Hey, Regulators: How About More Carrot & Less Stick?

For banks to afford the resources needed to handle today's regulatory demands, it may be time to discuss changes in compliance enforcement with the regulators.

As our organization works to meet the barrage of regulatory requirements, I start to contemplate the ever-increasing regulatory demands placed on financial institutions. Changes to previously enacted regulations and requirements for new regulations continue to inundate our industry. In Canada alone, the regulatory alphabet soup consists of Basel III, AML, FATCA, PEP, and CASL, to name just a few.

I understand the need for such requirements to safeguard financial institutions and consumers who entrust their life savings to us, but I constantly find myself asking, "When is it ever enough?" Too many of these regulations remind me of a spin class. Though I appreciate the exercise, at the end of the day it's just a whole lot of pedaling that doesn't take you anywhere. Similarly, there's an inordinate amount of regulatory spinning that doesn't have much to do with running a solid banking business or protecting consumers, but instead merely provides information to agencies other than the traditional banking regulators.

[Previously from Fred Cook: The '12th Man' -- Leveraging An Untapped Support Resource]

The financial industry remains saddled with the offloading of wants from government and policing agencies ranging from local to federal to international. This means a lot of regulatory work requested of the financial institution is for the benefit of these outside agencies. After the large multinational banking players got spanked in 2008 for holding toxic paper, small and midsized financial institutions now find themselves loaded with international regulations such as Basel III with its capital and liquidity requirements, stress testing criteria, and other outsized rules -- even though this group had nothing to do with that meltdown.

All financial institutions, large or small, must deal with this increasing burden of regulatory overhead. Large financial institutions may have the staff and monetary resources to address these ongoing demands, but it's much more challenging for small and midsized financial institutions, where a single individual often has to wear multiple hats. As the overhead in managing regulatory changes increases exponentially, it puts additional strain on very limited resources available to these institutions, and there seems to be no end in sight.

I do appreciate the need to provide information related to potential criminal activity for the benefit of society at large, but the recent Foreign Account Tax Compliance Act (FATCA) still has me shaking my head. This new regulation requires institutions to report taxable information on US citizens (living in Canada) via the Canadian Revenue Agency

(CRA) to the US government. This means that, when we open accounts in Canada, we're now required to collect customers' citizenship details. We also have to ascertain the citizenship of all our current clients, even though citizenship is not a requirement for opening or servicing a financial account. We are also required to report, through the CRA, details of any US citizen living in Canada with account balances of more $50,000. Ironically, until now asking for personal information such as citizenship was in direct violation of Canada's privacy laws.

How is implementing the overhead of FATCA regulations a benefit to the institution's business? Is it not just doing the US Internal Revenue Service's work for it? I would make the same case for tracking deposits larger than $10,000, reporting suspicious transactions, or determining politically exposed people and providing details about them to government and police agencies -- for free. Though managing these "offloading" regulatory requirements doesn't have any direct benefit to managing the bank's core business, they must be followed to stay in business under threat of substantial fines and criminal charges.

These government and policing agencies have zeroed in on the fact that banking is a necessity, and that the institutions providing these banking services have access to very personal information otherwise not readily available on consumers and their monetary habits. Therefore, my expectation is that our regulations will continue to expand while new ones are added.

Having come to terms with this reality, how do we, as an industry, continue to afford the additional resources that will be required to manage this growing onslaught of regulations, whether for additional staff or new software systems? It may be time for our industry to sit down with the regulators and discuss a change in how they enforce compliance. It's not that financial institutions don't want to be compliant, but perhaps it's time for less stick and more carrot in terms of compensation.

Currently, the only upside of a "satisfactory" regulatory audit rating is that the institution will not receive a whack of the stick -- major fines and/or potential criminal charges for management and directors. Maybe a "satisfactory" regulatory audit rating could also come with a tax credit -- or how about a tax credit on the software needed (whether purchased or internally developed) to support these regulations?

Compensating financial institutions in the form of a carrot approach won't just help these organizations (especially small and midsized ones) afford the resources needed to support this continuously growing regulatory overhead, but it just might also help financial institutions use these carrots to streamline and improve the information these agencies receive.

A few more carrots, please?

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