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Client Memorandum November 2012

A Compliance Management System: What The CFPB Says You Need ….

At the beginning of the month, the Consumer Financial Protection Bureau (CFPB) issued its first Supervisory Highlights, a report of the agency's supervision over certain financial institutions (banks, saving associations, credit unions and their affiliates, as well as other companies that provide consumer financial products and services — collectively "Supervised Institutions"). Among other topics, the Supervisory Highlights outlines three public enforcement actions taken by the CFPB to correct certain illegal practices. The actions resulted in $435 million being paid in restitution to approximately 5.75 million consumers and civil money penalties of approximately $101.5 million. In each of the cases, the CFPB found that the offending companies lacked proper compliance programs and compliance oversight by senior management and the board.

In addition to describing the compliance shortfalls of the offending companies, the Supervisory Highlights details the lowlights of compliance programs in place at several other Supervised Institutions and provides insight into what the CFPB expects in a compliance program. For financial institutions and service providers, as well as other organizations, this presents an opportunity to determine whether your compliance program is up to standards. The CFPB's guidance on what constitutes a sound compliance program has value to a wide variety of industries. As the CFPB aptly noted: "Weaknesses in compliance management systems can result in violations of law or regulation and associated harm to consumers."

The Compliance Management System

The CFPB requires financial institutions to have in place a sound compliance management system (CMS) — a program "designed to ensure that the financial institution's policies and practices are in full compliance with the requirements of Federal consumer financial law." A properly functioning CMS establishes compliance responsibilities, communicates those responsibilities to the company's employees, incorporates into business processes responsibilities for meeting legal requirements and internal policies, ensures responsibilities are carried out and legal requirements are met through frequent reviews, and enables and implements corrective action.

This article was originally published in *Corporate Compliance Insights* (November 2012)

In its review of the Supervised Institutions, the CFPB found that "one or more situations in which an effective CMS was lacking across the financial institution's entire consumer financial portfolio, or in which the financial institution failed to adopt and follow comprehensive internal policies and procedures." Examining what the CFPB found inadequate can help an organization develop a sufficient CMS.

While the CFPB recognizes that there is no one-size-fits-all formula for compliance, the agency notes that a full-functioning CMS has the following components:

- A formal compliance program that includes detailed written policies and procedures set forth in a flexible structure that allows for revision and updating as risks evolve and/or are identified;
- Regular, specific and comprehensive employee, officer and director training that addresses all aspect of consumer financial protection laws;
- Board and management oversight of the creation of the compliance function, approval of compliance policies, selection of the compliance officer, and routine review of the company's compliance status;
- Organized and risk-focused internal controls that include frequent and ongoing internal monitoring, oversight, independent testing, compliance auditing, recording of results, and the reporting of results to the management and board such that compliance issues are self-identified and corrective action self-initiated;
- A consumer complaint response protocol that allows for recording of complaints, prompt resolution, and the incorporation of information gathered into compliance program revisions; and
- Recordkeeping and review.

A CMS should be integrated into the overarching framework of the institution and applied to the entire product and service lifecycle (including product development, design, delivery, administration, and marketing practices). A CMS should be implemented by the chief compliance officer — an appropriately qualified and experienced individual reviewed and appointed by the board — and deputy compliance officers as appropriate based on the size of the organization.

As stressed by the CFPB, an important component of a CMS is the clear communication of policies and procedures to employees, followed by complete implementation and adherence by the entire company. Simply having sound policies that management fails to implement and oversee is not enough. One of the items specifically examined by the CFPB in assessing the adequacy of a CMS is the understanding and application of the compliance management program by both managers and employees. Thus, a sound CMS will be part of the day-to-day responsibilities of each person at the company, from the bottom to the top.

In addition to the foregoing, which are applicable to compliance programs at many organizations, financial institutions are also required to comply with the Equal Credit Opportunity Act (ECOA) — the requirement that prohibits a financial institution from discriminating against applicants on the basis of, among others, race, color, religion, national origin, sex, marital status, age, or reliance on a public assistance program. According to the CFPB, a robust financial institution compliance program that comports with the ECOA includes the following:

- An up-to-date fair lending policy statement;
- Regular fair lending training for all employees involved with any aspect of the institution's credit transactions, as well as management and the board;
- Ongoing monitoring for compliance with fair lending policies and procedures, as well as with other policies and procedures intended to reduce fair lending risk;
- Review of lending policies for potential fair lending violations, including potential disparate impact;
- Regular statistical analysis of loan data for potential disparities on a prohibited class basis in pricing, underwriting, or other aspects of the credit transaction, and including both mortgage and non-mortgage products, such as credit cards, auto lending, and student lending;

- Regular assessment of the marketing of loan products; and
- Meaningful oversight of fair lending compliance by management and the financial institution's board.
  Supervising Service Provider Compliance. As well as to ensuring the company's compliance with applicable regulations, an effective CMS provides oversight of service providers and other vendors employed by the institution. Proper oversight includes "consistent, risk-based procedures governing the retention and monitoring of service provider relationships, as well as policies and sufficient resources to employee training and oversight, and review of adverse action letters to ensure they provide applicants with the required information." At a minimum, tenets of an effective service provider oversight program include:
- Due diligence of service providers to determine each service provider's ability to comply with the law;
- Review of the service provider's compliance structure, policies, training and procedures;
- Defined contractual provisions that specify the company's compliance expectations and the service provider's obligations with regard to compliance, as well as consequences for compliance failures;
- On-going monitoring of the service providers compliance efforts; and
- A process to respond to compliance shortfalls by the service provider.

For financial institutions, insufficient oversight often is demonstrated by the financial institution and the service provider failing to adequately coordinate their correspondence with consumers, causing inaccurate or misleading information to be sent to consumers.

Final Thoughts. In each of the consent orders stemming from the public enforcement actions outlined in the Supervisory Highlights, the CFPB pointedly remarked that the board and senior management played an insufficient role in ensuring compliance. Board and senior management involvement is a critical component of a sound CMS. Institutions should have the compliance officer make regular reports on the state of compliance at the company, including the results of compliances audits, to both senior management and the board (or a committee thereof). The board should also have a structure in place to address reports of compliance risks, issues, and resolutions. Ensuring board and senior management supervision may mitigate penalties and other remedial actions.

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