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EXAMINATION PREPARATION

ENSURING INSTITUTIONAL READINESS

Examination Preparation: Ensuring Institutional Readiness

As the old saying goes, “The best defense is a good offense.” The adage holds true when it comes to preparing for a consumer compliance examination. A proactive compliance program is the best way to ensure you are ready when the big day comes. Being proactive is not always easy. It takes planning, organization, support from all departments, and most importantly solid, clear documentation and recordkeeping that is easily accessible. The goal of this BAI Whitepaper is to provide some helpful hints for your institution to follow to help ensure preparedness.

CFPB Exam Manual

A good place to start when preparing for an examination is to review the *CFPB’s Supervision and Examination Manual*. The comprehensive manual shows by regulation exactly what the CFPB will be looking at during regulatory examinations and its expectations for exams. Even if your institution is not regulated by the CFPB, specific examination procedures will be similar to those of other regulators and in some instances, state regulators. The CFPB owns the regulations, therefore other regulators will follow.

The CFPB’s supervision process is governed by three principles; a focus on consumers, a data driven approach, and efforts to ensure consistency. A regulatory agency will often look at how your institution detects and prevents practices that will pose harm to consumers. For the CFPB, harm would be considered an economic loss or other injury, such as an invasion of privacy that results from a violation of a consumer compliance law or regulation. A regulatory agency will also look at how your institution responds to and corrects practices that resulted in harm.

Exams will focus on a thorough analysis of available data. Data will be reviewed from a variety of sources including those provided by the institution, through observations during the exam process, and information obtained from various offices and divisions within the CFPB. This data can be reviewed at any time, not just during the exam. In the current regulatory environment, it is important that your institution is always prepared for an examination.

To ensure consistency, the CFPB will use the same procedures to examine all entities that offer the same types of consumer financial products or services, or similar activities. This consistency is intended to allow for a greater understanding of examiner expectations. In addition, by reviewing enforcement actions issued, your institution can ensure it is not guilty of the same acts outlined in the action or of completing similar violations.

The supervision and examination process is cyclical. It involves four areas:

1. Pre-examination/scoping,
2. Examination (on-site and off-site),
3. Communication of conclusions and required corrective actions, and
4. Monitoring.

The cycle is continuous. Since the CFPB views the exam process as continuous, your institution should treat examination preparation as continuous as well. This is why a strong compliance management program is essential.

Proactive Compliance Management Program

Examination preparation is much less stressful if compliance is your focus on a daily basis, and not just for the period after the examining agency's request letter is received. A solid proactive program ensures that your pre-exam prep is limited to logistics, preparing responses to the request letter, and ensuring documentation is clear and easily understandable. That can be easier said than done in a regulatory environment where Compliance Officers are stretched to the limit and departments are understaffed in trying to keep up with regulatory changes being rapidly introduced. It is not easy, but formalizing your compliance program will help. Once formalized, compliance becomes second nature. If documentation is already completed, it is a matter of collecting – rather than creating – which will greatly help reduce the stress and time commitment associated with exam prep. The following are some areas that can be formalized to create a more proactive program and a strong compliance management program.

1. Risk Assessments

Risk assessments are an industry hot topic and are essential to a modern compliance program. There is no right way to complete a risk assessment, but not completing one can be detrimental. Although subjective, the end result should be the same. The institution should know where risks lie within the organization. The institution needs to be aware of inherent risks and whether controls are adequate, and should then focus its efforts on the areas where the residual risk is greatest. The CFPB's exams focus on the consumer, and your institution's risk assessment should highlight the areas of greatest risks to your consumer. Your compliance program should revolve around the results of this risk assessment.

The risk assessment should be a living document. Every time a product or service is introduced, it will affect the risk, and the assessment should be adjusted accordingly. When exam time comes, an institution should know its areas of highest risk, and what it plans to do to mitigate those risks. Examiners will have their own risk assessment of your institution, but they should never have to tell an institution where risks are greatest.

Risk is unique to the organization. There is no one size fits all program. A mortgage loan may pose the greatest risk based on the product type, but if your institution makes three mortgage loans a year, focusing primarily on the mortgage department is likely not in the institution's best interest.

The risk assessment sets the tone for a compliance management program. It should highlight both strengths and weaknesses, and efforts should be placed on addressing those weaknesses. The risk assessment should help determine where training is needed, where self-assessments should be focused, and whether additional controls are necessary.

Examiners will want to know an institution's methodology for completing the risk assessment. They will go as far as to review the source documents used for determining the risk. If an institution states that there were 180 option ARMs, they will need to provide the report where that information was obtained. Examiners will want to see that the results are reported to the Board or an appropriate committee thereof to show that risks are within the institution's predetermined risk thresholds. They will want to see any action plans that result from the risk assessment and what will be done with the results. Risk assessments should be updated as needed, and at least annually. This document should be put together well before an exam occurs.

2. Self-Assessments

A strong, proactive compliance team knows that it is not perfect. It does not wait to be told of violations of regulation or policy by internal auditors, and especially not by examiners. It completes self-assessments to know whether everything is running as it should. Self-assessments identify whether more training is required, whether updates were implemented, and that policies and procedures are being followed.

The risk assessment should determine the frequency and scope of self-assessments. A schedule should be set at the beginning of the year and followed closely. An institution will want to ensure the schedule is reasonable. If a policy or program states that Flood self-assessments should be completed quarterly, and they are only being completed annually before an exam, the institution will need to reevaluate its resources and schedule to ensure that its practices match its policy.

Self-assessments should address the areas of deficiencies noted in the risk assessment. They should also look at any changes that occurred since the last assessment. For example, if a new disclosure was implemented, the content and delivery of those disclosures should be reviewed. The self-assessment should be completed by someone knowledgeable about compliance requirements. Oftentimes, the compliance department will be responsible for completing self-assessments, but in many smaller institutions that is not feasible. A self-assessment does not need to be independent of the department testing it, but the person completing it should be knowledgeable of the requirements, have enough authority for findings to be taken seriously, and there should be a reporting structure so that any corrective action is appropriately tracked and implemented. Any corrective action noted during a self-assessment must be addressed prior to the examination. It should be taken seriously.

In addition, to determine the risk for violations, the purpose of the self-assessment is to see where violations have already occurred. It is much better for your institution to find violations rather than to have an examiner point it out to you. If violations are found, it is essential that they are corrected prior to the examination. You will want to ensure that your methodology for completing self-assessments, the back-up documentations for the self-assessments, and final reports are ready to provide if requested.

3. Previous Exam and Audit Reports

It is imperative that prior to the exam all corrective action has been completed on any findings from previous examination reports, internal audit reports and self-assessments. It is important to have a strong system in place that documents both findings and resolution. A tracking mechanism should be implemented to ensure not only that corrective action is completed, but that it is completed in a timely and adequate manner.

The tracking mechanism can be as simple as a spreadsheet outlining the issue, parties responsible, corrective action required, and the timeframe in which it should be completed. The spreadsheet should be discussed at any compliance meetings and submitted to the Board as necessary. There should also be an escalation process to ensure proper follow-up and any restitution is made.

The institution will want to ensure that recommendations are being taken seriously, and that corrective action is occurring. If there are problems with resolving the issue by the due date, such problems must be clearly documented and the date adjusted as necessary. It should show that the institution is working on the issue even if it is to achieve a resolution. There must be sound reasoning as to why the issue is not resolved by the time of the next examination – especially when the issue was noted on a prior exam report

Incomplete corrective action will set the tone for an examination. It shows that your institution does not take compliance seriously and that compliance is not a priority. Repeat findings have a much greater effect on both ratings and reputation. The institution will want to avoid repeat findings at all costs.

4. Training

Employee training is essential to a strong compliance management program. All employees, including the Board of Directors, should receive job-specific training. Compliance should have a top-down approach. Compliance starts at the top, and it is essential that the Board understands their role in it. The Board not taking training seriously can set the tone that institutional compliance is not a priority.ⁱ

Training must be current and consistent with policies and procedures, and should be well documented. Up-to-date training records are essential for examination preparation. The institution can assume that examiners will be requesting training schedules, completion records, and the specific materials used for the training. A proactive approach will prevent the institution from scrambling for this information as the examination approaches. It is a good idea to collect all employees' training records on an ongoing basis.ⁱⁱ If PowerPoints or specific information are not available, ensure that an agenda or content description is included with your record retention.ⁱⁱⁱ An agenda will help to show that training is job-specific. The institution will want to include all training received, not just records from a computer-based training program. A strong training program should supplement a computer-based training program with face-to-face training.^{iv}

5. Complaint Management Program

Complaints have always been part of a strong consumer compliance program, and the CFPB has put a renewed focus on that importance. Recording complaints is not enough. The institution must address those complaints as well. Institutions should utilize a formalized program to ensure that root causes are determined, and patterns and practices noted are corrected.

Your institution should have a clear definition of what constitutes a complaint. Even if a complaint is resolved prior to a customer walking out the door, it is still a complaint and should be tracked and treated as such. Employees need to be aware of what constitutes a complaint, and what to do with the details. The institution will want to ensure these types of complaints get into the proper hands for analysis to determine if there are any underlying issues.

All complaints are not treated equally, as some complaints pose greater risks to the institution. Complaints that have underlying fair lending or unfair, deceptive or abusive acts or practices should be escalated appropriately. These types of complaints may raise legal issues beyond the regulatory compliance violations. The institution will want to ensure that appropriate action has been taken long before the exam occurs. Your complaint management program should address how these issues are handled.

Complaints should be monitored for similarities and patterns. A root cause analysis should be completed to determine whether operational changes are necessary, additional training is needed, or disclosures are unclear. Root cause analysis is not just a compliance issue; there can be a true operational benefit. Doing a root cause analysis can help institutions uncover something that they could do differently, or improve upon, to decrease complaints. The root cause analysis should result in an action plan. Similar to the corrective action spreadsheet, this action plan should be detailed and completed, or documented as to why not completed, prior to the exam.

6. Regulatory Changes

Compliance is constantly changing, and this is increasingly apparent in the current regulatory environment. When a new regulation is released, ample time is given before the proposed regulation becomes effective. The institution should designate an employee or department to be responsible for tracking regulatory changes from their first inception. These employees will need to consider all areas and personnel that will be affected by the changes, and the best way(s) to implement internal changes in time for the effective date. There are no excuses. If other financial institutions can do it in a timely manner, so should yours.^v

The institution will need to show examiners that regulatory changes have been addressed. There is no right way to do this, but formalizing communication flow is a good idea. Your program will need to show how your institution becomes aware of the impending changes and how that information is disseminated to the necessary employees. Project plans may be necessary for larger regulatory changes.

Many changes require extensive training, technological changes, disclosure changes, and possibly even the addition of necessary expert personnel. Creating a formalized project plan that outlines the entire project from start to finish is a sound way to ensure that necessary changes are made. Determine who the team will be and designate one person to be the project manager. Remember that documentation is key. A project plan should outline the who, what, where and when of the project. It should include risk assessments, training, testing and roll-out dates. This information should be readily available when requested by examiners. If examiners ask how the institution implemented the mortgage servicing rules, the institution can simply hand them a project plan showing the implementation from its inception to the testing and implementation phase.

Once the Request Letter is Received

A proactive compliance program will help prepare for an examination, but there are some things that must be done once the request letter is received to ensure a smooth examination experience. The more prepared and well-documented the responses to the request letter are, the more likely it may be that examiners will give the institution the benefit of the doubt on any gray areas discovered during the exam as your commitment to compliance will be evident.

Examiners provide a request letter so that you know what will be reviewed during the examination. Request letters specifically outline what examiners would like to see, and the dates they would like to see it. Gathering that information so it is ready upon arrival is crucial. An institution should not keep an examiner waiting. A delayed response implies something is not done, and is being created. That is not the impression you want to make.

Documentation must be clear and understandable. Make sure you are providing everything that is being requested. If the request letter states that examiners would like to look at all training logs and materials, provide more than print-outs from the computer-based training program showing completion rates. Ensure that the appropriate personnel read what is being requested carefully, and provides all information and materials requested. Be prepared with any back-up documentation not requested in the initial letter that may be requested at a later date.

Logistics should be determined prior to the exam. Ask how many examiners will be onsite and ensure you have a comfortable space for all of them to sit and work. If they need special key cards or codes, have those ready when they arrive. If they specifically request phones or other technology, ensure that the requested items are available.

Finally, ensure that all necessary personnel are available during the on-site exam. Inform those personnel as early as possible, so that vacations and time away from the office can be planned accordingly. Provide examiners with the appropriate phone numbers and contact names. Some institutions find that an entrance meeting is helpful to introduce all key players from the institution with whom examiners may wish to communicate.

The key to exam prep is to ensure that the institution does not sell itself short. Document the institution's efforts, and clearly show that compliance is a priority. Make compliance a part of everyone's daily activities, and show the proactive approach your institution is taking all year long, and not just when an examination is occurring.

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- i Consider in-person, customizable Board of Directors training leveraging the BAI Board of Directors Insight Series.
 - ii When providing training records, leverage reports available in the BAI Learning Manager, and contact your BAI Relationship Manager or BAI Customer Support Services if you would like assistance.
 - iii In BAI's experience, examiners are typically satisfied with high-level descriptions of our online courses and do not require a full BAI course script; however, if a comprehensive course script is required, you can submit the BAI Course Script Request Form.
 - iv Consider in-person training leveraging the BAI Compliance Classroom Toolkits.
 - v To aid in monitoring regulatory changes, BAI offers AlertsNow and a monthly 90-Day Regulatory Outlook report.