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INVESTMENT BANKERS

Regulatory Compliance:

Driving the Growth of Bank Technology

White Paper

By John Guzzo, Managing Director

Introduction

Banks and credit unions are encountering a new regulatory framework, in which improved technology and automated solutions are increasingly necessary to maintain compliance. Regulations are having a notable impact on electronic record keeping, social media monitoring, and oversight of traditional marketing practices. The greater focus on enforcement is encouraging financial institutions to become more proactive in meeting regulatory mandates.

Electronic Record Keeping

The first key trend is the demand for electronic record keeping solutions that facilitate compliance. Scalable technologies capable of supporting electronic document delivery and record keeping are vital for lenders, servicers, and sub-servicers as they adapt to a quickly changing landscape.

Dodd-Frank

The full outcomes from the implementation of Dodd-Frank are only starting to have an impact. Perhaps the most visible example is the Consumer Financial Protection Bureau (CFPB). The CFPB is beginning to review copies of monthly statements, consumer payment records, and bills from vendors documenting services related to loan accounts. The agency has also been given responsibilities under Title X of Dodd-Frank that were previously held by other authorities.

For instance, Regulation C, which implements the Home Mortgage Disclosure Act, used to fall under the purview of the Federal Reserve Board. It is now enforced by the CFPB. The CFPB is amending other rules, such as Regulation X of the Real Estate Settlement Procedures Act (RESPA) and Regulation Z as it relates to the Truth in Lending Act (TILA). Both of these mortgage servicing provisions are being updated because of Dodd-Frank.

Some credit unions may seek to outsource their compliance functions in order to focus on lending and serving their clients. Since regulations are constantly changing, it is sometimes more efficient to utilize the offerings of a credit union servicing organization (CUSO) instead of creating an extensive in-house compliance department. In addition, more stringent capital requirements and minimum reserve ratios are becoming the norm. Small institutions are not exempt from many of the regulations put forth by the Basel III standards, which could lead to an array of compliance and record keeping costs for community banks and credit unions.

Section 1073 of Dodd-Frank is another one of the most recent regulations coming into effect. This provision revises the framework established by Regulation E and the Electronic Funds Transfer Act (EFTA). Most significantly, it addresses the fees and taxes involved in payment remittances. These disclosure requirements are likely to present record keeping challenges since there are often multiple intermediaries engaged in processing cross-border consumer payments.

Social Media Monitoring and Oversight of Marketing Practices

The second key trend is how the social media and traditional marketing initiatives of financial institutions are changing. Social media is being used by banks and credit unions to solicit new customers, interact with current account holders, and disseminate information to a broad audience. However, many financial institutions lack a comprehensive internal policy that outlines their social media practices. It is often difficult to maintain proper oversight of these channels, leaving firms vulnerable to reputational and legal risks. Likewise, different supervisory standards apply to real-time communications versus static advertising on social media. This makes it even more crucial to have a proper organizational structure in place to monitor all social media activities.

Certain firms are using monitoring software and other tools to avoid potential compliance issues, which can easily occur when consumer complaints are initiated via social media. Banks and credit unions should also be aware of employee communications on social networks. Even personal social media accounts can be construed by some as reflecting the official views of a financial institution, so it is important to establish a basic amount of safeguards. Moreover, firms that decide to administer their social media accounts through a third-party service provider should exercise proper due diligence in the selection process.

Along these lines, the Federal Financial Institutions Examinations Council (FFIEC) is an interagency government body that develops uniform standards for financial institutions. FFIEC issued several social media guidelines earlier this year, largely focusing on risk management and consumer privacy concerns.

Pertinent rules have also been issued by the Financial Industry Regulatory Authority (FINRA). Registered FINRA members must adhere to extra conditions when archiving their communication records. Regulatory Notice 11-39 offers some guidance on FINRA's social media rules. One of its provisions is NASD Rule 3010, which stipulates that registered representatives must review social media sites to ensure compliance with federal securities law.[1] Broker-dealers also have to contend with rules for recordkeeping and linking to third-party sites. At the same time, smaller retail banks should take notice of these pitfalls as they begin to use social media more frequently.

Enforcement

Traditional marketing practices are being upended as well. A major bank encountered some problems last year with Section 5 of the Federal Trade Commission (FTC) Act, which prohibits "unfair or deceptive acts or practices affecting commerce." Some of the bank's third party call-center vendors were accused of misleading customers who had low credit scores. The vendors allegedly did so by up-selling customers without consent and ignoring requests to cancel unauthorized product purchases. Regulators, especially the CFPB, have been cracking down on predatory marketing practices. Besides levying penalty fees, the violations in this case resulted in a significant amount of money being refunded to consumers.

Conclusion

The strong interest in technology that assists the banking sector with mitigating risk and strengthening compliance is likely to continue. Likewise, technological growth in specific bank niches is often followed by investments in products and companies that offer these innovative solutions. This bodes well in particular for companies that assist with electronic record keeping, as well as those that help monitor social media and traditional marketing efforts.

About Berkery Noyes

Founded in 1980, Berkery Noyes is an independent investment bank that provides M&A advisory and financial consulting services to middle market companies in the information and technology industries. The firm offers skilled transaction management to publicly traded and privately held businesses and private equity groups in both sell-side and buy-side transactions. Berkery Noyes has managed over 500 transactions, ranging from several million to more than four billion dollars in value.

About John Guzzo

John Guzzo is a managing director in the Financial Technology Group at Berkery Noyes. He has worked on over 80 M&A transactions during his career, representing more than $3 billion in value.

References: Bank Systems & Technology. 1"Creating a FINRA Friendly Social Media Plan." March 27, 2012.

SELECTED FINANCIAL TECHNOLOGY TRANSACTIONS COMPLETED BY BERKERY NOYES

Venture
HAS BEEN ACQUIRED BY
Taylor

PRIMUS
HAS MADE AN INVESTMENT IN
G2 Web Services

PredictiveMetrics
Turning Probabilities into Profits
HAS BEEN ACQUIRED BY
SUNGARD AvantGard LLC
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