

2007 Directors Conference

CONCURRENT SESSION

Compliance - The Role of the Board

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9:15-10:15 am

WIB/AABD Directors Conference

Compliance: The Role of the Board

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Agenda

- Why Compliance is Important
- Director's Role in the Compliance Program
- Discussion of High Risk Compliance Areas
- Tips on Questions to Ask and Red Flags



Regulations

- Reg B, Equal Credit Opportunity
- Reg E, Electronic Funds Transfer
- Reg Z, Truth in Lending
- Reg BB, Community Reinvestment Act
- Reg X, Real Estate Settlement Procedures Act
- Reg DD, Truth in Savings
- Reg P, Privacy of Consumer Financial Information
- Reg F, Interbank Liabilities
- Reg O, Insider Lending
- Reg D, NOW Accounts/MMDA



Regulations

- Reg CC, Funds Availability
- BSA – Bank Secrecy Act
- FACTA – Fair and Accurate Credit Transactions Act
- Fair Housing Act
- Fair Debt Collection
- Information Technology
- Bank Protection Act
- Home Mortgage Disclosure Act (HMDA)
- Lending and Appraisal Policies
- Internal and External Audit Programs



Compliance Program Elements

- Policies
- Compliance Officer
- Procedures
- Training
- Allocation of resources
- Reviews and audits
- Board reporting
- Assessment and monitoring of risks



Compliance Program Questions

- How are compliance requirements and changes monitored?
- How is compliance tested on a transaction basis?
- Is there an independent review of the compliance program or at least of the highest risk areas?
- What kind of compliance training goes on?
What is it and who gets it?



Red Flags for Compliance

- Number and severity of audit and review findings
 - Timeliness in responding and correcting
- Staff changes and turnover in compliance
- The lack of compliance topics at board meetings
- Customer dissatisfaction and ***complaints***
- Lack of periodic compliance reports



Product Risk

- Which of the bank's products carry the greatest risk from the standpoint of
 - Materiality – how much do they contribute to the balance sheet
 - Stability – how long has the product been around and how complex is it
 - Product management – how much experience does the bank have in handling the product
 - Overall size of the bank or branch



Regulation Risk

- What is the potential consequence to the public and to the bank of noncompliance
- Includes factors such as
 - Financial harm to consumers
 - Financial harm to the bank
 - Legal harm to the bank
 - Reputation risk to the bank
 - New laws, regulations or amendments
 - The burden of corrective action including civil and financial liability



High Risk Compliance Issues

- BSA
- Insider Lending
- Information Security/BCP
- CRA
- Fair Lending
- Flood Act
- Truth in Lending – APR
- Specific Provisions of RESPA



BSA Program Requirements

- A system of internal controls to assure ongoing compliance with BSA
- Independent testing for BSA/AML compliance
- Designated person(s) responsible
- Training for appropriate personnel (everybody!)
- Customer information program (CIP); risk based procedures that enable the institution to form a reasonable belief that it knows the true identity of its customers



BSA Red Flags

- Written BSA/AML program
- All required program elements
- Written risk assessment
- SAR reports
- Are BSA/AML changes tracked and implemented
- **Annual testing**
- Training program and schedule in place
 - Should include BOD training



Reg O Actions

- A prohibition on loans to insiders unless a loan
 - is non-preferential **and**
 - does not present a higher-than-normal risk of repayment or other unfavorable features.
- A requirement that prior board approval is obtained for loans to insiders greater than a certain amount.
- A limit on lending to individual insiders and to insiders in aggregate.
- Restrictions on loans to executive officers in other ways.
- Restrictions on the payment of overdrafts for insiders



Reg O Overdraft Prohibition

- Unless there is a pre-approved line of credit or transfer
- Inadvertent
- \$1,000 or less
- Not more than five days
- Charged the same fee as any other customer



Reg O Red Flags

- Insider policy/Conflict of Interest
- Annually pass a resolution specifying the executive officers
- Annually complete form identifying insiders, related interests and immediate family
- Receive reports indicating any loans made to insiders, related interests or immediate family
- Proper overdraft protections put in place



Information Security

- Banks must take steps to:
 - Insure the confidentiality of customer records and information
 - Protect against any anticipated threats or hazards to the security or integrity of such records
 - Protect against unauthorized access to or use of such records that could result in harm or inconvenience
 - Ensure proper disposal of consumer information



Information Security Program

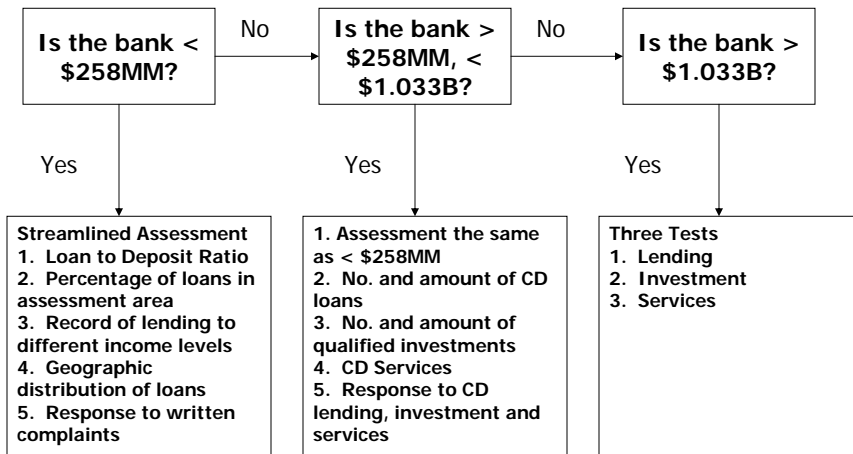
- Address three main components
 - Prevention
 - Detection
 - Response
- Must include
 - Risk assessment
 - Methods of risk control and management
 - Testing
 - Service Provider arrangements
 - Incident response and customer notification
 - Training



Questions for Info Security

- Does the bank have a written information security program?
- Is it updated at least annually?
- Does it address prevention, detection and response?
- Ask about and understand what steps the bank takes to protect customer information
- Pay attention to both low tech and high tech
- Make sure a process is in place to identify a breach and determine whether a response and notification is needed

CRA Assessment Levels



CRA Reports

- The bank's loan to deposit ratio
- The percentage of the bank's loans within the assessment area
- Dispersion of loans geo-coding report: the percentage of loans within each census tract of the assessment area
- Whether there have been any complaints against the bank



Fair Lending/ECOA Red Flags

- An existing or proposed lending policy whose standards for underwriting, pricing, or setting terms and conditions are vague or unduly subjective, or which allow substantial loan officer discretion.
- Any statements by officers, employees, or agents, indicating a preference, prejudice, or stereotyping on a prohibited basis, or an aversion to doing business in minority areas.



Fair Lending/ECOA Red Flags

- Segmentation of product markets, advertisements, promotions, application channels, or other access to credit along the lines of racial or national origin characteristics of applicants or geographic areas.
- Consumer complaints alleging discrimination in specific transactions.



Fair Lending/ECOA Red Flags

- Substantially fewer loans originated in areas with relatively high concentrations of minority group residents than in areas with comparable income levels, but relatively low concentrations of minority residents.
- Disparities in Home Mortgage Disclosure Act (HMDA) data.



Fair Lending/ECOA Red Flags

- Low levels of minority applicants even though minorities represent a significant part of the service area.
- Use of credit scoring models that have not been validated.



Flood Act

- May not be waived
- Procedures in place to monitor?
- Ability to “force place” insurance



Other Areas of Concern

- Truth in Lending – APR calculation
- RESPA – Settlement statements for covered loans



Regulations Requiring Annual Review

- Bank Secrecy Act
- Bank Security Program
- Community Reinvestment Act (CRA)
- Insider Lending
- Real Estate Lending Standards
- Interbank Liabilities
- External Audit Program
- Information Security Program
- Business Continuity Plan



Thank You

- Questions?
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regulations in terms of financial harm, litigation, reputation, and liability?

Included below is a brief description of some of the current high risk regulations

Bank Secrecy Act

There is no hotter “hot button” on the regulatory front than Bank Secrecy. Because of new initiatives in anti-money laundering that have resulted from 9/11 and the war against terror, the Bank Secrecy Act (BSA) and associated laws and regulations have taken on new importance in the last few years. In addition to increased regulatory attention, BSA also carries severe penalties for both the bank and individuals who violate the Act’s requirements.

When we speak of BSA, we are really including several different laws, policies and requirements including Bank Secrecy, the bank’s anti-money laundering program (AML), customer identification programs (CIP), and the provisions of the USA Patriot Act (USAPA).

Under the BSA, the board of directors is required to approve a written compliance program designed to assure and monitor compliance with the recordkeeping and reporting requirements of the Act. A customer identification program must be included as part of the compliance program. The Act specifies that the compliance program must, at a minimum:

- Provide for a system of internal controls to ensure ongoing compliance;
- Provide for independent testing for compliance to be conducted by bank personnel or by an outside party;
- Designate an individual or individuals responsible for coordinating and monitoring day-to-day compliance
- Provide training for appropriate personnel, and
- Establish a Customer Information Program (CIP); risk based procedures that enable the institution to form a reasonable belief that it knows the true identity of its customer

CRA is a regulation where “the proof is in the pudding”. Compliance is reviewed based on actual performance and activities, not just paperwork. The way that a bank’s performance is assessed depends on the bank’s size.

For small banks, a streamlined assessment is used that looks at the loan to deposit ratio, the percentage of loans made in the bank’s CRA area, the level of lending to various income levels (and businesses of various sizes), the geographic distribution of loans and the bank’s record of responding to complaints about its performance.

Intermediate small banks are assessed on the same basis as small banks but the number and amount of community development loans, the number and amount of qualified investments, the extent to which the bank provides community development services and the bank’s responsiveness to community development needs are also taken into account.

Large banks are evaluated on the basis of three tests: lending, investment and service.

To help understand and monitor the bank’s CRA performance, it is recommended that directors receive and review certain reports on a periodic (ideally quarterly) basis.

- The bank's loan to deposit ratio compared to the other competitors of the bank (hopefully better but at least in line)
- The percentage of the bank's loans within the assessment area and outside the assessment (looking for a majority within)
- Dispersion of loans geo-coding report; showing the percentage of loans within each census tract of the assessment area (this may be better accomplished on an annual basis)
- HMDA reports
- Whether there have been any complaints against the bank or comments received relative to the bank’s CRA performance

