

FS Regulatory Briefs*

Remarks by the Comptroller of the Currency – “The Need to Stay Focused on Compliance Supervision”

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Target Audience: Banks

On July 7, 2008, Comptroller of the Currency John C. Dugan addressed the Office of the Comptroller of the Currency’s (OCC) Compliance Conference and stressed the need for examiners to stay focused on compliance supervision, while also maintaining oversight of the significant safety and soundness issues currently facing national banks¹. Mr. Dugan indicated that while considerable regulatory focus is being placed on the increased risks to the safety and soundness of national banks, it is important not to lose sight of potential compliance issues — which can damage an institution’s reputation, divert management’s attention, and possibly harm bank customers. The Comptroller also highlighted the following key compliance areas that will likely receive the most attention in the coming year: Fair Lending, Consumer Protection Issues, Subprime Lending and the Community Reinvestment Act (CRA), and the Bank Secrecy Act (BSA).

The interdependence of compliance and safety and soundness

The Comptroller emphasized during his speech that compliance and safety and soundness are inherently interdependent — as compliance problems can divert management’s attention away the business of running a bank and can lead to potential serious ramifications including:

- Civil money penalties

- Lawsuits
- Restitution settlements to customers
- Reputational damage
- Attrition of senior executives
- Loss of customers
- Diversion of time and resources away from “day jobs” to help remediate compliance issues
- Limitations on merger or acquisition activity
- Increased regulatory supervision

While always problematic, compliance issues have an even greater adverse impact on the institution when it is simultaneously trying to address significant safety and soundness issues — such as credit and liquidity. As such, vigilant compliance supervision today will help ensure that the problems of national banks are not further compounded as they respond to today’s challenging market conditions.

What compliance issues are of most concern?

Mr. Dugan believes the following compliance areas will receive primary attention by the OCC in the coming year.

Fair Lending

Although Mr. Dugan noted that there have not been substantive fair lending problems in the national banking system in recent years, he believes the fair lending risk profile of national banks is changing due to the significant increase in the volume of mortgage delinquencies and defaults — and the associated actions that banks are taking to mitigate losses. In

¹ Comptroller Dugan’s speech can be viewed at: <http://www.occ.treas.gov/ftp/release/2008-76a.pdf>

particular, the risks of potential discrimination have now expanded as national banks make discretionary decisions on what loans to foreclose upon, how quickly to foreclose, and what borrowers receive access to loan modification programs.

The Comptroller also committed to creating greater transparency into the OCC's current fair lending examination process through improved documentation and communications.

Industry Action Points

To manage the increased fair lending risks in the mortgage servicing area, financial institutions should ensure that they have sufficient fair lending processes and controls in place that include:

- Policies, procedures, training, and other controls to ensure consistency, equal treatment, and fair practices during foreclosure, loan modification, and other loan collection processes; and
- Fair lending monitoring and testing processes that include periodic monitoring and testing for potential disparate treatment (by race/ethnicity, gender, or other prohibited bases) in foreclosures, loan workouts, or loan modifications.

Additionally, although the OCC has indicated that it plans to expand its current fair lending focus into the loan servicing and workout areas, institutions should expect regulators to continue to focus on traditional areas of fair lending risk — such loan decisioning, loan pricing, and redlining.

Consumer Protection Issues

Mr. Dugan noted that consumer protection issues should continue to get a considerable amount of congressional and regulatory attention in the coming year. He specifically identified the Federal Reserve's proposed rules relating to credit card and home mortgage lending practices as areas that have received significant attention from Congress and the media — particularly in the area of unfair and deceptive practices.

The Comptroller also pointed out that the proposed rules in this area will necessitate a significant change in regulatory approach — one that shifts away from a disclosure-focused regulation to one that will become more prescriptive in prohibiting certain practices.

At the time of his speech, the Federal Reserve had not yet issued final rules regarding home mortgage loan practices. These final rules, which amend Regulation Z (Truth in Lending) and were adopted under the Home Ownership and Equity Protection Act (HOEPA), were subsequently approved by The Federal Reserve Board on July 14². The final rule largely follows the Federal Reserve's proposal and is effective October 1, 2009. The proposed rules addressing credit card disclosures and practices, and other unfair and deceptive practices, are still proposed. If the rules pass in their current form, institutions will face significant operational challenges in their implementation.

Industry Action Points

Financial institutions should closely review the Federal Reserve's final mortgage rule and monitor further developments in these areas so that appropriate measures can be implemented prior to any mandatory compliance dates.

Subprime Lending and CRA

Many banks, in recent years, have stretched their underwriting standards in order to make subprime loans that qualified for CRA credit, or to make higher priced loans to riskier borrowers to increase profits. With the increased scrutiny of the subprime market, the Comptroller expressed concern that many lenders may permanently retreat from the subprime market, which could dramatically limit access to credit by creditworthy low-income borrowers — which is encouraged by the CRA.

² Federal Reserve final rules for home mortgage loans can be viewed at: <http://www.federalreserve.gov/newsevents/press/bcreg/20080714a.htm>

The Comptroller's message was that, due to the new environment, examiners will likely see lower volumes of CRA loans and maybe even new types of products that could qualify for CRA credit, which should be evaluated by examiners in "in a fair and balanced way".

Bank Secrecy Act

The Comptroller pointed out that although BSA is not in the media as much as it was a couple of years ago, BSA has not lost its importance and continues to be an area of regulatory focus. Mr. Dugan indicated that during his first year in office, he committed to the Senate Banking Committee that one of his top priorities would be "to ensure that banks have effective BSA programs, but without imposing undue regulatory burden". Subsequently, the number of examiners and amount of time dedicated to BSA compliance increased significantly. Mr. Dugan noted that this has since decreased slightly, which he attributes to improvements in institutions' BSA programs. Mr. Dugan also stressed that the level of BSA supervision has leveled, become more consistent, and this will continue in the upcoming year.

Conclusion

Overall, the Comptroller's speech reinforces the continuing significance of compliance supervision due to its importance to customers, national security, the safety and soundness of the national banking system, and to the OCC's reputation as a regulatory agency. Mr. Dugan's speech sends a strong message to institutions that they cannot lose focus on compliance while addressing safety and soundness issues, as the OCC will not accept this as an excuse for non-compliance, and the OCC will not be reducing their supervision over compliance issues. The speech also provides insights into the compliance areas that the OCC will likely focus on in the upcoming year including Fair Lending, Consumer Protection, CRA, and BSA.

Additional Information

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