Community bankers, consultants and regulators offer tips to stay ahead of the compliance curve

By Apryl Motley

In today's regulatory environment, it goes without saying that compliance burdens—the result of a steady accumulation of changing requirements and increasing scrutiny—are unprecedentedly great for community banks. This inexorable regulatory change, along with the limited resources of community banks, principally influences how regulators, consultants and community bankers are conducting themselves. "Exams are definitely more intense," offers Stacy Wilson, internal auditor for Security State Bank , a $346 million-asset community bank in Centralia, Wash. "The complexity and speed of the changes are difficult to manage."

1 Regulator's Advice

The FDIC offers five areas for community banks to evaluate and review to improve their compliance operations:

Evaluate compliance, fair lending and CRA risks based on the products and services and the market the bank serves, and develop a compliance program that properly addresses those

risks.

Study industry trends, public comments and policy discussions on bank regulation to recognize emerging consumer protection concerns.

Monitor the Internet and social media to see what comments are being made that might affect customer satisfaction or a bank's reputation.

Maintain an effective consumer complaint system to ensure the appropriate people are reviewing complaints, reporting the findings to senior management and taking appropriate action.

Support an effective compliance audit function that identifies risks and has the frequency and intensity commensurate with the institution's complexity and size. The audit function should include documentation of the reviews, management reporting and an ongoing monitoring system to ensure appropriate corrective action is taken.

"Examiners are looking at things more closely," adds Alice Judd, director of the mid-Atlantic region for ICS Risk Advisors, a New York-based risk advisory firm for financial institutions. "There's been a lot of focus on client management systems and the presence of communication channels up and down the chain of command."

Simply put, community banks are operating in an environment of "enhanced scrutiny," says Maureen Busch, director of compliance for Jon Campbell & Associates Inc., a consulting firm in Brandon, Fla. "Things are being looked at in a new light that weren't questioned before. Banks by and large are all about compliance and regulation, but it's discouraging for bankers when the regulations keep changing. Banks are giving their best effort to comply, but sometimes the questions regarding new regulations or changes to regulations outnumber the answers provided on how to comply."

"We're all wondering what's coming next," admits Scott Cameron, chief examiner for the California Department of Financial Institutions. "The regulations being issued in dribs and drabs

make it difficult to work through them. That's a real concern for both the banking industry and regulators."

Even so, community banks seem to be faring well in this intensified regulatory environment, according to the FDIC. The agency's officials praise community banks for consistently managing their compliance responsibilities. Over the past three years, during one of the most rapidly evolving periods of consumer protection regulation, the compliance ratings for the more than 4,500 banks that the FDIC supervise have been relatively stable. As of July 31, the agency had rated 92 percent of those banks favorably for compliance.

The Office of the Comptroller of the Currency has a positive outlook on bank compliance performance as well. "Through our examination process, we also see efforts to manage new regulations and limitations, which is positive in terms of stability of the community banking industry," says Grovetta Gardineer, the OCC's deputy comptroller for compliance policy.

Nevertheless, more than ever, financial institutions will be asked to demonstrate that their compliance policies translate to effective practices, regulators and consultants agree. "We definitely have made changes to processes and systems, particularly in consumer lending compliance," offers Carrie Harwood, vice president and senior compliance officer for $940 million-asset D.L. Evans Bank in Burley, Idaho.

"Make sure your practice reflects your policy," advises Virginia Wilson, an attorney with the law firm of Butler, Snow, O'Mara, Stevens & Cannada PLLC in Memphis, Tenn. "Pay particular attention to preparing for the fair lending exam. Many banks are not accustomed to having to provide the level of detail that's now required."

As community banks strive to provide regulators with what's now required, these best practices—offered by state and federal regulators, consultants and compliance professionals—highlight the importance of coordination, consensus and communication.

Coordinating across channels

Regulators' expectations about how a community bank addresses compliance across its lines of business have only increased. To stay up to speed, interviews with regulators, consultants and community banks highlighted 14 points of general advice for community banks looking to manage those compliance expectations. Community banks should strive to ...

1. Create a culture of compliance by establishing an internal compliance committee. "We have changed our culture so that compliance is everyone's job, not just mine," Harwood says. Two years ago she began chairing D.L. Evans Bank's internal compliance committee, which meets quarterly to reinforce awareness of and adherence to the community bank's compliance program. Representatives from various areas in the bank serve on the committee, including operations and lending staff.

Security State Bank has had a compliance committee for 16 years. Stacy Wilson sits on the committee along with the bank's compliance officer, the head of operations and the head of loan operations. "Compliance is everyone's job, but this committee of four reviews recent regulations and determines staff training needs," she says.

Wilson notes that in the past examiners have made favorable comments about the bank's committee structure, which she says is effective because "the committee atmosphere is one of divide and conquer, instead of putting all the responsibility for compliance on one person."

2. Monitor all employees' adherence to compliance policies. Harwood emphasizes that an effective compliance program goes beyond training staff: "It comes down to monitoring processes and following up with staff to establish accountability for compliance." She says employees at her bank have been written up for noncompliance, and that documentation is used in employee reviews.

3. Make staff training relevant. Online training is appropriate in certain circumstances, but it shouldn't take place in a vacuum, Busch cautions. "The bank needs the ability to insert its own policies and procedures into the training or to supplement online training with the bank's own specific expectations. People get confused if they are trained on one thing and the bank has a different policy. Train staff to actually follow your policy."

4. Review everything with new eyes and be consistent. "What worked years ago won't work

today, so everything needs to be reviewed in a new light within the current regulatory mindset," Busch says. For example, community banks may have to rethink what's acceptable for disclosing terms in an advertisement to avoid the chance of veering into potential regulatory word-game traps.

Community banks will also need to make sure that all documents outlining policies are consistent. For instance, some banks have updated the disclosure documents given to customers, but information on their websites hasn't been similarly updated.

5. Focus on risk management. According to Cameron, community banks need to think about whether they have the right people in place to handle their compliance workload. Risks associated with commercial lending are also a focal point. "There should be a thorough review of concentrations and levels of risk in a loan portfolio," agrees Manuel Flores, commissioner of the division of banking for the Illinois Department of Financial and Professional Regulation.

Further, regulators are very much concerned with enterprise risk management. "One of the lessons learned from the economic downturn is that you have to look at the complete enterprise and really appreciate compliance risks and how product development impacts safety and soundness requirements like credit and capital," Gardineer says. "It is an all-inclusive package; a successful compliance operation can't stand alone."

Reaching consensus, top to bottom

Given today's tangled and sometimes contradictory regulatory environment, getting everyone on the same page is critical. Regulators view compliance as a strategic function that must be addressed at the highest levels of a bank's management. With that in mind, strive to …

6. Establish a tone from the top that supports compliance. "Our CEO used to work as a state regulator. He has created a strong compliance atmosphere," says Stacy Wilson of Security State Bank. "We can always count on him to back us up and be there to support us."

Flores says his agency looks at whether a bank's compliance process is part of the bank's

overall culture.

“We’re beginning to see a realignment of the attention senior management is giving to the compliance area,” adds Gardineer. “There is more partnering between the chief compliance officer and other senior executives to look at risks across the entire enterprise to manage them appropriately and dedicate necessary resources.”

7. Give compliance officers regular access to the board of directors. “This job would be impossible without support from executive management and the board,” says Harwood, of D.L. Evans Bank. She communicates weekly with her board’s secretary, who chairs the board’s compliance committee. Harwood also attends all board meetings, where she provides directors with updates and training. Examiners, she says, want to see documentation of board members’ training, including for compliance issues.

8. Engage the bank’s board of directors. Judd agrees that the level of board involvement in compliance is definitely a key concern for regulators: “It starts with the tone from the top and recognition from the board, in action and not just words, that they are ultimately accountable for compliance performance and that they are seeking and obtaining information from the institution about its compliance status.”

Flores says the Illinois Department of Financial and Professional Regulation looks to see how board meetings are being conducted. “If a bank has a compliance manual with 700-plus pages, and it is adopted at one meeting, we wonder how much of it the directors really discussed.” He advises banks to break up a large and complex effort into pieces and have subcommittees address specific chapters or areas of compliance.

9. Senior management should provide appropriate resources. Judd, of Integrated Compliance Solutions, says community banks should have a routine reporting process in place for compliance information to flow up to senior management and the board as well as some mechanism established to document their institution’s responsiveness in addressing any issues. “Problems occur when senior management is not engaged in dialogue with the compliance officer on a regular basis to review the compliance program and [monitor] whether it’s working,” she says.

The OCC's Gardineer also emphasizes the importance of community banks remaining consistently focused on compliance even as they are faced with other challenges. "Once you begin to make cutbacks, problems emerge in the compliance program, which causes more issues in the long run."

Communicating fully, frequently

Effective internal and external communications are essential to the success of any compliance program, so your community bank should …

10. Encourage compliance staff to participate in regular training and networking events. Harwood of D.L. Evans Bank says she participates in state association roundtable discussions with compliance officers from other community banks at least three times a year. Three of the four members of Security State Bank's compliance committee have compliance certifications through ICBA.

"We keep up our certifications, which involves taking continuing education credits every year," Stacy Wilson explains. "We participate in a lot of webinars, which are cost-effective, and a lot of people can sit in on them. Going away for training is definitely more expensive, but it's good for networking."

"Any access your staff can get to other compliance officers for brainstorming and troubleshooting is invaluable," says Virginia Wilson with Butler, Snow, O'Mara, Stevens & Cannada. "Compliance is not a competitive activity, and it makes regulators happy to see banks reaching out to pool resources."

11. Document compliance actions. Focused documentation is crucial, Harwood emphasizes. "In the past, we weren't documenting our activities sufficiently to provide proof to examiners about what I said we had done, so we've since created timelines to document when and how we carried out specific parts of our compliance program," she says. "This definitely helped us during our last compliance exam."

12. Maintain up-to-date policies. Update employee guides and other references that employees use. Make note of anywhere you've made a change and keep everyone informed of those changes. In addition to updating policies, banks should review them to see if their major decisions are in line with their current policies.

"Make employees aware that policies could change again and they will receive updated memos or other communications so that they can act accordingly," Busch says.

13. Involve compliance staff in the development of new products and services. "In exams, we've seen that community banks are looking for alternatives to supplement their income streams while remaining profitable and competitive," Gardineer says. "As they expand into areas where there is consumer demand, they should fully address the risks associated with those products and offerings. They need to involve compliance staff in product development and enhance risk management as necessary."

14. Contact your regulator. State and federal regulators should be used as a resource for guidance and answering compliance questions, says Cameron, of the California Department of Financial Institutions. "Institutions will not be tainted by asking questions," he says. "If anything, it shows us that a management team is proactive and not waiting until we show up on their doorstep."

Flores, with the Illinois Department of Financial and Professional Regulation, says it's the responsibility of regulators to maintain open lines of communication with the banks they supervise. "We need to share best practices and discuss trends so that we can better ourselves for future challenges," he says.

"We have to continue to reach out to our banks and let them know our expectations as regulators and our desire to provide clarity and consistency. Everybody wants a functional financial system that remains strong."

Apryl Motley *is an* ICBA Independent Banker *contributing editor.*