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Spotlight on consumer financial protection

Are you fighting fires rather than building
a stronger compliance program?

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The stakes are high for the financial services industry as they work to achieve compliance with Consumer Financial Protection Bureau (CFPB) rules, particularly because regulators' expectations about risks in areas such as fair lending and unfair and deceptive practices are not always clearly defined. In addition, even traditional regulations have become more stringent, resulting in the need for compliance management teams, including the line of business, to have deeper expertise not only in the regulatory requirements but its impact on system modifications for core systems and enhanced models for data analysis.

Increasing complexity in consumer compliance

Consumer protection rules apply not only to large banks, but also to auto finance companies (with ripple effects for retail dealerships), mortgage companies, financial technology (fintech) firms, payday lenders, and businesses offering prepaid cards, also known as general purpose reloadables.

Additionally, banks with less than \$10 billion in assets preparing to acquire or merge need to prepare for greater oversight by the CFPB once they hit the \$10 billion threshold.

CFPB regulations are complex and compliance risk is ultimately the

responsibility of the line of business. A recent comment by Calvin Hagins, deputy assistant director for originations at the CFPB, made it clear that the bureau will meet with line of business leaders, not the compliance team, during an examination to discuss controls for products and services that mitigate identified risks. In other words, the days of the compliance team acting as a buffer are gone. Line of business leaders need to be knowledgeable and versatile when it comes to understanding the company's risks and the compliance-related controls necessary to mitigate those risks. While compliance should play an integral role in advising the line of business, the line of business leaders will be at the table during examinations.

Compliance is also increasingly difficult due to the sheer volume of data required. Mortgage lenders, for example, need to input data into two dozen fields for each loan to comply with provisions of the *Home Mortgage Disclosure Act*. By 2018, the number of required fields will increase to 48. In addition, reporting on home-equity line of credit activity, now voluntary, will be mandatory. The doubling of data fields in mortgage lending may require 1) changes to core systems for loan origination, 2) changes to fair lending models used to analyze data, 3) revised processes, and 4) additional personnel for data integrity and quality assurance.

The deepening mine of required data will also provide more information for regulators to review for errors in data integrity and to look for patterns of disparate treatment, possibly leading to accusations of unfair lending practices.

Holistic response needed

Because of the widening scope of scrutiny, compliance with consumer-facing regulations is of concern not only to chief compliance officers, but also to senior executives and business line leaders. The scope of oversight is broad, beginning with marketing, and continuing through debt collection and foreclosure practices. Lawsuits and court decisions are likely to be relied upon to define what constitutes “unfair and deceptive practices” against consumers.

Consequently, organizations need to move from a perfunctory “check the box” approach to implementing proactive and comprehensive programs for consumer compliance. Making this shift will help to break down siloed approaches. An inclusive approach is needed – one that involves an organization’s compliance leaders especially in fair lending, UDAAP, and the *Community Reinvestment Act*, along with input from chief risk officers, chief operating officers, enterprise risk management leaders, and the line of business that owns the risk.

Rather than merely interpreting what regulations specify, compliance leaders need to evaluate the adequacy of the current enterprise compliance program and their role and responsibility within its numerous components. Compliance leaders should carefully consider the following elements of a compliance program:

- Enterprise risk assessment
- Policies and procedures
- Monitoring and testing
- Adequate and meaningful reporting
- Role of technology
- Change management
- Corrective action
- New products and initiatives
- Vendor management

Benefits of getting ahead of the regulatory curve

As new and amended laws and regulations have added to the compliance burden, so too have consent orders, examination findings, and internal audit findings, as well as the outsourcing of services. Many financial services organizations find themselves short of experienced resources since much of compliance officers' time is spent working across multiple lines of business helping to remediate regulatory orders while also conducting business as usual. As a result, many organizations lack a comprehensive enterprise risk assessment, which then hinders identification of areas of high risk and actions the line of business needs to take to mitigate risk. Many organizations could benefit by taking a step back and envisioning more effective approaches.

Effective compliance depends on vigilance across departmental boundaries and business lines. Adequate staffing and experienced resources help organizations develop stronger, sustainable programs.

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Some of the benefits of such programs include:

- Greater confidence in addressing the detailed terms of numerous regulations in consumer banking and finance
- Stronger collaboration with the line of business and other departments and avoidance of repetitive effort
- More comprehensive discovery of risks, along with having compliance controls in place to mitigate risks and prioritize issues
- Integrated systems and methods, resulting in comprehensive yet cost-effective approaches
- Avoidance of monetary fines and reputational damage due to ineffective programs for monitoring fair lending and other practices.

Recent experience indicates help is needed in the following areas:

Enterprise compliance risk assessment (ECRA)

(ECRA). The content of the ECRA extends from high-level corporate governance to compliance risks and controls within lines of business. The assessment may focus primarily on consumer-facing regulations, but also on areas such as treasury, human resources, and institutional safety and soundness. A thorough approach helps clients 1) identify control gaps based on process mapping within the line of business and 2) develop enhancements needed to correct weaknesses. Conducting an ECRA enables identification of higher-risk areas for attention and remediation, which makes for smarter use of limited resources.

Fair and responsible banking. Larger organizations are consolidating programs for fair lending and the prevention of unfair, deceptive, or abusive acts and practices (UDAAP) into fair and responsible banking programs. Others may need help building an integrated program from the ground up. The typical starting point is assessing current workflows to determine the adequacy of staffing, training, monitoring, and reporting to the board of directors. A review of best practices can spur improvement ideas based on successful programs implemented elsewhere.

Information systems and technology tools. Many organizations have automated governance, risk, and compliance (GRC) solutions, but these may not be operating as expected for purposes of compliance risk. Many GRC solutions need to be customized to accommodate compliance risks and controls, in addition to assisting with traditional operational risks and controls for which most of the systems were designed. Organizations that have grown through acquisition also need to integrate disparate GRC systems.

Compliance lookbacks. Finding a mistake – especially when processes are automated – can be indicative of a trend. Some organizations may detect issues in specific areas and conduct a multiyear review before regulators intervene. Consumer regulatory compliance lookbacks frequently relate to flood insurance, the *Servicemembers Civil Relief Act*, and the CFPB's Regulation Z (calculations of annual percentage rates).

Better monitoring. Effective key risk indicators help to spot risks and address variances before they develop into major problems. Opportunities to run afoul of regulations exist for all organizations, but especially for large and complex organizations. Infractions can happen in manual processes such as marketing when a copywriter unknowingly uses a “trigger term” that requires particular phrasing to be compliant. In addition, loan originators and servicing personnel may waive requirements for one borrower but not another, thereby increasing risk of discrimination due to discretion. An automated monitoring tool can tap into data, apply parameters, and alert the risk owner to potential problems.

Fair lending analytics. It's critical for the business and compliance function to identify trends in data and also how organizational data compares to that of its peers. Analytics are a valuable statistical tool for cutting through vast amounts of data and detecting patterns. The findings can be visualized in dashboards for tracking performance and spotting abnormalities. Some organizations may already have models in place to identify trends. Those models, however, may need validation of analytic techniques and an assessment to determine if staff know how to run the models effectively in accordance with standards for underwriting and pricing, and if they comprehend and know how to act on the results.

Bank meets tight regulatory deadlines while upgrading compliance program

Crowe was recently called to help a large financial services organization remediate consent orders that affected multiple business lines. To avoid similar problems in the future, institutional leaders decided not only to deal with immediate matters, but also to improve governance, processes, and systems for overall compliance with consumer-facing regulations.

As the engagement began, the project team saw inconsistent prioritization of compliance-related issues, and not enough understanding of interdependencies to resolve matters at the program level. Multiple functions competed for the same resources with a lack of accountability.

In the role of project manager and compliance specialist, the Crowe team clarified the remediation challenges and aligned work streams to execute priorities. Roles and responsibilities were realigned with a revised governance structure to meet ongoing regulatory challenges.

Working within a tight time frame, Crowe helped the organization achieve its immediate goals to satisfy enforcement demands. At the same time, Crowe also helped the client build for the future by strengthening its governance framework and by facilitating collaboration to stay on top of regulatory change.

Remediation of consent orders. For this highly specialized area, the compliance program office may need to engage an outside service provider that can bring in experienced professionals who have held compliance positions in similar organizations. The depth of experience offered by these professionals can help organizations to remediate consent orders more rapidly and strategically, an undertaking that should be a focused priority for any organization dealing with a consent order.

Operationalizing processes for effective compliance

Rather than dealing with compliance only at the back end (or, after an enforcement action), organizations need to focus more attention at the front end. To avoid fines and reputational damage, organizations benefit from a proactive approach across the spectrum: from planning and bringing people together in compliance-related activities to implementing more effective controls and detecting and correcting issues before they grow into serious problems. Verifying that your organization has a clear understanding of the differences between operational risk and controls and compliance risk and controls will help prepare the line of business, among other groups, to deal with the increasingly complex consumer compliance regulations.



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