



COMPLIANCE MONITORING: ONE OF THE LINES OF DEFENSE

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Agenda

PART I

- Key components of effective compliance monitoring
- Techniques for building a scalable monitoring program
- Documentation and reporting tools of the trade
- Information sharing between workshop participants

PART II

- Put the concepts into practice
- What does the future hold?

- **Umpqua Bank**
 - Over \$23 billion in assets with over 350 locations in California, Idaho, Oregon, Washington, Nevada, Arizona and Utah
- **Workshop Members**
 - What's in place now?
 - Strengths and challenges

Workshop Participant Feedback



**WHAT DO YOU
THINK?**

What Is It?

CFPB Supervision & Examination Manual

Monitoring is a compliance program element that seeks, in an organized and risk-focused way, to identify procedural or training weaknesses in an effort to provide for a high level of compliance by promptly identifying and correcting weaknesses.

Monitoring and testing is generally more frequent and less formal than compliance audit coverage and reporting, may be carried out by the business unit, and does not require the same level of independence from the business or compliance function that an audit program does.

What Is It?

FDIC Compliance Examination Manual

Monitoring is a **proactive** approach by the institution to identify procedural or training weaknesses in an effort to preclude regulatory violations. Institutions that **include a compliance officer** in the planning, development, and implementation of business propositions increase the likelihood of success of its compliance monitoring function.

Monitoring also **includes reviews at the transaction level** during the **normal, daily activities** of employees in every operating unit of the institution...Monitoring at this level helps establish **management and staff accountability** and **identifies potential problems in a timely manner.**



Why Do We Do It?

- **It's Required**
 - Required component of a sound CMS
- **It's Necessary**
 - Board & Management need to know how well bank is adhering to requirements and managing the associated risks
 - Evidence that Bank is not just in compliance, but in compliance on purpose
- **It's a Good Idea**
 - Early Detection = Limit Size & Scope of Consumer Harm
 - Business Process Improvement – efficiency, early identification of weaknesses
 - Relationship Building – becoming a trusted advisor

CFPB Guidance – Bulletin 2013-06

Enforcement action factors:

- Nature, extent, and severity of the violations identified
- Actual or potential harm from those violations
- History of past violations; and
- Effectiveness in addressing violations

“This guidance is being provided to inform those subject to the Bureau’s enforcement authority that in addition to these and other factors, there are activities they can engage in both before and after the conduct in question has occurred that the Bureau may favorably consider in exercising its enforcement discretion.”

CFPB Guidance – “Responsible Conduct”

- **Proactively self-police** for potential violations
- **Promptly self-report** to the Bureau when it identifies potential violations
- **Quickly and completely remediate the harm** resulting from violations, and
- **Affirmatively cooperate** with Bureau investigation above and beyond what is required
- **Other substantial and meaningful activity** particular to its situation

“If a party meaningfully engages in these activities, it **may favorably affect the ultimate resolution** of a Bureau enforcement investigation... the fact that a party may argue it has satisfied some or even all of the elements set forth in this guidance will not foreclose the Bureau from bringing any enforcement action or seeking any remedy if it believes such a course is necessary and appropriate.

Regions Bank Enforcement

“The Bureau found that Bank...Delayed fixing the violation until almost a year after discovering it:

Thirteen months after the opt-in rule’s mandatory compliance date, an internal review by the bank found that linked-account overdraft fees violated the rule. But Regions failed to stop the charges for almost another year. It was not until April 2012 that the compliance department brought the violation to the attention of senior executives, who then reported the error to the Bureau. Regions reprogramed its systems to stop charging the unauthorized fees in June 2012. In early 2015, the bank discovered additional accounts that had been charged unauthorized fees...

The CFPB’s order requires that Bank...Pay a \$7.5 million fine:

Regions will make a \$7.5 million penalty payment to the CFPB’s Civil Penalty Fund. Regions’ violations and its delay in escalating them to senior executives and correcting the errors could have justified a larger penalty, but the Bureau credited Regions for making reimbursements to consumers and promptly self-reporting these issues to the Bureau once they were brought to the attention of senior management...”

<http://www.consumerfinance.gov/newsroom/cfpb-fines-regions-bank-7-5-million-for-unlawful-overdraft-practices/>



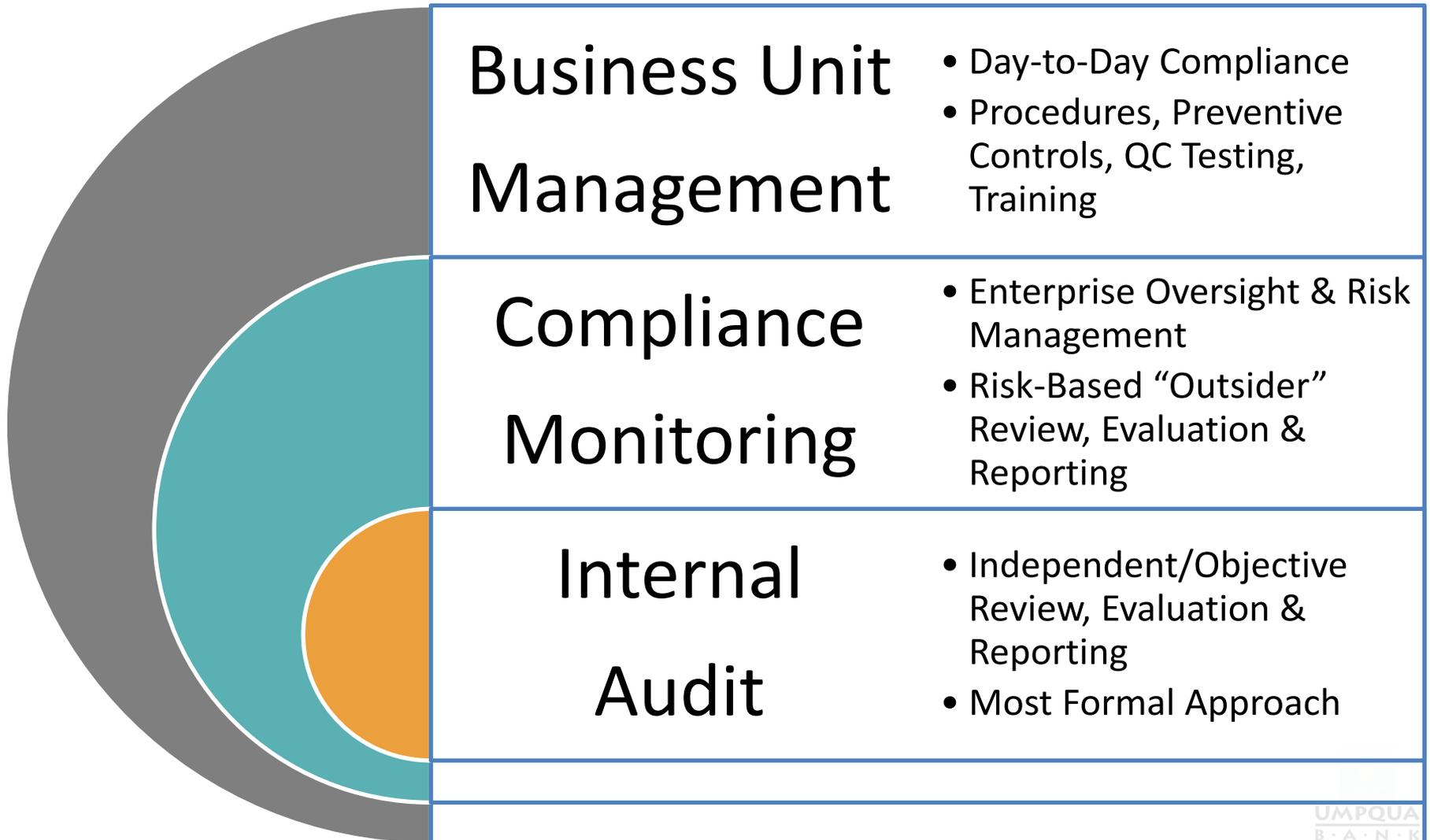
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Workshop Participant Feedback



**WHAT DO YOU
THINK?**

Three Lines of Defense



What Does It Look Like?

- **Business As Usual**
 - Advertisement Review
 - Disclosure Review
 - Complaint Handling
 - Business Unit Quality Control
 - Metrics Reporting
- **Continuous & Standard**
 - On-going, risk-based testing
 - Policy requirement
 - Best practice
- **Emerging**
 - Risk-based strategic monitoring
 - Changes in regulation, organization structure, products, systems, etc.
 - Complaint Handling – deeper review trigger
 - Industry Issues
 - Audit & Exam results
- **Residual**
 - Everything else!

So Much To Do – So Little Time!

- Compliance Risk Assessment
- Continuous Testing Trends
- Regulatory Hot Topics
- Changes
 - Regs
 - Products
 - Systems
 - Controls
 - Org Structure

Workshop Participant Feedback



**WHAT DO YOU
THINK?**

How Do I Structure This?

- **Determine your scope.**
 - Compliance only, or will you include operational risks?
 - Use a risk-based approach.
- **Start at the end.** What do you want to do with the information?
 - By Business Unit?
 - By Regulation?
 - By Product Channel?
 - By Risk?

How Often Is It Done?

- Risk-Based Frequency
 - Prioritize regulations where provisions include restitution and Civil Monetary Penalties
 - Prioritize consumer protection regulations
 - Prioritize regulations where changes or new implementations have occurred
- Greater Frequency = Real Time Feedback

How Is It Done?

- Transactional Testing
 - Population Identification
 - Sample Selection & Risk
- Policy & Procedural Review
- Employee Interviews/Surveys
- Spot Checks

Transactional Testing Detail

- **Attribute Development**

- Once you have your scope defined, you will need to identify specific test attributes you will be testing.
- We have opted to use more specific attributes which makes identifying specific areas of weaknesses easier. But broadly defined attributes can have advantages too (simplified reporting, etc.).

Transactional Testing Detail

- **Population Identification**

- Identify your data sources (system reports, manual logs, pipelines, etc.).
 - Independently run reports if possible.
 - Filters for all system reports.
 - Completeness and Accuracy are key!
- Define your scope period.
- Influenced by your testing structure. Will you need to pull reports by business unit? Will you need to identify product types?

Transactional Testing Detail

- **Sample Selection.** Define your methodology before you start.
 - Standard sample size (25 or 20% of the population)
 - Ensure coverage of your entire population (variety across the sample period, product types, geographic regions)
 - Determining how the control operates is important.
 - Sampling could be random, haphazard or judgmental.

- ERM independently generated a Cognos report on 7/10/2014 (see filter attached) of all legal fee expenses posted to the GL, which listed 562 invoices during the sample period. 25 invoices were selected for testing.
- The sample period was 06/01/2014 through 06/30/2014.
- Selections were made judgmentally based on case, outside attorney, and amount.

Transactional Testing Detail

- **Documenting Results**

- Determine your internal test documentation requirements ahead of time and be consistent.
 - Population/sample with sample determination defined.
 - Testing matrix shows results.
 - Example of 1 – explains testing.
 - Documentation for any exceptions.
- Reporting. Who is your audience?
 - Do they want to see high level trends or detailed results?
 - Will you report differently on compliance exceptions versus identified process improvements?

Testing Matrix

Section	1005.11(c)	Regulation	Regulation E: The Electronic Funds Transfer Act
Section Description	Reg E Error Resolution	Business Area	Deposit Operations
Population	1200 total (211 ACH, 986 debit card, 3 bill pay draft)	Sample	25 total (19 debit card, 5 ACH, 1 bill pay draft)
Test Objective	Ensure all Reg E errors reported by consumers are investigated, resolved, and results are reported on a timely basis.	Scope Period	06/01/2015 - 06/30/2015
Tester	Jon Smith	Test Date	07/13/15

Selection #	Name	Account Number	Type of Transaction	Date of Disputed Transaction	Date of Notice From Customer	Date Submitted	Date of Case Completion	Date of Result Notification	i. Were errors reported by consumers appropriately investigated on a timely basis? (Y)	ii. Were results reported on a timely basis? (Y)	Attachments
1	Jane Doe	987654321	ACH	06/05/15	06/08/15	06/08/15	06/18/15	06/18/15	Y	Y	Attachment A
2	Rob Brown	977654321	ACH	04/27/15	04/30/15	04/30/15	06/22/15	06/22/15	N {1}	Y	Attachment B
3											
4											
5											



Workshop Participant Feedback

**WHAT DO YOU
THINK?**

I Found Something...Now What?

- **Communicate** – no surprises
- **Remediate** - start immediately
- **Determine Root Cause**
 - Barriers to Root Cause Analysis
 - “But Why?”, or Life with a Three Year Old

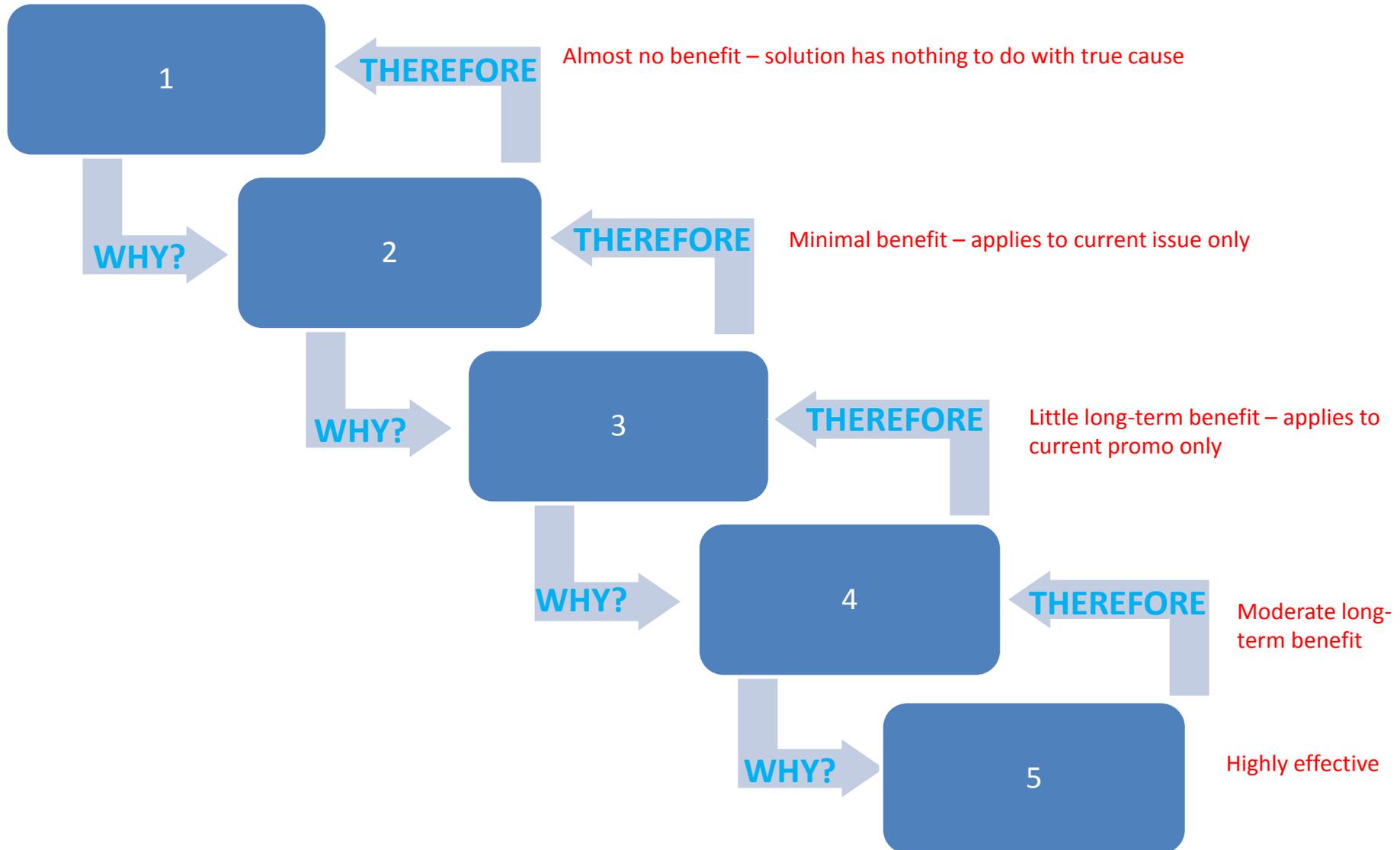
Barriers to Root Cause Analysis

Barrier	Impact
The problem is poorly, or incorrectly defined.	With a poorly or incorrectly defined problem, different people on the team may have different interpretations of what the problem is or the entire team could march off in the completely wrong direction solving something that isn't even a problem.
A systemic approach is not used.	An unfocused, random approach to RCA can lead to premature conclusions without data to back them up, revisiting the same issue again and again, dead end paths and wasted time.
Investigations are stopped prematurely.	The problem with stopping before you find the REAL root cause is that the solution will only be a Band-Aid at best. If you don't solve a problem at its source, it WILL come back to haunt you.
Decisions are made on guesses or assumptions.	While opinions (without facts) can help point you in the direction of a decision, making decisions without data can be risky and may lead the team on a wild goose chase.

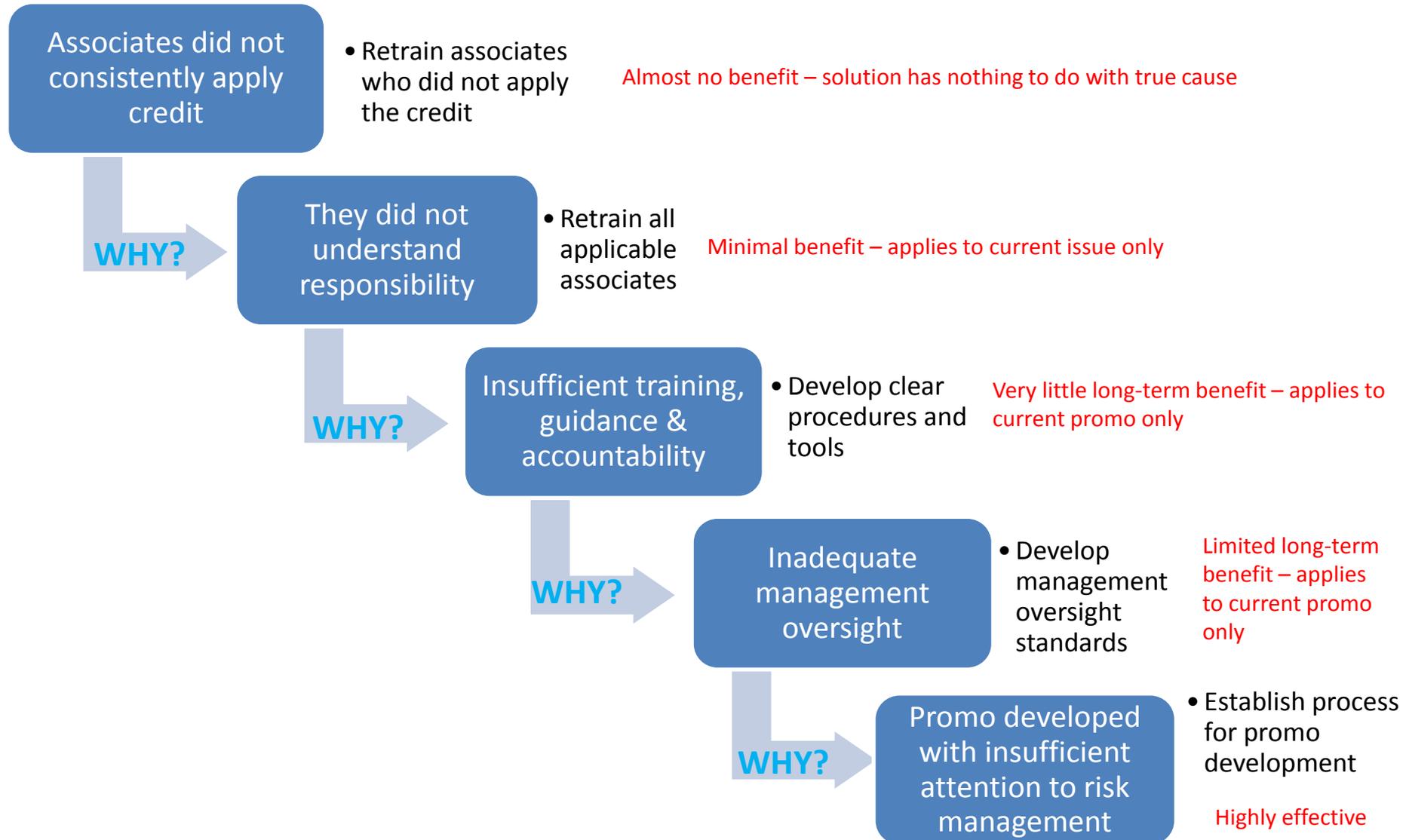
Barriers to Root Cause Analysis

Barrier	Impact
Interim containment fixes become “permanent”.	Sometimes, interim containment "hides" the problem effect "taking the pressure off" of getting to the root cause.
Skills, knowledge and experience are not available.	Team members may not have the necessary skills, knowledge or experience to drill down to the root cause. Symptoms of this barrier includes an inability to use special programs to access and analyze data, a lack of detailed knowledge of the process and /or not appreciating the history of the problem, process and players involved.
Fear of being blamed.	Root cause analysis will uncover problems with the existing system that someone, at some point, put in place. It is easy to point fingers when you start to get close to the root cause of a problem and that finger pointing could intimidate team members to the point that they cover up the real problem for fear of being blamed for it.

Root Cause Analysis – “But Why?”



Problem Statement: Advertised lending credit was not consistently applied for borrowers who met eligibility requirements... WHY?



Workshop Participant Feedback

**WHAT DO YOU
THINK?**

What Should We Do About It?

- Recommendations
 - “Best” Action – from whose perspective?
 - Business Unit Partnership
 - Prioritization
- Rating System
 - Quantitative & Qualitative
 - Risk Rating Tables

Risk Rating Table

Risk Rating	Severity LOW	Severity MODERATE	Severity HIGH
Probability LOW	Low	Moderate	Moderate
Probability MODERATE	Low	Moderate	High
Probability HIGH	Moderate	High	High

Documentation

- Workpapers & Testing Documentation Best Practices
- Compliance Monitoring Reports
 - Know Your Audience
 - Clear & Concise Summary
 - Root Cause Articulation
 - Actionable Recommendations
- Documentation Catch 22 & Exam Experience
 - Self-Reporting – “No Promises”
 - Language Choice: Risk, Exception or Violation
 - Transparency & Consistency

Taking Action...Is It Working?

- Rigorous Tracking Mechanism
- On-Going Communication
 - Extended action plans
- Thorough Documentation
 - Consumer Harm evaluation
 - Full evidence of remediation
- Validation Approaches

Consumer Harm – Actual & Potential

- **Quantifiable Harm**
 - Economic harm that can be measured
- **Non-Quantifiable Harm**
 - Injury or loss that cannot be measured, yet consumer still suffers some form of economic or other harm
- **Potential Harm**
 - Action (or failure to take action) that creates the *possibility* that a consumer may be harmed

Consumer Harm Remediation

Issue Identification

- Date issue first impacted accounts
- Date issue last impacted accounts
- Detailed root-cause description

Impacted Account Identification

- Detailed description of logic used to identify impacted accounts
- Details on the following considerations, if applicable
 - Systemic constraints on impacted account identification
 - Manual identification processes considered
 - Any cost-benefit considerations identified

Consumer Harm Remediation

Impacted Account Remediation

- Details on remediation process
- Details on the following backward-looking considerations to address harmed consumers, if applicable:
 - Late pays, charge-offs or credit reporting on incorrectly charged fees or finance charges
 - Communications provided to impacted customers

Root Cause Correction

- Details on underlying root causes of issue
- Details on how underlying root causes were corrected
- Details on any post-implementation verification of the effectiveness of root cause correction

Fair Banking – Risk or Violation?

- **UDAAP**

- *Unfair* – 3 prong test
 - Substantial injury, not avoidable, **and**, not outweighed
- *Abusive* – 4 prongs
 - Materially interferes with understanding, **or**, takes advantage of: lack of understanding, inability to protect interest, or, reliance to act in best interest
- *Deceptive* – 3 prong test
 - Misleads, reasonable interpretation, **and**, material

- **Fair Lending**

- Do results prompt Fair Lending Analysis?

Workshop Participant Feedback

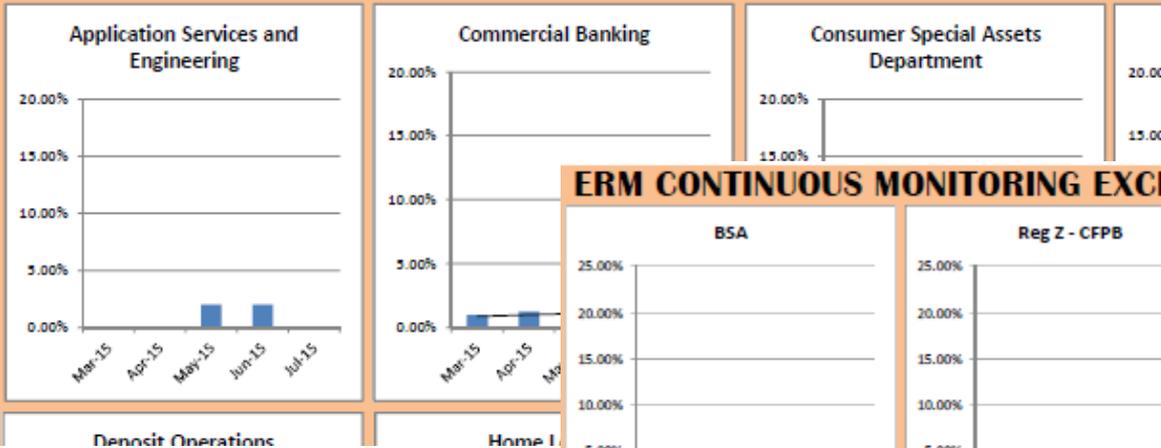
**WHAT DO YOU
THINK?**

Here's What We've Been Up To

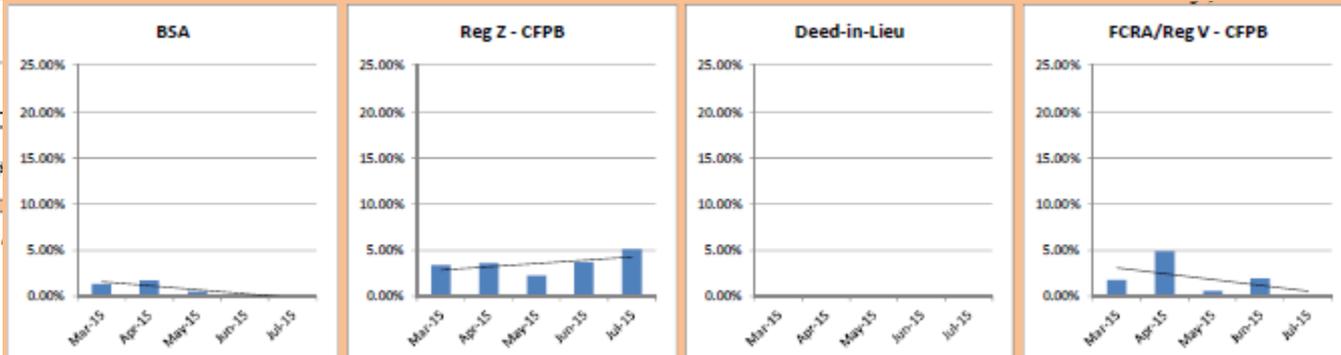
- Reporting – Know Your Audience
- Levels of Reporting
- Continuous Testing Trending Sample

Continuous Testing Reporting Sample

ERM CONTINUOUS MONITORING EXCEPTIONS BY DEPARTMENT



ERM CONTINUOUS MONITORING EXCEPTIONS BY REGULATION



JULY ERM CONTINUOUS MONITORING RESULTS BY DEPARTMENT

Reporting For 07/31/2015

			Sample Size	Exceptions	Exception Rate
Application Services and Engineering					
Overdraft Excessive Use	Excessive Overdraft Use		25	0	0.00%
Overdraft OD Notification	Overdraft Use Disclosure		25	0	0.00%
Application Services and Engineering Totals			50	0	0.00%
Commercial Banking					
BSA 103.121(b)	CIP - Customer Info		25	0	0.00%
FCRA/Reg V - CFPB 603(d)	Sharing of Credit Information with Affiliates		2	0	0.00%
FCRA/Reg V - CFPB 604	Permissible Purpose		25	0	0.00%
FCRA/Reg V - CFPB 605(A)	Fraud or Active Duty Alerts		0	0	0.00%
FCRA/Reg V - CFPB 609(f)(1)	Credit Denial Adverse Action		1	0	0.00%
FCRA/Reg V - CFPB 1022.82	Address Discrepancies		1	0	0.00%
FDPA 339.9(d)	Notice of Special Flood Hazard		0	0	0.00%
OFAC 594.201	OFAC Check		25	2	8.00%

Completing the Circle

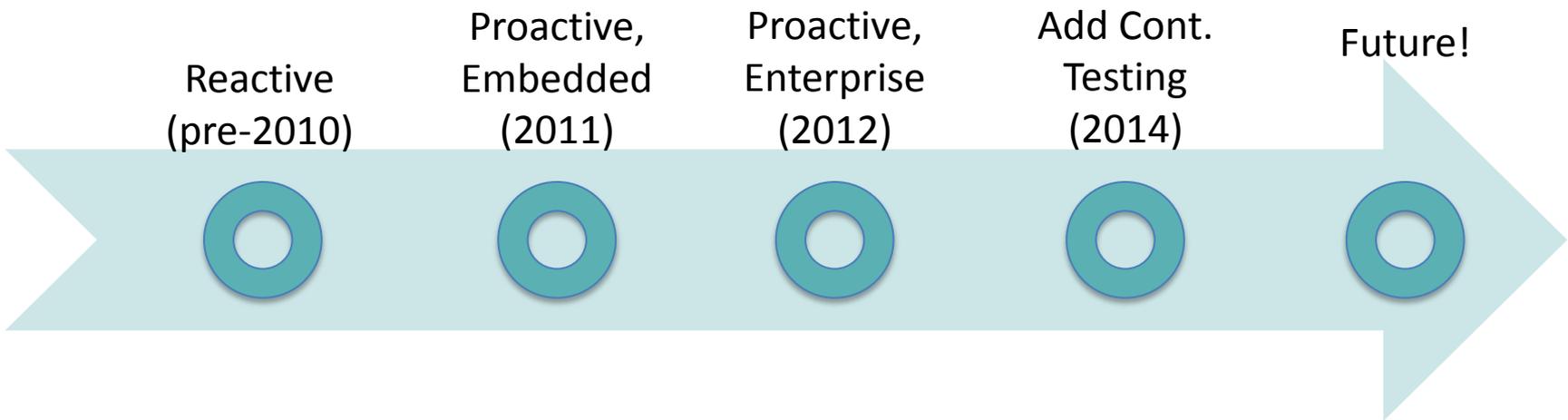


Challenges

- Why Are You Picking On Me?
 - Common understanding of purpose/benefit
- I Don't Agree on the Risk Level!
 - Who owns the risk?
 - Risk acceptance approval & documentation
 - Risk acceptance may → additional monitoring
- Knock, Knock...Anyone Home?
 - Lack of response
 - Timely action

Evolving Monitoring

- Umpqua Monitoring Program History



- Continuous Testing Focus – staying risk-based when there are no errors

What Does the Future Hold?



**WHAT DO YOU
THINK?**