INCLUDING COMPLIANCE IN THE BANK’S RISK PROGRAM

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by
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Regulatory Compliance & Documentation

*Defining risk – the probability of loss*

“Compliance is a risk that financial institutions must manage to the same degree they must manage capital adequacy, asset quality, earnings, liquidity and rate sensitivity.”

Robert L. Clarke
Former Comptroller of the Currency
Regulatory Compliance & Documentation

“... Regulations are like guardrails, they protect everyone from market excess. ...”

David Silberman
Consumer Financial Protection Bureau

Compliance Risk Management

Compliance is a form of risk management.

Key sources of compliance risk:

- staff turnover
- product complexity
- rapid growth of the financial institution or its product(s)
- economic forces in the FI’s market
- technology
To **measure compliance risk**, bank must look at:

- Quantity of risk
- Quality of risk management
- Aggregate risk
- Direction of risk

**Inherent Risk** – risk present before mitigants applied.

**Risk Mitigants** – “things” that reduce risk

**Residual Risk** – risk remaining after mitigants applied
Risk Evaluation

Likelihood of Compliance Risk:
• Past performance of institution
• Mitigating situations
• Experience/knowledge of personnel
• “tone at the top”

Risk Evaluation

Severity of Compliance Risk:
• Enforcement climate
• Specific penalties
• Patterns/practices
• Public pressure
Case Study #1

Facts: Financial institution’s initial disclosure states, among other information the following: “minimum balance to open is $100. This account is a free account as long as the customer maintains a balance of $500. If the balance at any time during the cycle falls below $500, a service charge of $5.00 will be assessed. Issues?

Case Study #2

Facts: Bank in large metropolitan city recently determined that changes in consumer real estate lending requirements under the Dodd-Frank Act and TRID would severely challenge the bank’s ability to meet the credit needs of many of its existing inner city loan customers. With specific loan-to-deposit ratios required to receive a Qualified Mortgage safe harbor, the bank transfers its mortgage loan officers from several of its inner city branches to a central location at its company headquarters located in the ‘burbs. Inner city customers can still apply for real estate loans, but not via a live mortgage loan officer. Issues?
Case Study #3

• **Facts:** Financial institution in an attempt to “go green” is offering all checking account holders e-statements monthly for no charge. A customer can sign up for e-statements at any lobby location; he/she will be charged a $2.00 fee per month for paper statements if they cancel e-statements in the future. All of this is disclosed within the bank’s Truth-in-Savings initial disclosures. Issues?

Case Study #4

**Facts:** Financial institution has decided to leap back into the home purchase & refinance business by signing up with a large, secondary market underwriter. While originated loans won’t be maintained on the bank’s books, the bank decides that at least with this option, it can compete with other megabanks in its trade area. All over town on billboards and in the bank’s lobby & website is the following statement:

“Lowest home rates in the county!! Some rates as low as 2.5%!! 100% financing available!! Come see us today before you apply with any other institution. We can help!! Equal Housing Lender” Issues???
Case Study #5

Facts: Bank’s monitoring software indicates elderly customer’s withdrawal patterns have increased substantially. In fact, further research now indicates that over 3/4ths of his $400,000 savings account has been withdrawn in the last 8 weeks. Bank requests customer to come in to discuss situation. When customer comes in, he is accompanied by a young woman who is of no relation. She is not on the account, but the customer refuses to talk to bank representative without his “friend” being present. He refuses to answer questions, refuses to say where money is/has gone and leaves bank extremely upset and mad. While he has two grown sons living in area, he is the only person on the account. Issues???

Risk Management

Compliance risk is created by noncompliance and noncompliance requires discovery!

Types of compliance risk:
• Financial
• Operation
• Reputation
• Competitive
Compliance Monitoring

*Should be conducted in nonadversarial atmosphere.*

Differences between monitoring and auditing –

**Monitoring:**
- Internal validation
- Occurs within day-to-day operations
- New procedures validated prior to implementation
- Immediately identifies and corrects findings
- Prevents recurrence of errors
- Report/findings go to departmental management for corrections

Compliance Auditing

Differences between monitoring and auditing –

**Auditing:**
- External validation
- “outside” look in
- Procedures tested after implementation
- Tests monitoring results
- Identifies after fact
- Corrections after problem has occurred
- Report to senior management/board
Compliance Controls

*Ineffective controls = ineffective risk management!*

Controls are established to fit compliance procedures/policies within risk tolerance.

Both passive & active controls.

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Compliance Controls

*Each financial institution must have an effective & effective resource allocation to address and implement compliance risk programs!!!*

Twenty percent (20%) of the most dangerous compliance violations cause eighty percent (80%) of the most serious compliance problems banks experience!!!
Compliance Officer Demand

Will continue to rise due to:
• Dodd-Frank/scrutiny on mortgage lending
• BSA evolution
• Technology
• Use of penalties to punish wrong-doers
• More & more expectations of compliance officer being a “specialty field”
• Regulator expectations

Necessary – NOW!!!

• Compliance risk must be included within institution’s overall risk assessment & management
• Compliance officer ‘command’
• Maintaining strong compliance program
• Involvement of BOARD
• *Compliance officer/department must be viewed as an asset*
Compliance Violation Consequences

- Civil liability
- Civil monetary penalties
- Customer reimbursements
- Retroactive correction
- Expansion delays/denials
- Serious negative public feedback
- Loss of bank charter
- Removal of bank officers

And now for something completely different . . .

REGULATION FOCUS!!!!!!
TIL/RESPA Integration – effective 10/3/15

• Will completely change ways consumer mortgage loans are closed
• Merges TIL/RESPA provisions and eliminates existing documents for consumer mortgage loans
• Two new documents
  o Loan Estimate
  o Closing Disclosure

TIL/RESPA Integration

• Emphasis is on closing costs
• No fess assessed/collected/charged until applicant has supplied – intent to proceed
• Closing Disclosure – completed 3 days prior to closing
• Loan Estimate – furnished within 3 days of application
• Business day has new meaning
TIL/RESPA Integration

• Old forms will still be applicable to certain loans
• Only excluded loans:
  o Reverse mortgages
  o HELOCs
  o Mobile homes without real property
  o Commercial/agricultural primary purpose (loans not covered by Regulation Z)
• Massive confusion with differences among document processors, title companies, attorneys

TRID

• $7,600,600 estimated savings to consumers by implementing TRID;
• $207,000,000 per year for five years to implement TRID for financial industry
• Estimated cost to implement TRID per mortgage origination - $27
• Estimated profit for financial industry for each mortgage originated - $1,100
(Federal Register 12/31/13, beginning pg. 80075)
Biggert/Waters Act

• Two implementation dates:
  o 1/1/16 – escrow provisions
  o 10/1/16 – force-placed provisions

• Escrow – must escrow flood insurance premium, with option to escrow to other borrowers with outstanding loans as of 1/1/16

• Exemption for Small Lenders:
  o assets less than $1 billion
  o as of 7/6/12 – not required to escrow taxes/insurance

Biggert/Waters Act (cont.)

• Exceptions for certain loans:
  o Subordinate liens
  o 1-4 family/mobile home securing business- or ag-purpose
  o HELOCs (unless senior lien)
  o Loans with terms less than 12 months

• New provisions pertaining to force-placement of flood insurance

• Private Insurance

• New sample notices
Military Lending Act

• Applicable to banks beginning 10/3/16
• Open-end accounts exempted until 10/3/17
• Adopts 36% Military APR which will include most fees
• Will not cover – mortgage loans
• Will cover:
  o Credit cards
  o Lines of credit
  o Installment loans (excluding purchase money)
  o Deposit Advances

Since material sent to school:

documento, documento, documento method bank
using to verify military status!!
CDD/Beneficial Ownership

• FinCEN – 4 core elements to Customer Due Diligence:
  o CIP (in place)
  o Beneficial ownership identification & verification (NEW)
  o Understanding nature/purpose of customer banking relationship to be able to develop customer risk profile (explicit mandate)
  o Ongoing monitoring for suspicious activity (explicit mandate)

CDD/Beneficial Ownership

• Legal Entity Customer – identify, verify & retain beneficial ownership information
• Legal Entity Customer – corporation, LLC or other entity created by filing a public document with Secretary of State or similar office; includes limited partnership and business trusts. Excludes: banks, governmental entities & publicly-traded companies listed on national stock exchanges.
CDD/Beneficial Ownership

• **Two prong test:**
  o Ownership prong – any/each individual who owns 25% or more of equity interests of legal entity – (could have up to 4)
  o Control prong – single individual with significant responsibility to control, manage or direct legal entity customer

CDD/Beneficial Ownership

• Bank must either:
  o Obtain certification from Appendix A, or
  o Obtain from individual opening account information required on beneficial ownership by providing certification to the best of his/her knowledge

• **Verification of beneficial ownership must be at minimum same as CIP requirements**
  (name, address, TIN/EIN, date of birth)
CDD/Beneficial Ownership

• Rule is effective May 11, 2018
• Does not cover existing accounts (opened prior to 5/11/18) *BUT only to identification/verification requirement; all other parts (ongoing monitoring, understanding nature of account) ARE EFFECTIVE*

Home Mortgage Disclosure Act

• Changes, required per Dodd/Frank, effective 1/1/18
• New threshold requirements:
  o Must originate at least 25 covered closed-end mortgages in each of two preceding calendar years, or
  o 100 covered open-end lines of credit in each of two preceding calendar years; and
  o Meet all other threshold requirements
Home Mortgage Disclosure Act

- Only cover business loans if they are purchase-money purpose
- Will exclude agriculture-purpose loans even if dwelling secured
- Home improvement loans only covered if secured

Home Mortgage Disclosure Act

- Over 20 new data fields for 2018 reporting
- Will require noting how government monitoring (GMI) collected
- Disaggregated subcategories pertaining to ethnicity and race will be allowed
- Data now submitted to CFPB not FFIEC
- If over 60,000 applications/covered loans – must report quarterly, not annually
- No longer required to provide HMDA data on request; inform customers that data is on CFPB’s website
Prepaid Accounts

• **DELAYED UNTIL APRIL 2018**
  • Will require ‘preacquisition’ disclosures in addition to initial disclosures
  • Requires prepaid account agreements to be provided to CFPB
• **General purpose prepaid accounts** – marketed/labeled as “prepaid” and usable at multiple, unaffiliated merchants for goods/services or ATM usage

Prepaid Accounts

• **Will include:**
  o Payroll cards
  o Government benefit accounts
  o Tax refund cards
  o Network branded general purpose cards
• **Will exclude:**
  o HSA accounts/cards
  o Gift certificates
  o Store gift cards
  o Loyalty, award or promotional gift cards
Prepaid Accounts

• Short form disclosure – ‘snapshot’ & provided prior to customer commitment
• Long form disclosure – 16 items under 8 defined categories
• Both forms must be in tabular formats
• Other details:
  o Periodic statements
  o Error resolution notices
  o Small Entity Compliance Guide from CFPB, along with 6 page Prepaid Account flowchart

And Now . . . . .

*Been in place prior to 2017, but still very potent!!!!*
Dodd-Frank Act – effective January 2014

Qualified Mortgages/Ability-to-Repay:
• Mandatory 1/14
• Applicable to closed-end consumer mortgages
• Establishes minimum underwriting considerations
• Definition of Qualified Mortgage (QM)
• Some exceptions for small creditors

Dodd-Frank Act – new January 2014

Mortgage Servicing Rules:
• Small servicers’ exceptions
• Periodic statements
• ARM notices
• Prompt crediting of payments
• Escrow error procedures
• Mitigation of delinquency procedures
• Delays in foreclosures
Dodd-Frank Act – new January 2014

Mortgage Loan Origination Compensation:
• Loan officer cannot be paid on any “term” of mortgage loan
• Allows 401(k) contributions
• NMLS# required on documents
• No required binding arbitration
• No financing of credit life premiums

Dodd-Frank Act – new January 2014

HOEPA:
• Increase coverage to purchase-money & HELOCs
• Changes in coverage spread over APOR
• Coverage ‘triggered’ if certain things happen
• Restrictions as to provisions of note/mortgage
• Requires housing counseling before loan closed
Dodd-Frank Act – new January 2014

Appraisals:
• All HPML loans must have certified/licensed appraisal
• Copy of appraisal/valuation furnished to all first lien loans – whether consumer- or commercial-purpose
• May be waived, but still must precede closing by 3 business days
• New requirements on “flipped” home financing

Dodd-Frank Act – new January 2014

Escrow:
• Mandatory mid-2013
• HPML must have escrow for 5 years
• Some exemptions
• New customer cancellation provisions
Regulation B

- Prohibited bases
- No discrimination in any aspect of any credit transaction
- Spousal guaranty issues
- Fair lending allegations:
  - Gender
  - Age
  - Race
  - Product pricing
  - Disparate impact
- Fair Lending will impact CRA ratings

Bank Secrecy Act

- Defined components of BSA Program – especially CDD & EDD
- Suspicious Activity
- Strong emphasis on money laundering risk assessment
- Must have board involvement!
- Can anyone define ‘Money Laundering’?
FCRA & FACTA

• Proper use of credit reports
• **ID theft procedures**
• Red flag program
• Risk-based pricing & credit score information
• Prohibition on medical information
• Defined, formalized program to resolve customer disputes involving credit information

American Savings Promotion Act

• Signed by President Obama in December 2014
• Banks may offer Savings Promotion Raffle:
  o Chance of winning with each savings account deposit
  o Only applicable to savings accounts
  o Subject to state law – not automatic
American Savings Promotion Act

- As of 12/31/16, allowable in:
  - Arkansas
  - Connecticut
  - Indiana
  - Maine
  - Maryland
  - Michigan
  - Missouri
  - Nebraska
  - North Carolina
  - Virginia
  - Washington

Regulation E

- Very strong pro-consumer regulation
- Large increase in customer refunds
- Remittance Transfer rules for consumer international wires
- Focus on electronic error resolution process – no chilling effects!
- Contains restrictions on overdraft fees defined in 2010 (automated OD plans)
- **FDIC does not like automated OD plans & has issued guidance**
Unfair, Deceptive & Abusive Practices/Act - UDAP

- Unfair
- Deceptive
- Abusive
- Examiners have been told to ‘look beyond technical compliance’
- CFPB includes extensive UDAP section in their Examination Manual

UDAP (cont.)

- UDAP issues:
  - Overdrafts
  - Order of item processing
  - Failure to follow privacy notice/policy
  - Advertisements
  - Fair lending allegations
  - “Is it in the best interests of the customer?”
Servicemember’s Civil Relief Act
SCRA

• DIFFERENT THAN MILITARY LENDING ACT!!
• If invoked, all servicemember rates, and payments, lowered to 6%
• Restrictions on foreclosure/repossession
• Cannot report negative information to third parties
• Examiners expecting strong, written SCRA procedures/processes
• Can be used to provide relief to servicemember’s immediate family

Deep Compliance Thoughts

• Fee income
• CRA
• Technology
Final Deep Thought!

Sometimes the best part of my job is that the chair swivels.

Thanks and WAY TO GO SENIORS!!!

“What did you take away from the meeting?”