Federal Reserve System

Community Bank Risk-Focused Consumer Compliance Supervision Program

Outlook Live Webinar - March 6, 2014

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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
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

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

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

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