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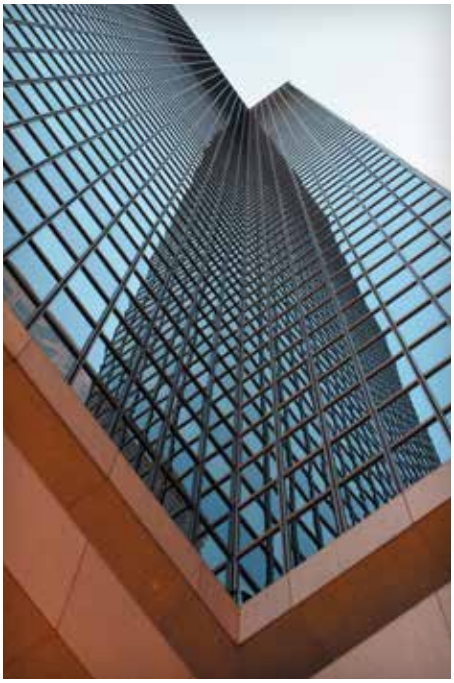
Governance

Avoiding Post-Acquisition Culture-Related Compliance Issues

By Paul R. Osborne, CPA, CPO, CAMS

Merger and acquisition activity in the banking industry has been keeping a steady pace, making due diligence commonplace for many larger institutions in acquisition mode. Due diligence, of course, requires paying significant attention to detail to help increase the odds that the systems of the surviving organization function in a way that is consistent with laws, regulations, and sound banking practices. But this attention to detail often overlooks a critical component—cultural differences between the acquiring and the acquired bank.



Why Culture Matters

Due diligence typically considers overall management, technology, personnel, infrastructure, operations, accounting, facilities, loan portfolios, and, yes, compliance. According to the Federal Deposit Insurance Corp., in the summer 2013 issue of Supervisory Insights, "[a] successful merger results in an integration of systems encompassing risk management, information technology, Bank Secrecy Act/anti-money laundering [BSA/AML], and compliance with consumer protection laws and the Community Reinvestment Act." Consideration of compliance, however, is incomplete without consideration of the cultural differences that can lead to compliance issues.

For example, an acquiring institution might handle compliance in an impersonal, highly automated fashion, while the acquired institution might deal with it in a more customer-relationship-based, hands-on manner. Perhaps the institution being acquired is a rural institution that offers "Doughnut Fridays," where customers come in to enjoy a baked treat, pick up their monthly statement, and maybe sit in on an informational presentation. If the acquiring bank applies a checklist approach to due diligence, it would simply request sample statements for testing from the rural bank and learn nothing about how statements are distributed. If the surviving institution begins mailing statements to former Doughnut Friday patrons without proper communication, rather than personally handing statements to customers as they are used to, it could lead to customer complaints being lodged with the Consumer Financial Protection Bureau. While banks could argue that this is not necessarily a complaint, consumers who were irked about the acquisition in the first place could use it as a means of voicing their opinion.

Recent enforcement activity confirms that compliance management systems at acquired or surviving institutions need enhancement, particularly when community banks struggling with compliance costs are involved. In one case, an institution in acquisition mode bought several smaller banks. The compliance and BSA/AML officers in the surviving institution came from one of the smaller banks and weren't prepared to deal with the heavier hand of the regulatory agency overseeing the surviving institution. The officers never had any problems with their former regulator, yet the new sheriff informed the bank that it needed to scale up its compliance efforts to be more appropriate for the size of the surviving institution. The smaller banks had simply relied on examination results to make improvements, but today's regulatory expectations call for banks to be more forward thinking and risk-based with their enterprise-wide compliance management systems.

To avoid such issues, those who perform due diligence should consider several types of potential cultural differences between institutions.

Product Differences

Different institutions offer different products. And different products come with different compliance requirements. A business-oriented bank faces few compliance requirements that affect its operations because compliance requirements focus largely on consumer products, such as mortgages and consumer loans. If a business bank acquires an institution with a consumer emphasis, it must prepare for an onslaught of new compliance issues.

Alternatively, an acquirer might reshape the acquired bank's products. A shift in product offerings is likely to not only affect customers but also personnel. A consumer-oriented bank looking for non-interest income, for example, might base part of its employees' compensation on the amount of monetary instruments sold to non customers. If the acquiring bank drops the sale of monetary instruments to non customers, it could send the wrong message to employees who might become less inclined to be properly rigorous about compliance.

To minimize such problems, the acquiring bank should take several steps, including:

- Reviewing the original contracts with customers to determine whether the documents address the possibility of changes and any associated obligations or prohibitions;
- Reviewing how products were marketed to the customers (for example, whether there were any implied guarantees, such as no late fees, minimum interest rates, or guaranteed 24/7 access to accounts);
- Confirming that any changes to home equity lines of credit will not adversely affect the consumer;
- Providing customers with adequate notices if changes are being made (regardless of whether legally or contractually obligated to do so);
- Verifying that existing products being moved to a new system are processed in accordance with provisions in the contracts and disclosures, such as those related to rates, rate calculations, and fees;

- Verifying that accounts will be serviced going forward as disclosed on balance computations, interest charges, and fees assessed; and
- Training staff on new products and systems.

Management Style Differences

Was management at the acquired bank supportive of compliance, or was it merely tolerant? Did it view compliance as an inescapable cost center instead of a valuable contributor to the institution's long-term health? Has the organization taken a proactive approach and allocated sufficient resources, or has it done the bare minimum? What do the results of compliance examinations reveal regarding the overall compliance efforts?

Due diligence should include meetings with both management and personnel to determine management's historical attitude toward compliance. If the attitude has been lax, the acquirer will need to send the message that the surviving institution is supportive of compliance and sees it as everyone's responsibility as opposed to leaving it only to the compliance officer or department. Relevant personnel should receive the training necessary to become familiar with the acquirer's compliance standards. It's imperative that the proper tone be set from the beginning.

Geographical Differences

Different locales have different ways of doing things, different priorities, and different paces of life. All of those factors can influence how compliance is carried out. For example, a big-city bank and a small rural bank probably have different methods for gathering input from community leaders as required by the Community Reinvestment Act (CRA). After the acquisition, these differences quickly could come to the forefront if the CRA assessment area were to expand. And those performing due diligence also need to consider the different state compliance requirements that might apply, including things such as community property laws.

System(s) Differences

The merging of two banks likely means the assimilation of different systems, ranging from the mainframe system to loan and deposit processing systems. Will the surviving institution run parallel systems or implement a switchover to a single system as of a certain date? The acquiring bank should be careful not to take a "been there, done that" approach in converting systems. Without fully understanding how the institution being acquired uses its systems, small yet important details could be overlooked. System differences and conversions could result in both the loss of data and processing gaps (for example, customers no longer receiving disclosures on the proper schedule). The potential negative repercussions for compliance are obvious. Certain fields could be used to identify special loan types or customers requiring special attention.

To minimize negative repercussions, it's important to establish a formal project plan and system conversion teams. The terms and conditions of every product must be reviewed, as should the acquired bank's use of the fields in its systems—you can't assume that the fields are used as labeled. Close analysis is essential to make sure that nothing falls through the gaps during or after conversion.

Contact Information

Paul Osborne is a partner with Crowe in the Indianapolis office. He can be reached at 317.706.2601 or paul.osborne@crowe.com.

Beyond the Nuts and Bolts

An acquiring bank must remember to look beyond the financial components of a merger or acquisition transaction to understand the culture of the acquired institution. Successful integration takes much more than a checklist approach. The act of combining institutions is more than a financial transaction, after all. It's also a merging of cultures.

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