Compliance as a differentiator

Strategic regulations worth watching

As mentioned earlier, the list of regulations is extensive and ever-changing. In this paper, we will focus on the key regulations impacting financial institutions today and the opportunities associated with these regulations. From a strategic perspective, lenders are placing most of their executive-level focus on two regulations that impact all parts of their business:

- Basel (II and III)
- Comprehensive Capital Analysis and Review (CCAR) and Dodd–Frank Act Stress Test (DFAST)

In addition to Basel and CCAR/DFAST, several other regulations, which we will cover in this paper, play a significant role in the day-to-day operations of the business, such as:

- Model and Attribute Governance (Office of the Comptroller of the Currency (OCC) Bulletins 2000–12 and 2000–16)
- Qualified Mortgage (Consumer Financial Protection Bureau (CFPB) driven)
- Know Your Customer/Customer Identification Program

BASEL II AND III

The most significant global regulation, formerly known as The Basel Accords, was introduced initially in 1988 by the Basel Committee of Banking Supervision to establish minimum capital requirements for banks. Nearly 20 years later (2004), the second edition of the accord was established, Basel II, to establish revised minimum requirements for banks based on the level of risk the bank took on. Additionally, Basel II was intended to maintain international consistency among international banks. However, Basel II received criticism for allowing banks to take on additional risk, which is believed to have contributed to the financial collapse. In response to the collapse, Basel III was created in 2010 to strengthen bank capital requirements by increasing bank liquidity and decreasing bank leverage. Basel III not only requires more capital on hand, but also requires that the capital can withstand adverse economic scenarios. Basel III focuses on three primary areas:

1 **BETTER QUALITY CAPITAL**
a stricter definition of core capital, more weight applied to core capital and a stricter regime of deductions

2 **INCREASED CAPITAL REQUIREMENTS**
a substantial increase with a counter-cyclical buffer and even stricter capital requirements for extremely large institutions

3 **ADDITIONAL LIQUIDITY REQUIREMENTS**
two new standards will be introduced to promote short-term resilience to liquidity disruptions and address funding mismatches: the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR)

All financial institutions need a Basel solution in place that provides compliant measures of the risk associated with exposures using an internal ratings based (IRB) system that promotes consistent lending decisions aligned to the institution's objectives and interpretation of Basel standards. However, the level of compliance will vary based on an institution's jurisdiction, type and size.