

TUNING YOUR COMPLIANCE PROGRAM

LESSONS FROM RECENT EXAMINATIONS

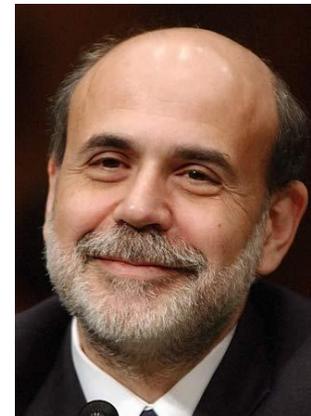
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Disclaimer....

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- My statements are solely my own, and do not necessarily represent the opinions of the Federal Reserve Bank of Boston.

- ...or the Federal Reserve System.



The Compliance Challenge

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“We’re a consumer compliance department that dabbles in mortgage lending on the side.”

CEO of a community bank as
overheard at a conference

Don't Lose Focus!

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- Why are we doing all this?
 - ▣ Ensuring consumers are treated fairly and...
 - ▣ Protecting your bank from a bona fide business risk
 - Compliance should be viewed, and managed as any business risk the bank faces.

Today's Agenda...

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- Flood Insurance
- RESPA (Escrow)
- Third Party (Vendor) Management
- Risk Assessments
- Internal Controls and Testing
- Senior Management Oversight

Flood Insurance



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- Still see flood insurance as a significant stumbling block - even for strong programs
- Majority of the problems we see are occurring **post-origination** when insurance comes up for renewal

Flood Insurance



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□ Things to watch for...

- Incorrect zone changes by agent
- Coverage changes by agent or consumer
- SFHA remapping – **This may put new loans in your flood portfolio!**

Flood Insurance



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- Use a tickler system, spreadsheet etc. with
 - Origination date
 - Loan Type (Residential or Commercial)
 - Loan amount at origination
 - Insurance coverage at origination
 - Loan increases, renewals or extensions (if any)
 - Increase, Renew or Extend date (if applicable)
 - Insurable value of property
 - Current flood insurance amount
 - Flood zone (Letter A or V)
 - Current policy - expiration date

Flood Insurance



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Coverage Calculations

- At least equal to the lesser of 1) insurable value, 2) loan amount 3) maximum allowed by NFIP program

Regulators Say...

- $\text{Insurable value} = \text{Property Value} - \text{Land Value}$

Flood Insurance



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Force Place

- 1) On date existing policy expires, or when you determine coverage is not sufficient - the “45 day letter” is mailed
- 2) If the borrower fails to get insurance in 45 days – force place

Flood Insurance



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Multiple Properties

- Each building needs its own policy
- If the loan amount is the limiting factor – then you will need to allocate the total insurance amount among the properties

Flood Insurance



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Multiple Properties Example 1 (Commercial)

Loan Amount = \$300,000

Property A – Insurable Value = \$2.5 million

Property B – Insurable Value = \$200,000

Property C – Insurable Value = \$10,000

Limit = Loan Amount or \$300,000

Property A - \$200,000

Property B - \$95,000

Property C - \$5,000

One Example (Regulatory Requirements)

Flood Insurance



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Multiple Properties Example 2 (Commercial)

Loan Amount = \$2 million

Property A – Insurable Value = \$2.5 million

Property B – Insurable Value = \$200,000

Property C – Insurable Value = \$10,000

Limit = 1) Program Max and 2) Insurable value

Property A - \$500,000

Property B - \$200,000

Property C - \$10,000

RESPA



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Not a lot of exam issues with new requirements

Escrow has been a reoccurring issue

- ❑ Disclosural problems affecting both initial and annual statements (but mostly annual)
- ❑ Several variations, but typically involve incorrect accounting of one or more escrowed items
- ❑ Also missing months (i.e. only 1 1 on statement)
- ❑ All issues were due to
 1. User error with servicer application
 2. Insufficient internal testing



Lessons Learned

- ❑ Internal Controls - Spot check documentation!
- ❑ Don't over-rely on servicers, or closing attorneys
- ❑ One person should be able to calculate escrow by hand
- ❑ Someone should know the operations of your loan origination/servicing system

Vendor Management



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Manage Your Vendors!

Don't forget – they work for you!

Product Servicing Vendors

- RESPA escrow example from earlier slides
- Periodically check MIS output to make sure it's correct
- Don't be afraid to ask questions
 - Why does this produce this output?
 - What are my options as a user?
 - Who is my compliance contact for your organization?

Vendor Management



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Audit

- The audit function is your tool - it's not for regulators
- The bank should drive the audit process
 - ▣ The scope and intensity of reviews should be based primarily by your needs
- Use the tool! Close the loop!
- Yes, audit tracking is great – but use it to find the source of issues – not to fix “one-offs”

Vendor Management



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One more point about audit...

- It is probably a good thing if you think your auditors are a bit “too” thorough
- Audit is not supervision
- I would rather have an audit that is a little tough and not be surprised at an exam than the other way around

Risk Assessments



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- ❑ Conducting a periodic assessment of inherent consumer compliance risks is a good practice
 - ❑ BUT ONLY TO THE EXTENT THAT IT IS EFFECTIVELY UTILIZED
- ❑ Should be a tool to help you more effectively allocate resources
- ❑ What poses the greatest risk to your bank?
 - ❑ **Business** – new products, complex products, significant growth
 - ❑ **Regulation** – visibility, complexity, changes
 - ❑ **Operational** – MIS, systems, delivery



Risk Assessments

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- ❑ This is scalable! The appropriate level of detail is a business decision for you and senior management
- ❑ Drivers should also be:
 - ❑ Audit findings
 - ❑ Examination results and recommendations
 - ❑ Internal testing findings
- ❑ A good risk assessment should play a role in these decisions
 - ❑ Training
 - ❑ Audit schedules and scope
 - ❑ Monitoring and internal controls /testing



Risk Assessments



Internal Controls and Testing



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- ❑ In my experience – reliance on third party audit function alone proves to be insufficient
- ❑ Need some degree of internal testing imbedded within the businessline
- ❑ Why?
 1. Time Lag – too much can go awry between regular audits
 2. Culture of Compliance – the best programs have compliance imbedded in day-to-day operations
 3. Internal testing should help drive audit process

Internal Controls and Testing



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- ❑ As with risk assessments, this is scalable!
- ❑ You will need to find the most effective balance here – cost / benefit

Senior Management Oversight

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- We talked about the notion of “imbedded compliance” and a “culture of compliance”
- These are the hallmarks of a solid compliance risk management program
- Compliance needs to be part of the daily operations of the bank – It can’t be viewed as just a cost center
- This idea needs to be driven by senior management and the board

Senior Management Oversight

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- When you present compliance issues to the board, audit committee, etc. - try this approach.
- **What?** – Regulation/Guidance Why was it adopted?
- **Impact?** – Our bank, products, systems. Risk of non-compliance?
- **Cost?** – Compliance, training, systems, forms
- **Plan?** – What are we going to do? Monitoring?

The End

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Thank You!
Questions?