

7 STEPS TO CREATE A LENDER'S COMPLIANCE BLUEPRINT

TARGET AMOUNT

TARGET TERM, MONTHS

TARGET PURPOSE

\$ 25,000.00

24

Asset purchase

Risk Overview

Application Form

Firmographic Analysis

Financial Statement

Bank Statement

Financial Ratio Score

CRITERIA	PARAMETER	SCORE
Profitability	Return on asset, %	3.6
Profitability	EBITDA margin, %	0
Leverage	Total liabilities/Total assets, %	0
Leverage	Equity/Total assets, %	1.5
Size	Equity/Total assets, %	9
Liquidity	Current ratio	3
Liquidity	Quick ratio	3
Growth	Net sales growth rate, %	4.5
Capital turnover	Days sales in outstanding receivables	3
Capital turnover	Days payable outstanding	3
Current position	Latest external outstanding debt/Latest equity capital	0



BENEFITS OF A STRONG COMPLIANCE FOUNDATION

A strong regulatory compliance program supports strategic, long-term growth. It can increase profitability, improve workflows, and reduce potential regulatory issues. In addition, it can protect a lender from the financial and reputation risks associated with a weak compliance infrastructure.

It's no secret that the Consumer Financial Protection Bureau (CFPB) in the US, and the European Banking Authority (EBA) in the EU, are targeting lenders. They have several good reasons.

From a regulator's standpoint, it makes good sense to scrutinize lenders. Especially those that use online channels for account origination, funds transfers, and payments processing as this niche isn't yet as well-controlled as brick-and-mortar businesses. That's why it makes equally good sense for lending professionals to hardwire regulatory compliance into their business model and product design.

It takes the right kind of tools to develop and implement an effective regulatory compliance program. This white paper includes a 7-step plan to help digital and alternative lenders create a comprehensive regulatory blueprint. A working document that can be used to manage an inhouse compliance department, or an outsourced compliance consultant.

Savvy lenders are learning to leverage compliance as an asset, instead of a necessary evil.

Digital and alternative funders cater to younger, tech-savvy prospects and offer simple online applications, fast credit approvals, and instant online funds transfers. FinTech products, in turn, deliver it all in a sexy fintech platform. Unfortunately, the same fintech functionality that supports cutting edge products and services also creates substantial systems vulnerabilities that are easily exploited by cybercriminals.





The latest lender database breach comes from First American Financial Corporation, a mortgage title insurance company in the US that exposed 885 million mortgage records.

These files contained social security numbers, bank account numbers, photocopies of identification like a driver's license or passport, property records, and government property tax records. This was an especially troubling leak because the system didn't need to be hacked. The entire First American database could be accessed by any current or prior client, just by logging on to their own account.

Proactive regulatory compliance management is doubly important for digital and alternative lenders because our landscape changes so quickly. Consumers are fickle. New products and technologies are released constantly. And new regulatory rules are issued on an almost daily basis. The emergence of open banking will probably accelerate the process. However, a solid regulatory compliance foundation will ensure your organization remains on firm ground, even as the marketplace evolves in ways that could never have been anticipated.

RISKS OF A WEAK COMPLIANCE FOUNDATION





A weak regulatory compliance foundation creates several tangible and intangible risks.

Tangible risks tend to be financial in nature, predominantly monetary penalties for noncompliance issues.

These intangible risks often convert to a tangible, quantifiable financial risk in a two-step process. Reputation risk, resulting from the negative press or social media backlash, can:

- Tarnish brand image
- Erode consumer trust
- Eventually, reduce sales revenue

In addition, investors could decide to withhold capital funding just when the company is about to enter a growth phase.

Intangible risks are more complex but just as if not more important to account for than the damage of non-compliance. For example, reputation risk and process inefficiencies.

A short-sighted compliance program can create two additional types of vulnerabilities.



The business model and product features may evolve over time. These changes could require major adjustments to a compliance program that was never designed to support long-term growth with new products or new geographic markets.



Digital lenders are being targeted by regulators. It can be expensive and timeconsuming to manage a regulatory examination.





HOW TO CREATE A REGULATORY COMPLIANCE BLUEPRINT

Regulatory compliance rules are often complex, which can make compliance program development and implementation into an overwhelming exercise. A good first step is to create a blueprint that will guide your task level activities.

Here's our 7-step plan:

1**Assign ownership, and fund the program****2****Map the touchpoints where consumers interact with your business****3****Determine the regulatory guidelines that apply to your business****4****Publish written policies and procedures****5****Launch the compliance program****6****Monitor and update on a regular basis****7****Leverage regtech software, and outsourced compliance resources**



1. ASSIGN OWNERSHIP, AND FUND THE PROGRAM

Start by assigning a director to own the regulatory compliance function. This is an oversight position with executive authority. It should be a CCO (chief compliance officer), or a senior manager who reports to a c-suite executive like the CEO or COO.

A formal program will telegraph to employees and regulators that regulatory compliance is a serious consideration for this lending operation. It's not just an exercise in checking the boxes and satisfying the minimum requirements. Stated another way the program procedures and launch communications will tell employees and regulators whether to take the program seriously or not.

During the first stage of the process it's important for the compliance owner to draft a budget, and for the CFO to fund the program. A well-funded regulatory program with a permanent seat at the executive table leaves no doubt that cybersecurity and compliance are top priorities for this lender. Your compliance program will gain immediate internal support, and it could pre-empt a deep dive examination during a regulatory agency review.

2. MAP CONSUMER TOUCHPOINTS

Regulatory rules are designed to protect consumers. Therefore, the basis of your compliance program will be the touchpoints where prospects and customers interact with your company:

- Revenue model, interest rates, and account fees
- Marketing strategies, advertising messages, and communications vehicles
- Onboarding processes, and new member materials
- Electronic funds transfers
- Transaction activity, and payments processing



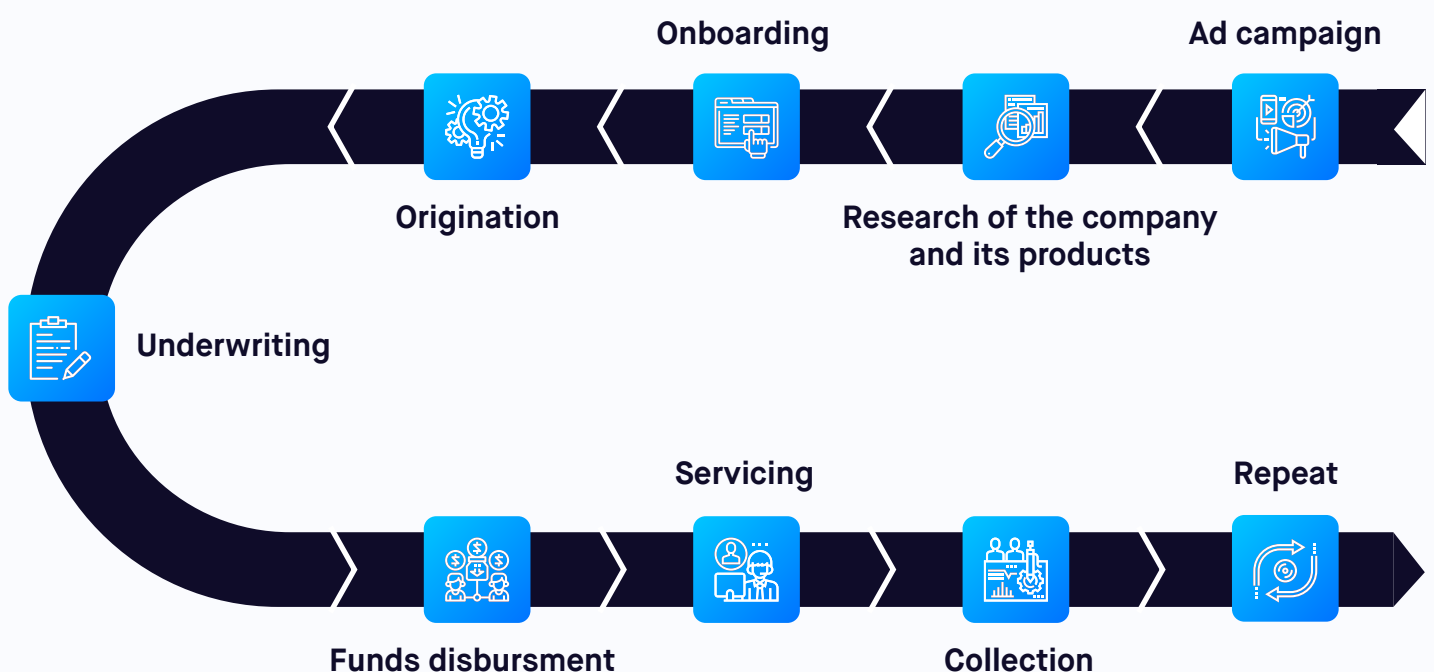
- Customer complaints procedures
- Fraud, money laundering, and unauthorized account use

The customer journey starts with the advertising campaign that attracted the prospect to your lending operation. Then it continues through a number of potential stages depending on credit review policies, account onboarding, funds delivery, and ongoing customer communications.

Review your revenue model, including all interest rates and account fees. Review the product features, including technical support, customer service communications channels, and customer service messages. Review the funds transfer processes, information security, transactions tracking and reporting, and account penalty fees. And finally, review the processes for managing customer complaints, and the processes for detecting and managing fraud and unauthorized activity access.

It may look like a daunting list. However, most of this information should already exist within your different company departments. It's the job of the compliance team to integrate the details into one cohesive map populated with customer touchpoints. Then this map will guide your compliance team, or an outsourced compliance consultant, as they build the optimal compliance stack for your lending operation.

Digital lending customer journey example





3. DETERMINE APPLICABLE REGULATORY AGENCIES AND GUIDELINES

In order to determine the regulatory agencies and rules that govern your lending operation, you'll need to conduct an internal and external review.

During the internal review, you'll examine your business model, revenue model, business plans, marketing plans, ad campaigns, product design, technology platform, operational processes, consumer touch points, and geographic markets. Be sure to consider the launch phase, as well as a growth phase with new products and expansion markets.

During the external review, you'll determine the regulatory agencies that govern your business, as well as all applicable rules within each agency. For example, in the US the CFPB oversees a wide range of lending activities, and the Securities and Exchange Commission (SEC) has a Cyber Unit that oversees Internet-related activities like online advertising and digital funds transfers. Lenders in the US must comply with all applicable federal regulations, as well as state regulations that govern in the geographic areas where a borrower lives.

This is an intense review process. However, the investment can pay back in spades when it means your regulatory compliance program won't require any major changes for several years. There's another strong business rationale for building a regulatory compliance review into the early stages of a launch plan. These guidelines often present opportunities to adapt the product design or business model in ways that will improve your profitability.

For example, an invoice factor might decide to offer a business line of credit (LOC) in addition to purchasing outstanding invoices. It might seem logical to minimize the lending compliance requirements, by entering into a licensing agreement with an established lender and dovetailing on their regulatory compliance program.





This strategy could backfire in two ways.

1

Regulated lending organizations are often required to ensure that their strategic alliances adhere to all the same standards that guide their own internal business practices.

2

Regulatory rules could prevent the invoice factor from sharing interest income and account fees generated from the business LOCs.

Alternative funders often believe that lending compliance is an expensive undertaking. However, a cost-benefit analysis prior to launch could lead them to adopt a different business model that delivers substantially higher returns.

Even though the compliance review process may be intense, the investment can pay back in spades if as a result, your regulatory compliance program won't require any major changes for several years.

4. PUBLISH WRITTEN POLICIES AND PROCEDURES

It's important to document and publish your compliance policies and procedures. Such publications ensure that every employee understands the importance of regulatory compliance, as well as the individual tasks they need to perform in order to administer the program.

Regulatory agencies typically read these documents as the first step in their audit, because it's an efficient way for them to identify compliance gaps.





Well written, comprehensive policies and procedures can be a lender's best defense because they go a long way towards gaining the auditor's confidence and pre-empting a more intense examination.

Your compliance publications should include a Standards Overview and a Policies and Procedures Manual.

Standards overview

The Standards Overview functions at a strategic level. It provides an overview of the company's compliance mission, objectives, and requirements. And it clearly directs all employees, consultants and third-party vendors to adhere to these standards. It defines ethics and integrity and uses them as the guiding force behind task level procedures. It states the company's commitment to comply with federal and state standards, and it goes a step further. It commits to maintaining a high ethical position, even when government guidelines don't provide a clear directive on every potential situation.

Policies and procedures manual

The Policies and Procedures Manual functions at a daily task, tactical, level. It provides details on each separate component of the overall compliance program with appropriate examples, and it includes templates for worksheets and reports. The different components of the compliance program will track directly to the areas identified in the consumer touchpoints map (outlined in step 2). Creating and updating regulatory compliance manuals can be a time-intensive assignment. These are living documents that must be changed and redistributed on a regular basis. You may want to consider using specialty software, or outsourcing the manuals to a compliance procedures expert, in order to ensure quality and gain process efficiencies.



5. LAUNCH THE COMPLIANCE PROGRAM

Give your compliance program launch the same care and respect you'd give to a new product launch. Don't just post an off-the-shelf training manual in the company online resource library.

Think like a marketer, and create a campaign that uses both oral and written channels in a series of integrated communications.

Generate excitement with a benefit-driven teaser and an announcement invitation. The communications channels are part of the message. Don't rely on a generic email blast. Schedule a live CEO presentation to convey importance. The kickoff presentation should be followed by departmental meetings and hands-on training sessions. The training sessions should be offered at regular intervals for new employees, or as a refresher for current employees.

Employee training is an area that can be outsourced to a professional learning center. The modules could include direct training sessions for task level employees or train-the-trainer sessions where human resources managers are instructed to lead the learning program.

6. MONITOR AND UPDATE ON A REGULAR BASIS

Regulatory compliance isn't a set-and-forget program that can run on autopilot. Your program must be monitored and updated on a regular basis, as regulatory rules change in response to new technologies, new products, and changes in the political landscape.





Monitor regulatory changes

Your compliance team will need to stay on top of these changes, by monitoring regulatory agency platforms where new guidelines are published. According to a Thomson Reuters report, financial governing agencies worldwide publish more than 200 new or updated rules every day. This same report goes on to say that the typical compliance officer spends 31% of their time tracking, analyzing, and reporting on policy changes. It's easy to see how this function can be timeconsuming. Regulatory technology (regtech), or an outsourced compliance resource, can manage this task far more efficiently and cost-effectively than an in-house, manual process.

Update policies and procedures

Financial governing bodies mandate a variety of compliance procedures that may require regular testing. For example, all money service businesses (MSBs) in the US are subject to the bank secrecy act (BSA). This act includes a directive for a written anti-money laundering (AML) program with annual auditing and testing.

Your Policies and Procedures Manual must include formal guidelines on how to update your compliance program. The manual should also include the process for distributing notifications and outlining any additional training requirements. Proper employee notifications and training will ensure all changes are clearly understood and implemented on a timely basis.

7. OPTIMIZE USING REGTECH SOFTWARE AND OUTSOURCED COMPLIANCE RESOURCES

A regulatory compliance program can be expensive to develop, launch, and maintain. That's why regtech software, and/or an outsourced compliance consultant, can be cost-effective solutions for many lenders. According to a recent business survey, 25% of financial companies outsource some or all of their compliance function. Outside resources can increase a lender's regulatory compliance expertise, reduce manpower, improve process efficiencies, reduce costs, and increase regulatory program performance.



Regtech software

Regtech is a general term that describes a family of technologies, platforms, and software packages. These programs automate regulatory compliance systems, delivering substantial process efficiencies and cost savings.

A typical regtech package will include:

1

Regulatory reports submission module

2

Anti-fraud and anti-money laundering modules

3

New borrower onboarding module

4

Risk management for digital funds transfers

5

Cybersecurity module

6

Safe storage of sensitive customer information

Outsourced compliance resources

Many lenders outsource all or part of their regulatory function to a compliance consultant. Outsourcing is a great way to leverage someone else's time and expertise. It boosts your creative juices and helps you focus your best energies on innovation and long-term growth strategies.

It's important to choose a consultant that specializes in your particular type of lending, and in your geographic market. An outsourced resource can deliver a one-time consultation, ongoing on-demand fractional c-suite support, or a fully managed compliance department complete with CCO.



CONCLUSION

Fintech-driven lending is a financial category that's exploding. The media attention is intense, but so is the regulatory scrutiny. It's the job of the regulators to protect consumers from potential harm. That process starts with a strong regulatory compliance program.

Successful lenders in the digital age will embrace the compliance function. They'll see that a solid compliance foundation can ensure long-term business health and profitability. They'll learn to leverage compliance to optimize their business model and product design prior to launch. And they'll use smart resources like regtech and outsourced compliance solutions to make the process more efficient.

NEXT STEPS

One of the best ways to implement a lender compliance program is to leverage LaaS software with built-in regulatory compliance rules. These fully managed, cloud-based lending platforms are regulatory compliant out-of-the-box, customized to meet local market rules, and updated on a timely basis as new regulations take effect.

If you're exploring regulatory compliance options for your lending operation, then it's time to request a TurnKey Lender Free Trial.

Book an intro call to learn how TurnKey Lender can help grow your business today.

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