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Newsletter Article

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RATING COMPLIANCE: REGULATORS PROPOSE CHANGES

By Sterling Compliance LLC (originally published in Sterling Navigator, June 2016. *Reprinted with permission)*

ABOUT STERLING COMPLIANCE LLC

Sterling Compliance LLC was forged out of a strong bond of integrity, shared vision and unwavering commitment to excellence in compliance consulting. With nearly 40 years of combined experience managing and regulating financial institutions, Sterling's mission is to be an integral, independent resource to your compliance management team.

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1980. The year we lost John Lennon, Mount St. Helens erupted, Pac-Man was released and the Rubik's Cube became popular. This is also the year the current Consumer Compliance Rating System was established. Since that time, the industry has become more complex and the broad array of risks in the market that can cause consumer harm has been increasingly clear. Violations of law, including for example, the SCRA and Section 5 of the Federal Trade Commission Act, as well as fair lending violations, may potentially cause significant consumer harm and raise serious supervisory concern. We've also seen an evolution in the way the federal regulatory agencies examine our banks. When the current rating system was adopted, exams focused more on transaction testing for regulatory compliance rather than evaluating the adequacy of a bank's compliance management system (CMS) to ensure compliance with regulatory requirements and to prevent consumer harm. In the intervening years, each of the FFIECagencies has adopted a risk-based approach to consumer compliance examinations to promote strong compliance risk management practices and consumer protection within supervised financial institutions.

Given these changes to examination approaches and risks within the industry, the FFIEC has requested comment on a proposal to revise the Uniform Interagency Consumer Compliance Rating System (CC Rating System).

The primary purpose of the proposed rating system is to ensure that all financial institutions are evaluated in a comprehensive and consistent manner and that supervisory resources are appropriately focused on areas exhibiting risk of consumer harm as well as on financial

> These revisions are designed to more fully align the rating system with the FFIEC agencies' current risk-based, tailored examination approaches.
>
> They were not developed to set new or higher supervisory expectations for financial institutions and their adoption will represent no additional regulatory burden.

institutions that warrant elevated supervisory attention. Under this proposal, the Agencies arerecommending that the current 5-scale framework be retained while incorporating revisions to the systemto enhance its effectiveness. Each financial institution would be assigned a consumer compliance ratingbased primarily on the adequacy of its CMS, which by its nature, is designed to ensure compliance on anongoing basis. The proposal outlines four key principles for proposed ratings:

RISK-BASED	TRANSPARENT	ACTIONABLE	INCENT COMPLIANCE
Recognize and communicate clearly that compliance management programs vary based on size, complexity and risk profile of supervised financial institutions	Provide clear distinctions between rating categories to support consistent application by the Agencies across supervised institutions and reflect the scope of the review that formed the basis of the overall rating	Identify areas of strength and direct appropriate attention to specific areas of weakness, reflecting a risk-based supervisory approach and assess the effectiveness of the compliance risk management program, including the bank's ability to prevent consumer harm and ensure compliance with consumer protection statutes	Incent the bank to establish an effective consumer compliance program and to identify and address issues promptly, including self-identification and correction of consumer compliance weaknesses

Under the proposed rule, there would be three categories of assessment factors that would be rated on the 1-5 scale:

- **Board and Management Oversight:** This category would be further broken down to address oversight and commitment; change management; comprehension, identification and management of risk; and, corrective action and self-identification.
- **Compliance Program:** Similar to the category above, the compliance program category would address individual areas including policies and procedures, training, monitoring and/or audit and the bank's consumer complaint response.
- **Violations of Law and Consumer Harm:** This category would provide examiners with a framework for considering the broad range of violations of consumer protection laws and evidence of consumer harm. In conjunction with assessing your CMS based on the first two categories, examiners will evaluate the consumer protection violations and related consumer harm based on **four assessment factors:**
    - **Root Cause** (or causes) of any violations of law identified;
    - **Severity** of any consumer harm resulting from violations;
    - **Duration** of time over which the violations occurred; and
    - **Pervasiveness** of violations.
- Consumer harm may occur as a result of a violation of law. While many instances of consumer harm can be quantified as a dollar amount associated with financial loss, such as charging higher fees for a product than was initially disclosed, consumer harm may also result from a denial or an opportunity. For example, a consumer could be harmed when you deny the consumer credit or discourages an application in violation of the ECOA, whether or not financial harm occurred.

When assigning a rating under the proposed system, examiners would consider each of the assessment factors in each category. Keep in mind that the overall consumer compliance rating reflects a comprehensive evaluation of your performance under the rating system; it is not based on a numeric average or any other quantitative calculation. As such, you need not achieve a satisfactory rating in all categories to be assigned an overall satisfactory rating. Conversely, you may be assigned a less than satisfactory rating even if some of your assessments were rated satisfactory. The proposal includes a visual representation of what the resulting rating matrix would look like if approved. Comments on the proposal are due by July 5, 2016

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