Apogee Process Improvement LLC

Website: www.apogeepi.com

Top 5 Disclosure-Related Mistakes

Brent Bahnub, CEO/Founder

brentbahnub@apogeepi.com

Introduction

When it comes to Disclosures, financial services institutions play the "frog in the pot" role from the urban legend. As the story goes, a frog placed in a cool water pot will remain in the pot as the temperature is gradually turned up, eventually being boiled to death. While that story is a myth, it perfectly captures the gradual changes of the US financial services Disclosure environment over the past century.

In 1918, the Federal Reserve Act created the first US Banking regulator, the Federal Reserve Bank, which enacted a modest number of regulations, regulating limited products and customer communications channels. Fast forward to today and financial institutions have more than a dozen regulators, hundreds of regulations and rules, a plethora of products, and more customer communication channels than could be imagined more than a century ago including television, ATM screens, internet, mobile/SMS, and social media.

Over the past decade, failure to effectively communicate customer Disclosures has cost the financial services industry hundreds of millions of dollars.[1] Within the past month, a large bank was fined $50MM for "surprise overdraft fees."[2] Why were these fees a surprise? They weren't properly disclosed!

Rather than wasting time ignoring the problems with today's Disclosure environments, financial institutions need to fix them. The problem is: How do you begin to fix a massive issue whose tiny seeds were sown more than one hundred years ago?

In this whitepaper, we'll count down the five biggest mistakes financial institutions make in their current and proposed Disclosure environments. As the old saying goes, "You have to learn from the mistakes of others. You won't live long enough to make them all yourself."

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[1] https://www.consumerfinance.gov/enforcement/enforcement-by-the-numbers/

[2] https://www.consumerfinance.gov/about-us/newsroom/cfpb-orders-regions-bank-pay-191-million-for-illegal-surprise-overdraft-fees/

Mistake #5: No Definitions

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Coming in at number five on our list is not having a definition of a "Disclosure." It sounds silly, but it's true that most financial institutions do not have an enterprise-wide accepted definition of what a Disclosure is. …and without a definition of the issue, how can you possibly fix it?? Additionally, without a definition of Disclosures, how much time will you waste addressing non-Disclosure issues?

To have a risk-based approach to customer communications, financial institutions must segment distinct types of customer communications. In order to create segmentation, definitions must be created or adopted.

Commonly, people refer to disclosures (lower case "d") as anything "disclosed" to the customer (or employee, regulator, investor, etc.). However, not all information disclosed carries the same risk. Information required to be disclosed is certainly more important – and therefore higher risk – than information that is not required to be disclosed.

At our clients, we established the following definitions of Disclosures and Disclaimers (both upper case "D" representing the Apogee definitions of both terms) to help drive a risk-based approach to creating world-class Disclosure environments:

- A **Disclosure** is content required by law, regulation or rule, for the purpose of providing specific information on or clarity to the product offer or service.
- A **Disclaimer** is content to be included that limits or clarifies the scope of a product offering or service, for the purpose of protection from unwanted claims or liability.

Based on these definitions and the fines associated with them, US Federal Customer-Facing Disclosures are the highest risk for financial institutions and should be the first to be addressed when improving a Disclosure environment.

Mistake #4: Lack of Ownership

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The next big mistake is a lack of Disclosure ownership. Similarly, having multiple owners can be as bad as no owner. If everyone is responsible, no one is responsible.

Disclosure ownership is critical to achieving and maintaining a “rationalized” Disclosure set (Single Source of the Truth or “SSOT” as we call it at Apogee). To fully appreciate the role of the Disclosure Owner, let’s walk through a simplified example.

We’ve all seen the phrase “Past performance is no guarantee of future results” or some similar phrase on our investment statements. It’s eight simple words. Would it surprise you to know that we discovered more than fifteen variations of these eight words in customer communications at a single client? What was the rationale behind the variations? It was simply a result of different lawyers, compliance, operations, and marketing personnel putting their unique “twist” on the phrase. Without having a single owner of the phrase, variations abounded. And while most were compliant, there were several that were questionably compliant at best (“Past performance is not a reliable indicator…”).

Without Disclosure ownership, Disclosures cannot be rationalized, maintained, and properly controlled. As a result, these financial institutions create unnecessary variations, and unnecessary variations increase the financial institution’s risk.

Mistake #3: Lack of Traceability

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The previous mistake ("Lack of Ownership") highlights the need to create and maintain "what" is said. Meanwhile, the "Lack of Traceability" mistake demonstrates the need to identify "why" the Disclosures exist and "where" the Disclosures are used.

Disclosures by Apogee's definition are required by law, regulation, or rule (LRR). This is the most critical part of the Disclosure definition. If the item (text or symbol) is not required by LRR, it is not a Disclosure. For an item to be classified as a Disclosure, there must be at least one LRR citation that it fulfills.

To maintain compliance with LRRs, companies must create, maintain and monitor the links between LRRs and Disclosures. When an LRR changes or is proposed to be changed, this must trigger a review and potential update of all associated Disclosures required by the LRR.

Similarly, if a Disclosure requires a change to remain compliant, all customer-facing communications using the Disclosure must be updated. Rather than using a "fire drill" mentality each time a Disclosure needs to be updated in a variety of communications, companies must create and maintain the links between Disclosures and customer-facing communications. This concept fits hand-in-glove with current or future content management initiatives.

What are the implications if these links are not built and maintained? Here is an example of a relatively recent issue with non-Disclosure content. For many companies involved in the transition away from LIBOR (a Disclaimer, not a Disclosure), because there was no record of which communications contained LIBOR language, a six-month effort was required by hundreds of employees to find and replace this text. If an inventory with links had been created and maintained, the effort would have been minutes instead of months. Months of "best efforts" searching and replacing various pieces of content are an unnecessary operational expense totaling millions of dollars.

Mistake #2: Not Monitoring Disclosure Issues

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Creating a world-class Disclosure environment has three distinct benefits:

1. Improved customer experiences
2. Reduced risk, particularly regulatory (fines), legal (class action) and reputational risks
3. Reduced operational expense, partially addressed in "Lack of Traceability"

Mistake #2 "Not Monitoring Disclosure Issues" addresses benefits 1 and 2. If a company does not uniquely classify, monitor, and resolve Disclosure issues, they are blissfully unaware of the potential fines, lawsuits and reputational damage coming their way. Internal control and audit issues should be combined with external customer feedback to paint the true picture of a company's Disclosure environment.

It has become more prevalent for regulatory fines to begin with customer complaints. The CFPB has gone as far as to actively solicit customer complaints for the basis of some of their investigations.[3] Therefore, in order to prevent regulatory fines, financial services firms need to improve customer complaint monitoring for high-risk items such as Disclosures, and proactively address any issues before the regulators levy enforcement actions.

The CFPB continues to aggressively fine financial institutions for negatively impacting consumers. While these large fines are unfortunate, they seem to be the most effective way to drive operational changes. Since its inception in 2011, the CFPB has levied more than $13.5 billion in fines[4] – many of which had Disclosure shortcomings identified as part of the fine explanations.

[3] https://www.consumerfinance.gov/about-us/newsroom/cfpb-launches-initiative-to-improve-customer-service-at-big-banks/

[4] https://www.consumerfinance.gov/enforcement/enforcement-by-the-numbers/

Mistake #1: Not Getting Started

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"A journey of a thousand miles begins with a single step."
– from the Tao Te Ching

The number one Disclosure mistake is not getting started on your Disclosure improvement journey. This mistake is the costliest because it is the mistake from which all others grow.

Let's revisit the financial institution identified in the introduction, the bank fined $50MM for "surprise overdraft fees." If they had been monitoring customer complaints, the bank should have known about the Disclosure issue. If they had known about this Disclosure issue, the bank could have fixed the issue by proactively investing a small fraction of the ultimate fine to create a Disclosure environment capable of resolving all its Disclosure issues – not just this one.

By not proactively addressing its Disclosure issues, the bank destroyed at least $50MM of shareholder value and suffered reputational damage. Will they now choose to fix their entire Disclosure environment as they should have done years ago? …or will they just fix this particular Disclosure issue, not addressing their systemic issues, and hope that a few more years pass before they are hit with another fine?

Unfortunately, most financial institutions do not proactively address the root causes of their Disclosure failures until after a major fine is levied. The tragedy is that customers and shareholders are both damaged in the process – years of poor customer experience capped off with needless destruction of shareholder value. In most cases, financial institutions initiate Disclosure environment changes after a major fine. They end up paying twice – once for cure (the fine) and once for the prevention (fixing their Disclosure environment). Why not just pay for the ounce of prevention and avoid the pound for the cure?

A Final Word

The complexity of the Disclosure environment has been increasing for more than one hundred years and continues to increase. Most recently, US Federal regulators are implementing ESG (Environmental, Social, Governance) Disclosures which, if not properly addressed, will result in more fines for non-compliant financial services companies.

Rather than reactively addressing an insufficient Disclosure environment after a fine has been levied, companies should invest a fraction of the expected fines to create a world-class Disclosure environment based on ownership, rationalization, and traceability. Remember, if you don't improve your Disclosure environment it's not a matter of "if" you'll be fined, but "when" you'll be fined.

Contact Apogee for a 60-day Disclosure Environmental Assessment to understand your strengths and improvement opportunities, plus receive a high-level plan to implement these improvements. Start your journey to a world-class Disclosure environment today.

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