive advantage.</li> <li>Taking control of cost through effective spend management and cash forecasting practices.</li> </ul>   |
| <b>Leverage talent</b>               | <ul style="list-style-type: none"> <li>Defining and implementing an effective HR organization.</li> <li>Rethinking pivotal talent.</li> </ul>  |
| <b>Innovate and grow profitably</b>  | <ul style="list-style-type: none"> <li>Reshaping the IT function into a source of innovation.</li> <li>Transforming business information to drive insight and fact-based decision making.</li> <li>Evaluating acquisition and divestiture strategies to position the organization for the future.</li> </ul>                       |

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## *Appendix*

*Select qualifications.*

## **Compliance operating model re-engineering and cost control—US affiliate of a global bank**

|                 |   |
|-----------------|---|
| <b>Issues</b>   | <p>The client was the US affiliate of a global bank that was experiencing significant difficulty in meeting heightened US regulatory expectations, including those related to AML/BSA, consumer protection, and safety and soundness regulations.</p> <p>As a result, the client was exposed to spiraling costs of non-compliance, due to significant regulatory fines and settlements. At the same time, the institution had to retain additional headcount in the compliance function to cope with a significant volume of remediation initiatives, provide assistance and guidance to the business, and to test controls.</p>  |
| <b>Approach</b> | <p>PwC was retained by the client to help re-engineer the institution's compliance operating model and capabilities. PwC helped the institution:</p> <ul style="list-style-type: none"><li>• Align its compliance risk assessment process more closely to the methodology employed by the initiation for operational risk and control self-assessments.</li><li>• Consolidate compliance and operational risk assessments on a shared platform.</li><li>• Revamp the operating model for controls testing, by standardizing tests and enabling the near-shoring and offshoring of certain testing activities.</li><li>• Improve the quality of oversight and compliance, by implementing a compliance assurance function.</li></ul> |
| <b>Benefits</b> | <p>The client has been able to better manage its projected cost of compliance while improving its ability to promote that it is in compliance with heightened regulatory expectations.</p>  |

## ***Operational and compliance risk integration—US regional bank***

|                 |  |
|-----------------|--|
| <b>Issues</b>   | A major US regional bank was encountering significant difficulties in extracting management insights from the compliance risk assessments and operational risk assessments performed respectively by its compliance and risk functions. The bank was unable to take an integrated, portfolio view of its compliance and operational risks along product and organizational lines. It performed a number of overlapping assessment and testing activities at significant cost yet without meaningful return.  |
| <b>Approach</b> | PwC was retained by the risk function to improve the risk assessment process by better supporting both the operational and compliance risk assessment needs of the organization. PwC helped the institution: <ul style="list-style-type: none"><li>• Design and implement an integrated risk assessment methodology to assess compliance and operational risks by major product and enterprise process, as well as along organizational lines.</li><li>• Document the value chains supporting major products and enterprise processes, such as mortgages and treasury management. The resulting process flows are used as key inputs into risk assessment activities.</li><li>• Redesign the operating model for testing controls and for managing issues identified through testing and other channels.</li><li>• Streamline reporting for operational risk and compliance risk management purposes..</li></ul> |
| <b>Benefits</b> | The institution has gained a far deeper understanding of its risks and risk management activities end-to-end, across the value chains. In particular, hand-off points between organizational units are better understood by the corresponding stakeholders, and regulatory compliance-related and operational controls can be placed in a common process context, thereby facilitating rationalizations.   |

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*To have a deeper conversation,  
please contact:*

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PwC FS Viewpoint, August 2013. [www.pwc.com/fsi](http://www.pwc.com/fsi)

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