

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



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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



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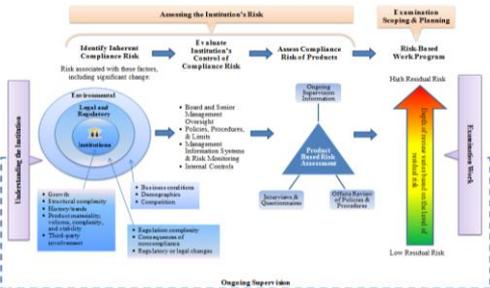
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Risk-Focused Supervision Framework [CA Letter 13-19](#)

- 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 Framework

Risk-Focused Supervision for Community Banks



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

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Identifying Inherent Risk (Continued)

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

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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

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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

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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

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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

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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	Range of Examination Activities
High	System reviews ¹
Considerable	Judgmental sampling Review of targeted aspects of a product, service, or business line
Moderate	Review of bank MIS parameters Review of bank forms and disclosures
Limited	Interviews Questionnaires
Low	No further review

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.

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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

Risk-Focused Examination Work Program

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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

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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

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Questions



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