

## FINANCIAL SERVICES

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#### About Navigant

Navigant Consulting, Inc. (NYSE: NCI) is a specialized, global professional services firm that helps clients take control of their future. Navigant's professionals apply deep industry knowledge, substantive technical expertise, and an enterprising approach to help clients build, manage and/or protect their business interests. With a focus on markets and clients facing transformational change and significant regulatory or legal pressures, the Firm primarily serves clients in the healthcare, energy and financial services industries. Across a range of advisory, consulting, outsourcing, and technology/analytics services, Navigant's practitioners bring sharp insight that pinpoints opportunities and delivers powerful results. More information about Navigant can be found at [navigant.com](http://navigant.com).

# RATIONALIZE CONTROLS USING LEAN SIX SIGMA PRINCIPLES TO COMBAT RISING REGULATORY RISK MANAGEMENT COSTS

## EXECUTIVE SUMMARY

Since the end of 2010, the "Big Six" banks in the United States have spent more than \$180 billion on settlements with regulators related to unsound mortgage practices and other financial misconduct.<sup>1</sup> Improper practices have resulted in increasing regulations and oversight by way of the Wall Street Reform and Consumer Protection Act (Dodd-Frank), which created the Consumer Financial Protection Bureau (CFPB), and the issuance of multiple consent orders from the U.S. Office of the Comptroller of the Currency (OCC) and U.S. Federal Reserve. Banks are incurring significant costs to ensure compliance with evolving regulations by layering controls and resources onto increasingly complex and inefficient processes.

To reduce this burden, Navigant recommends that banks proactively rationalize their internal control structure, taking a holistic approach and incorporating Lean Six Sigma principles. Key Lean Six Sigma principles entail:

- Focusing on improving customer satisfaction,
- Reducing process variation,
- Understanding and improving process flows, and
- Eliminating waste (non-value-adding activities) from processes.

These guiding principles are the foundation of our recommendations below.

## THE RISING COSTS OF COMPLIANCE AND NON-COMPLIANCE

Today, the cost of regulatory non-compliance is high, but so is the cost of compliance. Between 2010 and 2013, after the initial shock of the financial crisis passed, regulators focused on correcting and punishing banks for actions that contributed to the financial crisis by overhauling regulations, levying fines, and initiating lawsuits.

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<sup>1/</sup> The biggest banks have paid \$180 billion in fines since the financial crisis.  
Source: <http://www.marketwatch.com/story/large-banks-have-paid-180-billion-in-fines-since-2007-2014-12-02>

A recent study by Standard and Poor's stated that large banks were expected to spend \$2 to \$2.5 billion on compliance related expenses annually.<sup>2</sup> Analysts are predicting this amount to grow by 6.9% annually as large banks continue to spend on risk management and / or compliance technologies.<sup>3</sup>

Aside from compliance costs, the banking practices that have generated the largest fines from regulations include:

- Loan Servicing Misconduct,
- Product Misrepresentation,
- Market Manipulation, and
- Lack of Employee Oversight.

## HOW TO RATIONALIZE YOUR INTERNAL CONTROL STRUCTURE LEVERAGING LEAN SIX SIGMA PRINCIPLES

Regulatory compliance is a fundamental, expensive objective for any bank. This is especially true when the velocity of change is high and banks address new regulations in a piecemeal manner, creating increasingly complex and inefficient processes. However, banks can reduce the burden of regulatory compliance, increase customer satisfaction, and improve operational effectiveness by proactively rationalizing their internal control structure leveraging Lean Six Sigma principles.

### Gather and Proactively Address VOC (Voice of the Customer) to Improve Customer Satisfaction

A central focus of Lean Six Sigma is to improve customer satisfaction. Many regulations and regulator enforcement actions (such as Dodd-Frank, Consent Orders, penalties, etc.) stem from unfairly treated and unsatisfied customers. A proactive approach to gather and analyze VOC will increase customer satisfaction, help banks stay ahead of the compliance curve, and minimize operational disruptions. Successful institutions actively monitor and review current events, customer complaints, and social media to identify control breakdowns and accurately gauge the sentiment of the customers they serve. In addition, they solicit feedback and engage in open dialogue with regulators to understand and opine on the direction and nature of future regulations (e.g., the CFPB focus has been on consumer protection from malpractice). This allows banks to proactively implement solutions to improve customer satisfaction, address pending regulations, and / or potentially mitigate the need for additional regulations.

### Centralize Regulations and Map to Procedures and Controls to Measure Compliance

Responsibility for regulatory compliance is often divided among numerous stakeholders with inconsistent compliance processes. To ensure regulatory compliance consistency and completeness, a best practice is for legal and compliance functions to maintain an up to date, centralized system of all applicable regulatory pronouncements along with the business units, products, and systems impacted by each regulation. Ideally this system includes a translation of the technical requirements (i.e., regulatory pronouncements) by legal and compliance experts into defined business requirements to avoid misinterpretations and to make comparisons easier. Once regulations are catalogued, they are mapped to existing procedures and controls to measure compliance. This centralized system decreases the likelihood of neglecting regulations, eliminates the need for individual business units to review and interpret regulatory pronouncements in a siloed manner, and helps identify process and control improvement opportunities.

### Eliminate Unnecessary Redundancies to Reduce Variation and Streamline Processes

Lean Six Sigma promotes reducing variation while ensuring regulatory compliance. To do so, forward thinking institutions perform a holistic overlap analysis to identify similar requirements and the limitations associated with each (e.g., loss mitigation mailing timeframes, dual tracking requirements). Rather than trying to comply with each requirement independently, they consider the costs and benefits of focusing on the most stringent requirements. This conservative approach simplifies the operational and internal control requirements and eliminates the need to address future changes until a more stringent regulation is imposed.

Additionally, a similar analysis helps to identify and eliminate redundant procedures and controls. Redundant controls are often rendered ineffective because there is an expectation that another control or individual will be there to ensure regulatory compliance. If multiple processes within an organization have procedures that address the same regulations, there is likely unnecessary overlap and inefficiency. In these instances, less is more. Eliminating redundant procedures and / or applying best practices organizationally and placing more emphasis on well designed, key controls mitigates material and / or multiple risks in an efficient and effective manner.

2/ Standard & Poor's conducted a research in August 2012 on average cost of compliance per year for large banks in the nation since the implementation of Dodd-Frank. This cost does not reflect expected increase in cost from the new CFPB servicing rules. Source: <http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245338539029>

3/ Based on International Data Corporation's latest publication, major banks worldwide are expected to see an average of 6.9% growth on risk management & compliance technology spending. U.S average is expected to be slightly below the global average. Source: [http://www.americanbanker.com/issues/179\\_7/banks-risk-tech-spending-expected-to-grow-steeply-through-2017-1064780-1.html](http://www.americanbanker.com/issues/179_7/banks-risk-tech-spending-expected-to-grow-steeply-through-2017-1064780-1.html)

## Employ Lean Controls to Eliminate Waste

Lean controls ensure regulatory compliance without sacrificing quality, speed, customer satisfaction, and cost efficiency. A best practice is to analyze where there are opportunities to implement preventive and / or automated, key controls that eliminate waste and improve processing speed. For example, the CFPB's Qualified Mortgage rules emphasize income calculations and the CFPB may require banks to provide debt-to-income ratios in future Home Mortgage Disclosure Act data submissions. We have observed elevated opportunities for risk in manual, inconsistent, and / or inaccurate income calculations by bank underwriters and loss mitigation specialists for borrowers with both standard and non-standard income. Detective controls based on sampling catch some errors and require re-work. A better, lean control comprises a clear process for all income calculations across the bank including automatic workflow / decision trees, data validation, and calculations to prevent errors.

## Monitor Controls to Ensure Ongoing Compliance

Top institutions execute periodic internal control reviews to assess their design and effectiveness in ensuring regulatory compliance. The initial review involves the legal and compliance function to validate that each control addresses its related technical requirement(s). Regulators also recommend leveraging external personnel to conduct periodic reviews and provide an independent view of internal controls.

### Summary Chart

The chart below summarizes how financial institutions can proactively rationalize their internal control structure by leveraging Lean Six Sigma principles to reduce the burden of regulatory compliance, increase customer satisfaction, and improve operational effectiveness.

CURRENT STATE	SUGGESTED ACTION	ADDED VALUE
<ul style="list-style-type: none"> <li>Reactive response to customer complaints and new regulations</li> </ul>	<ul style="list-style-type: none"> <li>Gather and proactively address VOC and engage regulators</li> </ul>	<ul style="list-style-type: none"> <li>Ensures real-time understanding of current customer sentiment</li> <li>Identifies controls breakdowns</li> <li>Improves customer satisfaction</li> <li>Reduces need for additional regulations</li> </ul>
<ul style="list-style-type: none"> <li>Disparate housing and delegation of responsibility for compliance with regulatory requirements across departments and systems</li> </ul>	<ul style="list-style-type: none"> <li>Centralize regulatory requirements and map to existing procedures and controls</li> </ul>	<ul style="list-style-type: none"> <li>Eliminates individual reviews and interpretations of regulatory pronouncements</li> <li>Decreases likelihood of neglecting regulations and helps measure compliance</li> <li>Helps identify process and control improvement opportunities</li> </ul>
<ul style="list-style-type: none"> <li>Overlapping regulations</li> <li>Redundant procedures and controls</li> </ul>	<ul style="list-style-type: none"> <li>Consider focusing on most stringent regulatory requirements</li> <li>Eliminate unnecessary redundant procedures and controls; focus on best practices and key controls</li> </ul>	<ul style="list-style-type: none"> <li>Simplifies operational and internal control requirements</li> <li>Reduces variation and streamlines processes</li> <li>Improves control effectiveness</li> </ul>
<ul style="list-style-type: none"> <li>Manual and detective controls</li> </ul>	<ul style="list-style-type: none"> <li>Employ lean controls</li> </ul>	<ul style="list-style-type: none"> <li>Eliminates waste (e.g., re-work)</li> <li>Prevents errors</li> <li>Improves processing speed</li> </ul>
<ul style="list-style-type: none"> <li>Reactive, regulator-driven control reviews</li> </ul>	<ul style="list-style-type: none"> <li>Monitor controls via periodic reviews</li> </ul>	<ul style="list-style-type: none"> <li>Validates control effectiveness</li> <li>Ensures ongoing regulatory compliance</li> </ul>

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## HOW NAVIGANT CAN HELP

Navigant is an independent consulting firm, recognized for its technical competence, innovative solutions, and hands-on approach. Navigant specializes in operations strategy and transformation, regulatory strategy and compliance, and risk management. We have executed large, complex engagements including account / loan level reviews, process improvements, internal control design, and risk assessments. Navigant is the only firm to complete the Independent Foreclosure Review mandated by the OCC. Navigant professionals have a wide range of experience and accreditation including CPAs, CIAs, MBAs, PMPs, Lean Six Sigma experts, financial analysts, industry experts, and former regulators.

We hope that you find this material to be informative. If you have questions, would like additional information, or wish to arrange a briefing for your executive team, please contact us.

