PART ONE OF A SERIES ON REGULATORY CHANGE

Transforming the Regulatory Agenda

A strategic opportunity for the financial services industry

KPMG

After a tumultuous and uncertain period following the financial crisis, certain aspects of the global regulatory agenda are now generally understood. However, demands on financial institutions to ensure compliance with the new requirements continue to escalate, as scrutiny intensifies from multiple stakeholders that includes rising pressure from regulators, investors, counterparties, and other market participants in a post-crisis environment where compliance demands are now far more intensive and detailed than ever before. Following the crisis, financial institutions have emerged with a larger, more global footprint, which has challenged them to understand and manage regulatory requirements both in more jurisdictions and for more services than ever before. While regulators endeavor to strike a balance between economic growth and greater systemic stability, higher compliance and monitoring standards are nevertheless unlikely to recede and, in some cases, may not even lend themselves to prescriptive rulemakings, as evidenced by the recent international emphasis on addressing certain structural, cultural, and technological deficiencies.

The stakes have never been higher for institutions struggling to address these existing and emerging regulatory mandates, the pace, volume, and management of which continue to be daunting for Boards of Directors, executives, management, and operational staff. There is a critical need for global, horizontal, and vertical views that holistically and efficiently address the current high-risk and high-stakes environment and allow institutions to better integrate new regulations and assess their impact on business and operating models; legal entity structures; existing and contemplated products and services; capital, liquidity, and leverage requirements; and tax obligations.

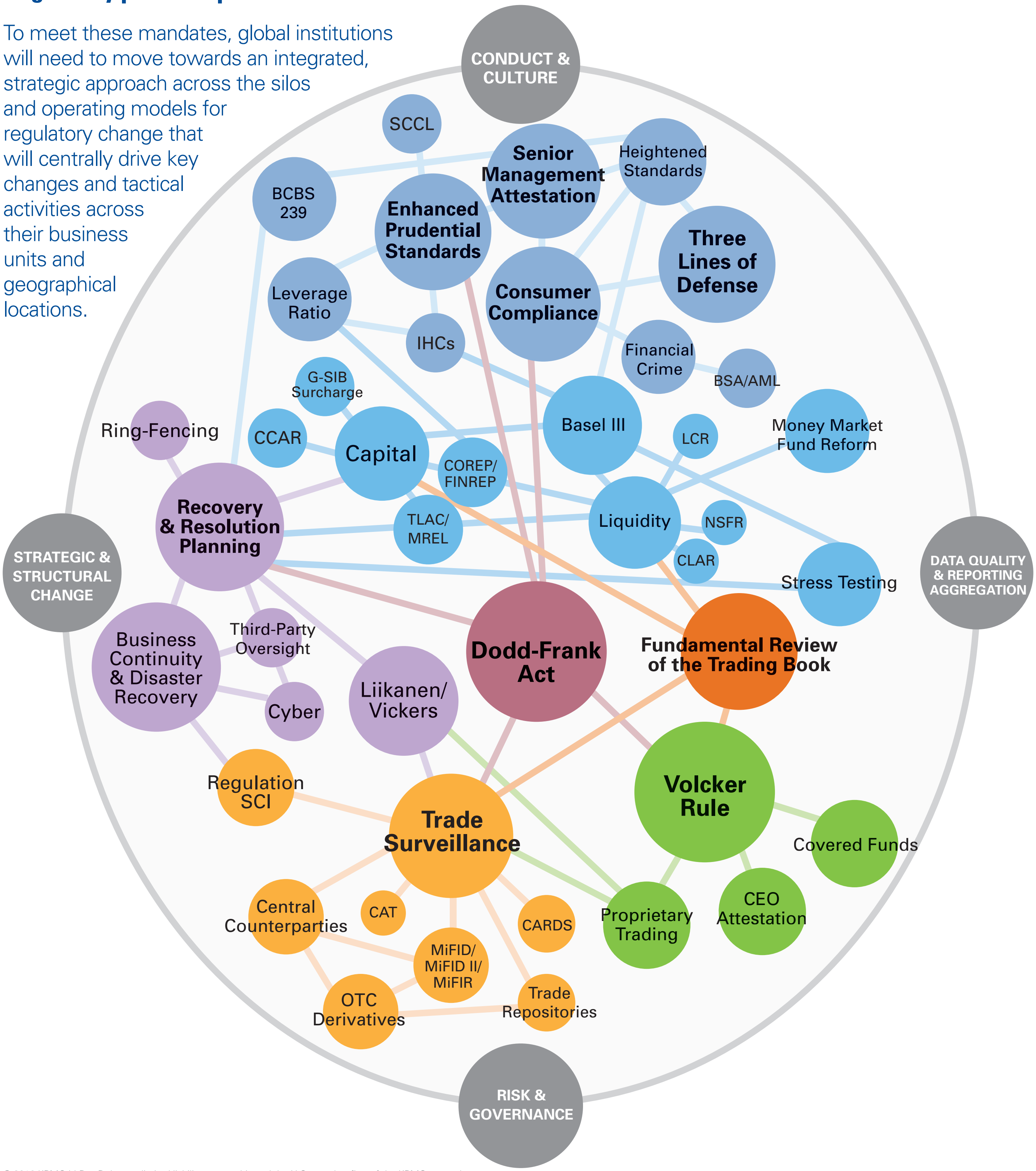
However, addressing these regulatory obligations in a reactive, siloed manner misses the transformational opportunity for institutions to differentiate around cost and gain greater strategic understanding that will add tremendous value and realize significant benefits. By implementing a change management framework that centralizes and synthesizes current and future regulatory demands, institutions can improve coordination across the silos and gain meaningful insights that improve overall performance, ensure risk management frameworks and compliance controls are integrated into strategic objectives, avoid redundancy and rework, and better address regulatory expectations in a practical and efficient way.

Regulatory change management as a conduit for compliance transformation

Regulatory change management is foundational to developing an effective compliance program, as it links compliance controls with obligations, policies and procedures, monitoring, testing, reporting, and ongoing risk assessments.

Regulatory pressure points

To meet these mandates, global institutions will need to move towards an integrated, strategic approach across the silos and operating models for regulatory change that will centrally drive key changes and tactical activities across their business units and geographical locations.



The current state: Reacting and responding to regulatory changes, findings, and risk events

In attempting to effectively manage this dynamic regulatory environment, institutions face myriad challenges that are unlikely to abate. Despite attempts to increase coordination among national financial authorities and international standard-setting bodies, supervisory oversight remains a work in progress entangled in cumbersome, duplicative, and potentially contradictory rules and standards. Regulatory pressures, stemming from multiple jurisdictional authorities for the largest, most globally active institutions, combined with outmoded technologies and siloed organizational structures that span disparate business units, legal entities, and geographical regions, have historically challenged management to holistically evaluate and demonstrate adherence to local and global requirements. Fragmented, impracticable reporting, insufficient documentation of actions taken to address regulatory changes, and inadequate data standards and management controls are also unavoidable consequences of the current reactionary mode.

When these interdependencies are left unidentified or inadequately leveraged, redundant, inconsistent, and ultimately costly output is the inevitable result. In a low interest rate environment replete with depressed earnings and unyielding economic pressures, this current decentralized approach is now more costly than ever before.

Regulatory expectations and the case for change

Evolving Regulatory Environment

External Environment

- Complex regulatory mandates
- Compressed timeline for compliance
- Multijurisdictional nuances

Multiple Regulators

- Commodity Futures Trading Commission (CFTC)
- Consumer Financial Protection Bureau (CFPB)
- European Banking Authority (EBA)
- Federal Deposit Insurance Corporation (FDIC)
- Federal Financial Supervisory Authority (BaFin)
- Federal Reserve Board (FRB)
- Federal Trade Commission (FTC)
- Financial Conduct Authority (FCA)
- Financial Industry Regulatory Authority (FINRA)
- Financial Services Agency (FSA)
- Financial Stability Oversight Council (FSOC)
- Hong Kong Monetary Authority (HKMA)
- Monetary Authority of Singapore (MAS)
- Office of the Comptroller of the Currency (OCC)
- Office of the Superintendent of Financial Institutions (OSFI)
- Prudential Regulation Authority (PRA)
- Securities and Exchange Commission (SEC)

Recent Global Mandates

- Consumer Protection
- Financial Crime (e.g., BSA/AML)
- Culture and Conduct Risk
- Recovery and Resolution Planning
- Structural Reform
- Senior Manager Certification
- FINREP
- FCC Dealer Swaps
- Dodd-Frank Act
- Volcker Rule
- Basel III
- Risk Data Aggregation and Risk Reporting
- MiFID
- CCAR/Stress Testing
- Leverage Ratio

Regulatory Expectations

Forward looking view of change horizon

Senior management's clear understanding of the regulatory impacts and implications

Complete inventory of global regulatory obligations

Coordination and integration across the three lines of defense to effect regulatory change

Minimum disruption of the global financial markets due to change

Bank Challenges

Enterprise level transparency into adherence to regulatory obligations

Strict timelines for compliance with punitive repercussions

Redundancy contributes to a higher total cost of compliance

Understanding the interdependencies between strategic initiatives across the business

Vague and evolving regulatory expectations

Multiple data challenges

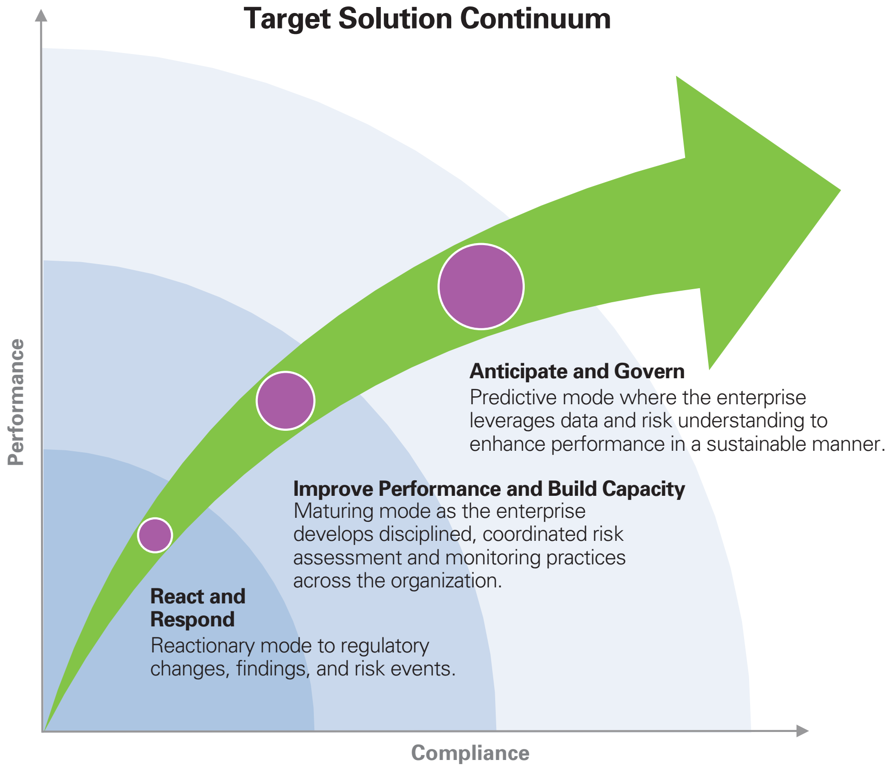
Complex global legal entity structure

Siloed and non-calibrated business and IT environment

The optimal state: Anticipating and governing to sustainably enhance performance

In order to move beyond the current state, institutions should aim to develop a holistic approach to managing regulatory change that starts at the "top of the house" and facilitates understanding and prioritization of change, allocation of resources, and communication to global regulators. This approach to a longstanding industry problem breaks down the current silos and replaces them with a centralized approach that not only addresses both macro- and micro-prudential regulatory demands, but also provides for greater strategic insights and benefits. Specifically, moving towards an enterprise-wide approach provides thorough identification and inventorying of global regulatory obligations, improved understanding of global interdependencies with other strategic initiatives and regulations, and increased organizational intelligence through the creation of strong linkages to existing compliance and risk infrastructure activities and tools such as Risk and Control Self-Assessments (RCSAs), scenario analyses, testing, and monitoring.

Industry transformation



Ideally, a robust regulatory change initiative should be a catalyst for properly assessing performance across the enterprise. This is achieved by providing thorough strategic impact assessments and a centralized, as well as horizontal, view of compliance that allows institutions to confidently execute on regulations and streamline their internal processes. When institutions build an optimal infrastructure capable of providing assurance to regulators and demonstrating "credible challenge" to decision making, (1) consistency and increased alignment with firm strategy is achieved, (2) clear accountability across the "three lines of defense"[1] is evidenced, and (3) strong linkages to compliance infrastructures across multiple jurisdictions are established.

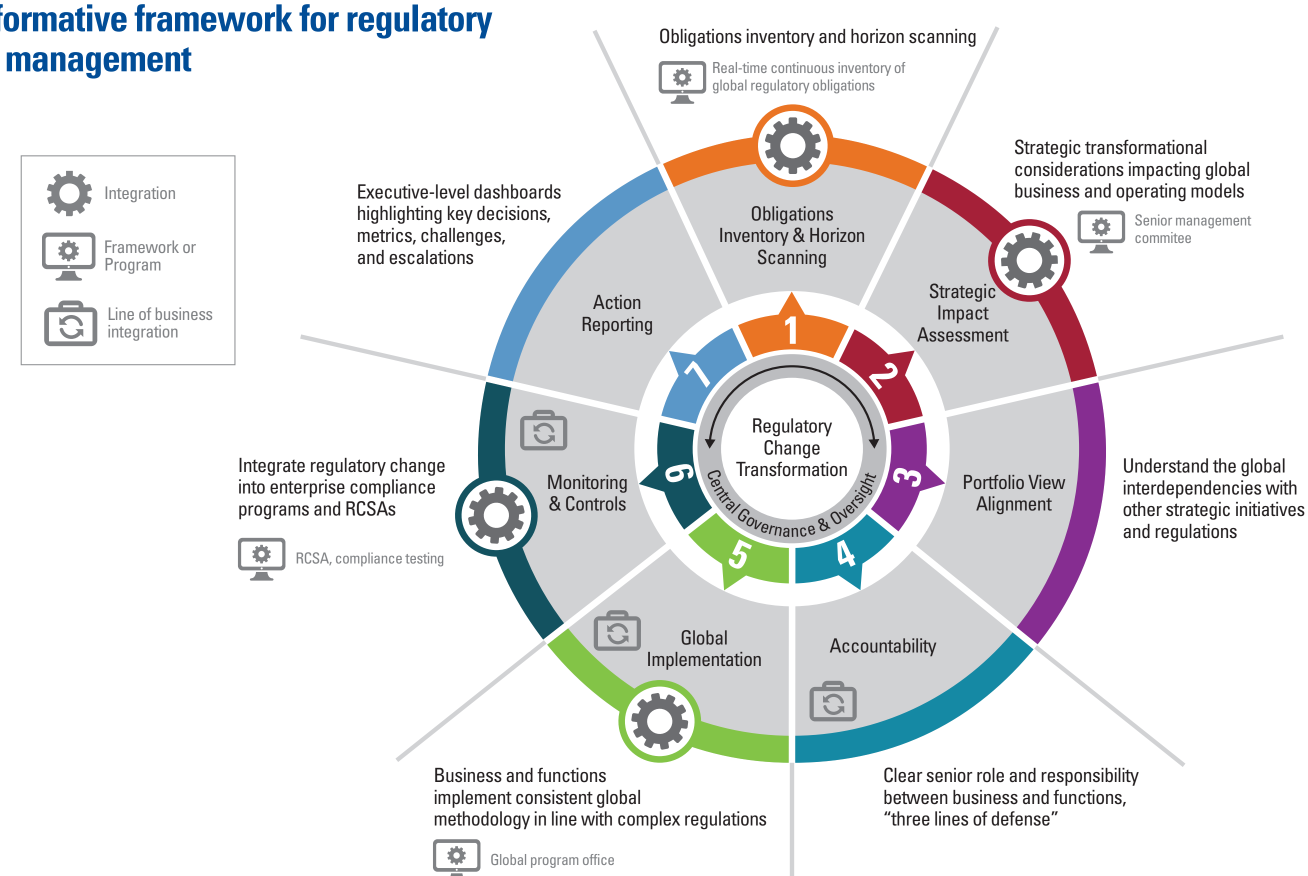
1 The "three lines of defense" model provides a construct for management control, risk control and compliance oversight, and independent assurance by defining clear roles and responsibilities within an organization's wider governance framework: the "first line" includes operational management, the "second line" includes the risk management and compliance functions, and the "third line" includes internal audit. The Institute of Internal Auditors, *IIA Position Paper: The Three Lines of Defense in Effective Risk Management and Control*, January 2013.

A transformative approach to current strategic initiatives

In order to provide a more holistic view of compliance with regulatory changes across the enterprise, KPMG LLP believes institutions should embrace a flexible, adaptable framework for managing change that is wholly aligned to their current strategic initiatives. This transformative framework, which will likely lead to improved compliance and enhanced risk management standards, should be supported by enabling technology that includes both internally developed, and externally provided, governance, risk management, and compliance (GRC) regulatory change tools, and incorporate the following key components working in concert:

- Real-time, continuous inventorying of global regulatory obligations and horizon scanning that identifies new and emerging changes or triggering events;
- Assessing the strategic transformational considerations impacting all aspects of institutions' global business and operating models;
- Creating an aligned view across portfolios in order to understand the global interdependencies among other strategic initiatives and regulations, improve operational efficiency, and enhance cross-border coordination across multiple jurisdictions;
- Establishing accountability and clarity of the roles and responsibilities between the business lines and functional areas as well as across the three lines of defense;
- Implementing a consistent global methodology harmonized with complex regulations and administered by a global program office;
- Integrating regulatory change into enterprise compliance programs and RCSAs as well as conducting compliance testing of the program; and
- Developing customizable, executive-level dashboards that highlight key decisions, metrics, challenges, and escalations—a key deliverable for both Boards of Directors and regulators that aids in facilitating and demonstrating credible challenge.

A transformative framework for regulatory change management



Top 5 strategic actions global institutions can do now to transform their business

1 **Take stock now of your current regulatory change program** and ask if your institution has a strategic, holistic framework that avoids rework and redundancies and where your institution stands relative to leading industry peer practices that may be setting precedents. Adopt a transformative approach that calibrates to regulatory and industry expectations and enables your institution to move along the continuum from reacting and responding to change to anticipating and governing it.

2 **Deploy a strong global process for identifying change** that is risk based and centrally managed, but locally customizable, in order to assess change, categorize for treatment, and adopt protocols and a consistent approach for performing a strategic impact assessment based upon high-risk regulatory change events.

3 **Develop an end-to-end centralized global inventory of obligations** that demonstrates sustainable compliance to regulatory change through visible linkages and laws and rules mapping from regulatory obligations to your institution's policies, procedures, and control structures. Create a common risk taxonomy for mapping obligations by jurisdiction, legal entity, business line, product, and service.

4 **Establish or clarify sustainable regulatory change roles and responsibilities across the three lines of defense**, including the business lines and operational management (first line), the enterprise-wide or corporate risk management and compliance functions (second line), and internal audit (third line). Assess regulatory developments against your institution's existing governance framework to confirm appropriate actions are being undertaken across all three lines.

5 **Improve regulatory change reporting** by developing real-time capabilities and executive-level dashboards that meet Board of Director/C-suite inquiry and regulatory expectations as well as demonstrate compliance to obligations across the global institution and by compliance themes. Proactively identify and address gaps before regulatory action.

IN SUMMARY

Rethinking regulatory change management to achieve greater strategic insights

The current regulatory environment undoubtedly poses significant challenges for financial institutions. Stakeholder demands are not likely to subside in the foreseeable future, but rather, will likely only be replaced with unforeseen ones. Although these challenges are particularly pressing for the largest, most globally active firms, institutions of all sizes will need to consider how to address this growing scrutiny and pressure. While daunting and, in many cases, costly, these demands are not insurmountable when a robust structure is deployed throughout the organization. For savvy institutions of all sizes, a transformative opportunity exists to address these demands in an integrated fashion by providing a strategic framework to managing regulatory change.

Getting this right realizes significant business advantages as well, as it allows institutions to better identify and understand the impact of regulatory requirements and, therefore, the costs and risks of conducting business in different jurisdictions. Institutions will also achieve improved governance, informed risk appetite articulation, and better pricing of their products and services, as they will now be able to better factor in the associated regulatory cost. This ultimately leads to improved strategic decision making on which activities institutions want to engage in, where they want to conduct their business, and what resources will be needed within different jurisdictions.

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