FINANCIAL SERVICES ADVISORY AND COMPLIANCE

SUPERVISORY AND ENFORCEMENT IMPLICATIONS FROM THE NEW UNIFORM INTERAGENCY CONSUMER COMPLIANCE RATING SYSTEM

INTRODUCTION

The Federal Financial Institutions Examination Council (FFIEC) is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Consumer Financial Protection Bureau, and to make recommendations to promote uniformity in the supervision of financial institutions. In 2006, the State Liaison Committee (SLC) was added to the FFIEC as a voting member.[1,2] The regulators believe that the FFIEC generally helps them achieve consistency. In situations where they are unable to achieve consistency, it helps them identify where there may be differences or gaps between agencies.

The FFIEC recently issued an updated Uniform Interagency Consumer Compliance Rating System, replacing the one that has been used for more than 35 years. The regulators designed the updated rating system to align with their current risk-based approach to consumer compliance examinations. Regulators began using the updated rating system on examinations beginning on March 31, 2017.

Summary of the Updated Rating System

Under the updated rating system, examiners will evaluate:

- Board and Management Oversight
- Compliance Program (including policies and procedures, training, consumer complaints process, and compliance audits)
- Violations of Law and Consumer Harm

1. The SLC includes representatives from the Conference of State Bank Supervisors, the American Council of State Savings Supervisors, and the National Association of State Credit Union Supervisors. The FFIEC established the SLC to encourage the application of uniform examination principles and standards by federal and state supervisory authorities. The SLC represents state supervisory interests and serves as an important conduit to state examiners.
2. https://www.ffiec.gov/

The updated rating system includes valuable Consumer Compliance Rating Definitions, which list the assessment factors examiners will consider within each category, along with narrative descriptions of performance.[3] The factors include:

BOARD AND MANAGEMENT OVERSIGHT	COMPLIANCE PROGRAM	VIOLATIONS OF LAW AND CONSUMER HARM
Oversight and Commitment	Policies and Procedures	Root Cause
Change Management	Training	Severity
Comprehension, Identification and Management of Risk	Monitoring and / or Audit	Duration
Corrective Action and Self-Identification	Consumer Compliant Response	Pervasiveness

The regulators will continue to use a 1-5 rating system when evaluating financial institutions under their jurisdiction (with 1 being the highest rating and 5 the lowest). Additionally, while they will continue to consider the financial institution's size and complexity when assigning a rating, they will also continue to use judgment when assigning a rating. Furthermore, they will likely continue to assign adverse ratings when there are widespread violations or violations that persist over time.

The updated rating system places an emphasis on and appears to reward being proactive and actively identifying and resolving issues. It also establishes 2 as a passing or satisfactory score.

The exhibit below highlights some of the other key changes to the updated rating system.

COMPLIANCE MANAGEMENT SYSTEM (CMS)

Financial institutions must have a robust CMS. The CMS may vary from institution to institution based on its size and complexity; however, it is mandatory for every institution, including startups.

VENDOR MANAGEMENT

Regulators expect financial institutions to extend their compliance program to address third-party vendors and be responsible for any violations.

VIOLATIONS

While regulators will continue to evaluate financial consumer harm, they will also evaluate non-financial consumer harm such as denials of credit opportunities.

Regulators will likely not assign a satisfactory rating under the updated rating system if a financial institution does not have a strong CMS, even if it does not have any violations. Regulators will likely only assign a 1 in situations where a financial institution's compliance program proactively prevents, identifies, and resolves compliance issues. Additionally, if the regulators determine that violations occurred as a result of an insufficient CMS, they will likely assign an adverse rating of 4 or 5. The regulator's decision to assign a 4 or 5 will be based on the level of CMS deficiency.

As a key component of a CMS, regulators will explicitly factor vendor management into a financial institution's rating. Failure to effectively manage the risk associated with outsourcing will adversely affect a financial institution's own compliance rating.

While regulators will continue to evaluate items such as substantive fair lending violations, they will also evaluate non-financial consumer harm items such as denials of credit opportunities or improper credit reporting when determining violations.

3. https://www.ffiec.gov/press/PDF/FFIEC_CCR_SystemFR_Notice.pdf

KEY CONSIDERATIONS

Financial institutions will continue to face the challenges related to having multiple regulators issuing ratings that may not be consistent between agencies. To further exacerbate the challenge, examiners currently do not have to explain their conclusions, leading financial institutions and other regulators without support to understand the basis for their conclusions.

Nevertheless, financial institutions should seek to obtain a satisfactory rating, as an adverse rating of 4 or 5 may lead to more examinations or prohibitions on new activity, and may potentially have safety and soundness implications. Financial institutions must be aware of the updated rating system and take the necessary actions to ensure a smooth transition, including, but not limited to:

- Financial institutions need to be proactive, and create a culture of compliance.
- Financial institutions must establish an effective CMS composed of four key pillars, which are Board and Management Oversight, Compliance Program, Customer Complaints Process, and Compliance Audits.
- As the regulators will explicitly factor a financial institution's management of third-party relationships into their ratings, institutions must develop a framework to mitigate the risk of third-party vendors and provide a mechanism for ongoing monitoring.
- Given that the regulators will continue to use judgment in assigning ratings, financial institutions may want to more thoughtfully consider proactively presenting issues to the regulators.

HOW NAVIGANT CAN HELP

Navigant has unparalleled consumer finance experience. We have executed hundreds of high-profile mortgage banking and consumer finance engagements over the last decade, and know all aspects and stages of consumer banking from origination to collateral disposition. Accordingly, we have valuable insight and perspective as banks and nonbanks begin or continue to assess the impact of the updated rating system and prepare for consumer compliance examinations. We have significant experience advising financial institutions on the evolving regulatory landscape to ensure that our clients are on the forefront of industry best practices and are prepared for potential examinations and / or investigations.

Using independent, outside resources who have industry-wide perspectives allows financial institutions to implement best-in-class solutions in the most cost-effective manner. Navigant's breadth and depth of experience allows us to serve as trusted advisors for banks and nonbanks dealing with regulatory challenges.

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About Navigant

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