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Controls to Prevent Common Fair Lending/Banking Related Violations

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Fair Banking Update

- First year with the new expanded HMDA data and Regulator feedback and scrutiny
- Use of proxy methodology for loans without GMI
- Model validations of fair lending related models
- Redlining or more about perceived redlining
- Peer comparison (when applicable based on FOM)
- Complaints driving lookbacks, such as error resolution and provisional credit
- Crediting back or waiving fees at some branches and not others

Fair Lending Misconceptions

- ✓ We are a closed field of membership and we know our members
- ✓ Our HMDA data never comes back with errors, so fair lending isn't an issue
- ✓ We review all of our adverse action notices so we are covered
- ✓ Our indirect lending partners sign a contract indicating they will comply with regulations, so we are fine
- ✓ We have an approved policy and procedure related to fair lending so we are in compliance

So where do we start?

Three Lines of Defense

“The Third Line”

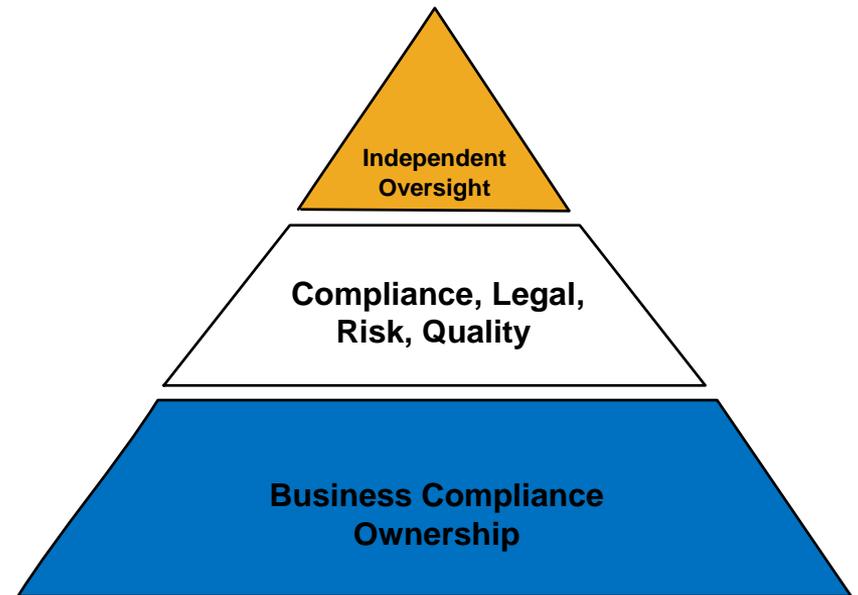
Internal Audit will provide independent oversight and auditing.

“The Second Line”

Compliance will provide compliance management, facilitation, framework and policies.

“The First Line”

Management is accountable for identification of risks, internal controls, compliance activities and monitoring in order to be compliant with laws and regulations.



The First Line of Defense



“The First Line”

Management is accountable for identification of risks, internal controls, compliance activities and monitoring in order to be compliant with laws and regulations.

So who is the first line?

- Our line of business
- Our call center
- Our member service representatives
- Our field sales/community development staff
- Our Loan Officers, processors, underwriters

Compliance, while thought of as just a department, is actually the responsibility of everyone at the Credit Union. To have a successful Compliance Management function, it must start with well trained and committed first line individuals.

The First Line of Defense



“The First Line”

Management is accountable for identification of risks, internal controls, compliance activities and monitoring in order to be compliant with laws and regulations.

What controls might the first line implement and be responsible for:

- ✓ Designing formal operating procedures, desk guides, etc.
- ✓ Reviewing pipeline reports for timely disposition of applications
- ✓ Reviewing overrides or exceptions to approval and denial decisions
- ✓ Reviewing denied applications prior to communication to the applicant to determine if any options exist to get it approved
- ✓ Reviewing adverse action notices for accuracy, completeness and timeliness
- ✓ Reviewing fee waivers or increase/decrease from standard fees
- ✓ Reviewing complaints related to the loan application process and discussing with Compliance if certain “key words” warrant further action
- ✓ Reviewing application activity of indirect auto partners
- ✓ Reviewing relationships with third parties such as realtors, brokers, etc.

The Second Line of Defense



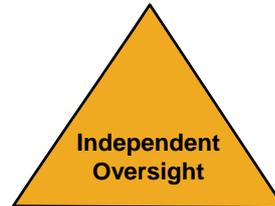
“The Second Line”

Compliance will provide compliance management, facilitation, framework and policies.

What controls might the second line implement and be responsible for:

- ✓ Review a sample of pipeline reports for correct focus and timely disposition of applications
- ✓ Review a sample of overrides or exceptions to approval and denial decisions
- ✓ Reviewing a sample of denied applications prior to communication to the applicant to determine if any options exist to get it approved
- ✓ Reviewing a sample of adverse action notices for accuracy, completeness and timeliness
- ✓ Reviewing a sample of fee waivers or increase/decrease from standard fees
- ✓ Reviewing a sample or all complaints related to the loan application process and discussing with Compliance if certain “key words” warrant further action
- ✓ Reviewing a sample of application activity of indirect auto partners
- ✓ Reviewing relationships with third parties such as realtors, brokers, etc.
- ✓ Running on-going analysis (regression, proxy, etc.) based upon the risk assessment risk

The Third Line of Defense



“The Third Line”

Internal Audit will provide independent oversight and auditing.

What controls might the second line implement and be responsible for on a continuous basis:

- ✓ Test a sample of pipeline reports for timely disposition of applications
- ✓ Test a sample of overrides or exceptions to approval and denial decisions
- ✓ Test a sample of denied applications prior to communication to the applicant to determine if any options exist to get it approved
- ✓ Test a sample of adverse action notices for accuracy, completeness and timeliness
- ✓ Test a sample of fee waivers or increase/decrease from standard fees
- ✓ Test a sample or all complaints related to the loan application process and discussing with Compliance if certain “key words” warrant further action
- ✓ Test a sample of application activity of indirect auto partners
- ✓ Test on-going relationships with third parties such as realtors, brokers, etc.
- ✓ Validate any models or analysis methods being used
- ✓ Validate risk assessment content and results
- ✓ Validate scope of the second line compliance testing



The Bigger Picture

What is an Effective Compliance Program?

Additional Elements associated with an Effective Compliance Program:

Positive Tone from the Leadership

- Does Leadership make themselves available to address compliance issues?
- Does Leadership support compliance?
- Are they involved and accountable?
- Does the Board conduct routine Executive Sessions with the Compliance Officer

Positive Compliance Culture

- Do individuals trust compliance (department, processes, investigations, etc.)?
- Are people adequately educated on compliance principles?
- Is compliance a part of the way business is done?

What is an Effective Compliance Program?

Additional Elements associated with an Effective Compliance Program:

Business Accountability

- Does the business own compliance activities and decisions?
- Is there business-line monitoring?
- Does the business have a clear understanding of compliance expectations and responsibilities?

- Examples:
 - Indirect Auto- is the Business monitoring and analyzing data at the Credit Union level **AND** the dealership level? Have we conducted due diligence on our dealerships? E.g. complaints, litigation, site visits, etc.
 - Mortgage- HMDA data analysis, redlining analysis, mystery shopping, etc?

Structure, Oversight, and Governance

- The CMS should be clearly established as a “Second Line of Defense” function within the organization.
- When the regulatory environment shifts or changes, an effective compliance system should not merely update policies, but rather **initiate action plans** designed to **assess impact** at an enterprise level, as well as, tactically in the business lines.
- Sound change management enhances your current CMS and helps ensure the success of the other areas such as: risk assessment, staffing, self-monitoring, training, policy and procedure enhancements, auditing, reporting and utilization of technology.
- These impacts may result in product and service offering revisions, executive management education, developing or amending risk assessments, audit program changes, business process changes or other changes required to remain in compliance.

Structure, Oversight, and Governance

- What does your Board expect from the CMS?
- In a depository institution, the Board of Directors is ultimately responsible for developing and administering a compliance management system that ensures compliance with Federal consumer financial laws and regulations and addresses and prevents associated risks of harm to consumers
- Whether the Compliance Officer reports directly to the Board or a board committee, there is certain information necessary to allow the Board or designated committee to understand enough to make decisions



Structure, Oversight, and Governance

- What do we expect from the CMS and Fair Lending Program?
- Risk Assessment- utilize the FFIEC's guidance which clearly sets forth the minimum requirements to be considered:
 - Structure and management
 - Supervisory History
 - Loan Portfolio
 - Credit and Market Operations, which includes:
 - Underwriting
 - Pricing
 - Steering
 - Marketing
 - Redlining



Structure, Oversight, and Governance

Board Responsibilities:

- Establish policy and program
- Promote strong values – the tone at the top
- Ensure issues are identified, addressed and resolved
- Annual assessment of program

The Key to Direction is Good Information

Sources of good information:

- Risk assessment
- Audits and internal monitoring results
- Compliance committee reports
- Exception tracking reports
- Key trends and issues/complaints
- Compliance Officer updates
- Regulatory agencies - public enforcement actions/policy statements/upcoming exam priorities



Structure, Oversight, and Governance

Senior management responsibilities are to:

- Establish, communicate, and enforce policy
 - *“The duty of senior management is to ensure that the compliance policy is observed and entails responsibility for ensuring that appropriate remedial or disciplinary action is taken if breaches are identified.”*

Senior management should, with the assistance of the compliance function:

- Establish a culture of compliance and lead by example
- Ensure that a permanent and effective compliance function is in place
- At least once a year, identify and assess the main compliance risk issues facing the company and the plans to manage them
- At least once a year, report to the board on the organization’s management of its compliance risk
- Assist the Board in making informed judgments on whether the organization is managing its compliance risk effectively
- Report any material compliance failures to the Board – PROMPTLY



Complaint Management

Consumer Complaint Management System – What you need to know!

- Despite our best efforts, sometimes things go wrong and customers complain
- All the agencies have had channels for consumers to file complaints. The CFPB *invites* consumers to share their experiences and provides step-by-step instructions
- Complaint data is used by the regulatory agencies to drive decisions about examinations and investigations
- An effective complaint management program is critical to meet business objectives and to manage regulatory risk
- Complaint data should be viewed as invaluable business intelligence

Complaint Program— Bureau Examination Objectives

- Consumer complaints and inquiries, regardless of where submitted, are appropriately recorded and categorized.
- Complaints and inquiries, whether regarding the entity or its service providers, are addressed and resolved promptly.
- Complaints that raise legal issues involving potential consumer harm from unfair treatment or discrimination, or other regulatory compliance issues, are appropriately escalated.
- Complaint data and individual cases drive adjustments to business practices as appropriate.
- Consumer complaints result in retrospective corrective action to correct the effects of the supervised entity's actions when appropriate.
- Whether weaknesses in the compliance management system exist, based on the nature or number of substantive complaints from consumers.

Excerpt from *Consumer Financial Protection Bureau Supervision and Examination Manual, Version 2.0—October 2012*

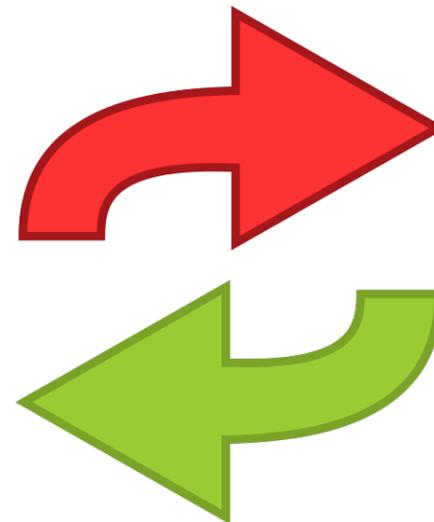
Consumer Complaint Management System – What you need to know!

- Regulatory agencies require financial service providers to be responsive to inquiries and complaints
- Effective programs not only collect and respond to complaints, but also monitor and analyze complaints to understand and correct weaknesses that could lead to violations or consumer harm



Complaint Management Systems – The Basics

- Ensure that the first priority of your complaint management program is to make sure members receive a satisfactory resolution to their complaints
- A clear understanding of what the Financial Institution defines as a complaint is critical
- Be sure there is clear understanding of the channels from which complaints can originate and will be accepted:
 - ✓ In person
 - ✓ In writing
 - ✓ By phone
 - ✓ By website
 - ✓ By social media
 - ✓ Through third parties
 - ✓ From the CFPB and the other regulatory agencies
- Make sure there is clear understanding of how to recognize a complaint at the front lines and within call centers, and other customer contact areas
- Have a structured, disciplined, and documented process for complaint intake



Complaint Management Systems – The Basics

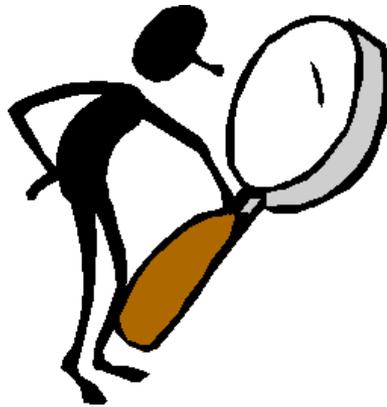
- The ability to analyze complaint data is a critical component of an effective process to manage regulatory risk, including risks associated with UDAAP, fair lending, and fair and responsible banking
- Collection of relevant data in a form and format that allows for analyzing the data and monitoring for patterns and trends is imperative and having a central repository for the information is preferred, if not necessary
- Whether database solutions (e.g. Access, Excel, etc.) or complaint management software is utilized, having a solution will help ensure consistency of the information collected, and allow for the tracking and monitoring that is critical to the process
- Important considerations include is it sufficient to handle complaint channels, volumes, and will it facilitate effective monitoring, tracking and analysis

Complaint Management Systems – Data Collection and Validation

- Documentation about the complaint should be clear and thorough
- Complaint data should be monitored for clarity and completeness; if using software, data validation routines can be useful in ensuring more complete collection
- If manual, frequent monitoring is necessary to ensure personnel understand the procedures and are collecting complete information (no blank or unexplained fields, lack of detail, unclear explanations, etc.)
- Keep in mind auditors and examiners will view the information and will need to understand what happened
- Customer service center calls that are recorded should be periodically reviewed to assess consistency and compliance with the complaint policy
- Centralizing complaints and their processing can help ensure customer are receiving consistent and timely responses and that potential changes to processes are based on the most complete data

Complaint Management Systems – Cause Analysis

- Managing complaints effectively requires understanding what gave rise the complaint
- The “Why” will help identify process changes that are needed to reduce or prevent future complaints and limit risk



Complaint Management Systems – Cause Analysis

- Once data is accumulated, sorted, and patterns identified, start asking why
- Make a closer review of complaints that are similar to understand why they are occurring
- It's a good bet that are customers are experiencing the same problem, but haven't lodged a complaint
- Cause analysis should help you determine what processes need to be changed or enhanced, disclosures or notices made clearer, advertising that may be confusing or misleading

Thank YOU!

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