Federal Reserve System

Community Bank Risk-Focused Consumer Compliance Supervision Program

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Agenda

• Provide an overview of the Risk-Focused Consumer Compliance Supervision Program for Community Banks, including:
  – Explaining the principles behind the program
  – Describing what state member banks can expect from the new program

• Summarize the examination frequency policy

• Discuss community bank considerations
Risk-Focused Principles

• A risk-focused consumer compliance examination program provides clear guidance and flexibility to:
  – Effectively evaluate an institution’s consumer compliance culture and processes for identifying, measuring, monitoring, and controlling compliance risk
  – Balance the nature and breadth of supervision with the level of risk to consumers and institutions
  – Ensure effective stewardship of resources
  – Support and document decisions and findings sufficiently
  – Effectively engage other supervisory disciplines and regulators to ensure a coordinated supervisory approach
Risk-Focused Supervision Framework **CA Letter 13-19**

• What is the purpose of the risk-focused supervision program?
  – Ensure the institution is effectively controlling its compliance risks

• What does the program achieve?
  – Alignment of resources with risk
    • Differentiation among institutions based on risk profile
  – Meaningful difference in work, based on residual risk at the product level
  – Supervisory activities adjusted to changing risk profiles
  – Ongoing supervision activities supplement point-in-time work
Risk-Focused Supervision for Community Banks

Assessing the Institution’s Risk

Identify Inherent Compliance Risk
Risk associated with these factors, including significant change:
- Environmental
- Legal and Regulatory
- Institutions

Evaluate Institution’s Control of Compliance Risk
- Board and Senior Management
- Policies, Procedures, & Limits
- Management Information Systems & Risk Monitoring
- Internal Controls

Assess Compliance Risk of Products

Examining Scoping & Planning

Risk-Based Work Program

Depth of review varies based on the level of residual risk:
- High Residual Risk
- Low Residual Risk

Ongoing Supervision
- Interviews & Questionnaires
- Offsite Review of Policies & Procedures

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Understanding the Institution

• Institutional profile
• Risk tolerance
• Information gathering
  – Institutional factors
  – Legal and regulatory factors
  – Environmental factors
Identifying Inherent Risk

- Institutional risk factors
  - Strategic/business factors
    - Growth
    - Structural complexity
    - History/trends
  - Product characteristics
    - Product volume
    - Product complexity
    - Product stability
    - Third-party involvement
Identifying Inherent Risk *(Continued)*

- Legal and regulatory risk factors
  - Consequences of noncompliance/consumer harm
  - Regulatory complexity
  - Change
- Environmental risk factors
  - Demographics
  - Business conditions
  - Competition
Compliance Risk Management

• Elements of the compliance risk management system
  – Board and senior management oversight
  – Policies, procedures, and limits
  – Risk monitoring and management information systems
  – Internal controls
Compliance Risk Management
(Continued)

• The risk-focused program places increased emphasis on:
  – Service provider management
    • CA Letter 13-21 Guidance on Managing Outsourcing Risk
    • Assessment of risk
    • Sound management practices
  – Change control processes, including new product approval processes
    • External and internal change
    • Effective change management processes
The Risk Assessment Process

• Residual risk balances the level of inherent risk with the strength of risk controls
• Assessment of residual risk drives the scoping process
  – The process will be of sufficient rigor for examiners to understand the institution’s risks and draw reasonably reliable conclusions
• Implications
  – Examiner time may shift to more work up front and less on site
  – Work program should be consistent with the risk assessment
  • There will be better alignment of resources with risk
Product Management and Materiality

• Product management
  – Relates to the institution’s ability to identify, measure, monitor, and manage the compliance risk inherent in a particular product
    • Board and senior management oversight
    • Policies and procedures
    • Monitoring and management information systems
    • Internal controls

• Product materiality
  – Reflects the relative importance of a product compared to other products offered by the bank
  – Materiality of products, as well as the associated level of residual consumer compliance risks, will be considered to ensure that resources are directed appropriately
Examination Plan

• Scoping will result in a customized work program based on the residual risk of the defined products or services
  – Management of individual products and services affects assessment of the overall program

• Range of examination activities
  – Level of intensity increases in direct correlation with residual risk

Risk-Focused Examination Work Program

Residual Risk Level

- High
- Considerable
- Moderate
- Limited
- Low

Range of Examination Activities

- System reviews
  - Judgmental sampling
  - Review of targeted aspects of a product, service, or business line
  - Review of bank MIS/parameters
  - Review of bank forms and disclosures
  - Interviews
  - Questionnaires

- No further review

\(^1\)From time to time, specific work programs may be developed to assess consumer compliance in certain higher risk areas. These System reviews may be precipitated by concerns about a particular product, service, business practice, or regulatory requirement.
Examination Plan (continued)

• Low-risk products or services
  – Possibility of no further review if examination objectives achieved through scoping and planning

• High-risk products or services
  – Transaction testing

1From time to time, specific work programs may be developed to assess consumer compliance in certain higher risk areas. These System reviews may be precipitated by concerns about a particular product, service, business practice, or regulatory requirement.
Fair Lending and Unfair or Deceptive Acts or Practices (UDAP)

- Fair lending guidance is consistent with the Interagency Fair Lending Procedures
- Fair lending and UDAP compliance is considered with a focus on material products and services
- Examiners evaluate inherent risk of products and services in the context of the institution’s risk controls to determine residual risk
Fair Lending and Unfair or Deceptive Acts or Practices (UDAP) (continued)

• Examination intensity is commensurate with the level of residual risk identified

• When fair lending inherent risk is high, examiners typically will test the risk controls before concluding that they effectively mitigate the high inherent risk
Ongoing Supervision

• Informs the point-in-time supervisory activity by having an up-to-date understanding of the institution and its risk

• Assesses key changes to the compliance risk management program
  – Utilization of a questionnaire with standard key questions

• Continues follow-up on supervisory issues/findings

• Communicates supervisory expectations and discusses changing regulatory requirements
Revised Examination Frequency Policy

**CA Letter 13-20**

- Examination frequency ensures examination resources are appropriately directed to an institution commensurate with institution’s asset size and effectiveness of its consumer compliance risk management program.
- More financial institutions eligible for a longer consumer compliance and CRA examination frequency cycle:
  - 48 or 60 months for banks with assets less than $350 million and satisfactory or better compliance and CRA ratings.
  - 36 months for financial institutions with assets between $350 million and $1 billion and satisfactory or better compliance and CRA ratings.
Community Bank Considerations

• Understand your institution’s level of inherent compliance risk
• Implement a control environment sufficient to manage this compliance risk
• Identify and respond to changes timely and effectively
• Adapt the compliance program as risks change
Questions