Financial Services Regulatory Update

July, 2018

This communication is designed to provide you with quick snapshots and timely perspectives on recent regulatory developments.

Fair and Responsible Banking: Customer Care is Good for Business

Background

With regulators focusing on compliance risk assessment and management, financial institutions are finding their greatest compliance risk resides in consumer protection regulations. And while navigating regulations and related guidance from multiple agencies can be challenging, the financial industry is challenged all the more by competition from emerging digital and FinTech providers. This is especially true for smaller institutions facing the ever-rising cost of compliance, in system and process enhancements and in increasing staff to manage compliance risk. However, the most forward-thinking executive managers are also seeing the benefits of regulatory changes that protect consumers: fair and responsible banking practices improve a bank's reputation in the marketplace, promote the positive impact a bank can have on the communities it serves, and underscore the advantages of banking locally.

The Latest in Enforcement Focus

Regulators continue to focus on unfair, deceptive or abusive acts or practices during compliance examinations, and with several exam cycles using CFPB guidance behind them, exam teams have accumulated a good number of examples to help them spot questionable products, services or practices. In addition to products or services that cause financial harm to consumers, regulators are also critical of how and to what extent fair and responsible financial products are made available to consumers and whether they are promoted and offered consistently.

In addition to the technical components of Fair Lending and consumer protection laws, regulators are beginning exams by evaluating the institution's compliance management system (CMS) to assess the likelihood of consumer harm. If examiners determine a bank's practices appear to increase the risk of consumer harm, or if they find weaknesses in any of the three lines of defense, Board or management oversight, training, or compliance function staffing and expertise, the exam team will likely expand transaction testing, scrutinize procedures and practices, and withhold a presumption of good faith on the institution's part. One frequent mistake banks make in evaluating their risk of consumer harm is to focus only on credit products, rather than on all of the bank's products, services, and practices—from marketing and product development to servicing and account closings.

The best course of action for financial institutions is to develop and implement a solid CMS, ensuring all three lines of defense are working effectively and efficiently to manage compliance risk, and continually addressing practice weaknesses that could be viewed as unfair, deceptive or abusive, either in the way products or services are offered, or in the way they are delivered. Then, the CMS can be used to guide development of new products or services, taking into consideration the consumer need for the product or service, marketing strategies for promoting it fairly, and offering it in a way that reflects the institution's commitment to building financial relationships that lead to customer satisfaction and retention.

Telling the Bank's Story: Compliance Meets Marketing

At the heart of a solid compliance risk management program is the institution's own statement of vision and mission. This statement, along with whatever follows from the statement, forms the institution's Fair and Responsible Banking

narrative. Boards of directors dictate strategic objectives, which they authorize and empower executive and senior management to oversee, and establish the institution's risk appetite. Management in turn dictates the policies and procedures, to match practices with strategic objectives and risk profile, and the formalized, documented expectations for those practices to meet regulatory requirements. When the organization has taken sufficient time and care to develop compliance risk management controls within the CMS to understand, test and confirm the alignment of strategic objectives and actual business practices across the institution, the results of testing and data analysis will confirm staff are meeting expectations, and that products and services are being offered, delivered and serviced in a manner consistent with regulatory expectations – not only for compliance with regulations but also in reflecting the Board's and management's stated objectives. In other words, the Board has dictated a path toward certain objectives; management understand those objectives and what steps must be taken along the path; staff are adequately trained and equipped to walk along that path; and together, the organization has created its Fair and Responsible Banking narrative.

However, in cases where the data analysis or testing results do not confirm expectations are being met, or worse, where testing and analysis are insufficient to recognize instances where the institution is not meeting strategic objectives, regulators will create the institution's narrative based on their assessment of the CMS and the conduct of business according to rules, regulations, and the institution's policies. Frequently, what results is a misunderstanding of the bank's business or strategic objectives, a failure to understand or appreciate the reasons for the Board's objectives, and an order or recommendation to adjust practices in a manner likely to be inconsistent with strategy. In other words, if the bank cannot tell its own story by effectively developing, implementing and testing its narrative, it may be unhappily surprised when its regulator suggests changes to the manner in which the bank does business, whether or not the suggestion makes sense given the bank's strategic objectives. This is especially true for institutions whose consumer customers are being lured away by FinTech providers who enjoy a much lower cost of compliance because their operations have largely automated compliance controls and processes, leaving them little need for increased staff. If a financial institution cannot demonstrate its worth to the communities it serves through its Fair and Responsible Banking narrative, it will have a hard time attracting new customers and retaining existing customers.

Financial institutions are not permitted to share copies of their compliance examination reports with the public; however, they *can* and should integrate their dedication to consumer protection through a Fair and Responsible Banking program with their customers and communities. Reflecting the institution's mission statement, community investment vision, and commitment to consumer protection can make an institution attractive as a financial partner to a consumer—especially when consumers see the institution taking steps to strengthen the communities it serves.

Self-Assessment: Compile, Compare, Correct

Most Compliance Officers understand how to translate regulatory language into practical terms, paying attention to unwritten rules (like suggestions from examiners), and to enhance compliance risk management processes across the organization to meet regulatory expectations. The best Compliance Officers will do both, while keeping in mind the Board's strategic objectives and engaging in regular, frequent dialogue with the Board to keep them informed of developments or necessary adjustments based on regulatory, business or community changes. For any Compliance Officer to fully understand and effectively articulate the institution's compliance risk profile, data from several sources must be taken into consideration for compliance risk assessment purposes. For example, customer complaints can provide a wealth of information about how consumers view the bank's products and services, which can be very different from how the Board or management team anticipates the products will be viewed. Compliance monitoring testing and audit results also are important sources for identifying changes in compliance risk. Comparing data from all

of those sources in the process of performing or updating the bank's compliance risk assessment accomplishes more than checking the annual risk assessment off of the to-do list: it yields critical information about heightened risk of consumer harm, increased risk of consumer dissatisfaction, and opportunities for the institution to improve its performance in meeting the banking needs of the community.

Taking into account what their peers hear from regulators, what the agencies communicate through guidance or during web conferences, and what they know of their own institutions, Compliance Officers have a unique opportunity to help the organization form and communicate its Fair and Responsible Banking narrative. The first step in defining, quantifying and communicating the narrative is gathering the data necessary to analyze the organization's actual business practices. Whether in the form of Home Mortgage Disclosure Act and Community Reinvestment Act loan application register data, core system reporting of loan originations (how many, how much, to whom and where), customer complaints, deposit and loan account attrition reports, and reviews of consumer and small business denials, the data will demonstrate in tangible terms whether the bank's practical narrative – its practices – truly reflects the stated narrative.

More important than simply reading the narrative is shaping it: taking into consideration plans for growth, any limitations or advantages based on systems, processes, locations, and so on, resident expertise among management and staff, and weaving those facets together into a cohesive, deliberate action plan. Organizations with a well-defined, data-supported narrative will fare far better in compliance examinations than their less proactive, less informed counterparts, and will enjoy the benefit of happy customers.

How Experis can help

Experis Finance offers industry experience in all aspects of Financial Services, including:

- Performing Fair Lending, Compliance Management Program and Compliance Risk Management assessments
- Assessing the adequacy of your organization's compliance control environment
- Developing internal compliance monitoring and audit programs to address unique risks
- Developing data-based analysis and related Board reporting
- Evaluating processes and practices and developing program enhancements to address weaknesses

Our Risk Advisory Services practice can evaluate your compliance management program, provide comprehensive recommendations for improvement and help you address those recommendations.

Our team of professionals has extensive experience working with clients to address these issues to help them avoid costly fines and penalties. If you have any questions about or concerns around your implementation of these steps, contact an Experis representative at financialservicesindustry@experis.com or visit our website Experis Finance.