2014

Effective Compliance Risk Management in a Rapidly Changing Regulatory Environment: A Conversation from the Clearinghouse Annual Conference

Lissa L. Broome
Richard Neiman
Sally Belshaw
Tim Clark

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EFFECTIVE COMPLIANCE RISK MANAGEMENT IN A RAPIDLY CHANGING REGULATORY ENVIRONMENT:
A CONVERSATION FROM THE CLEARING HOUSE ANNUAL CONFERENCE

I. INTRODUCTION

On November 22, 2013, the Center for Banking and Finance at the University of North Carolina School of Law hosted a dialog on compliance risk management in a changing regulatory environment at The Clearing House’s 2013 Annual Conference. The Clearing House also provided generous financial support for this discussion. Biographical information about the moderators and the panelists is set forth before the transcript of the dialog begins.

Moderators

Lissa Broome is the Wells Fargo Professor of Banking at the University of North Carolina School of Law and also the Director of the school’s Center for Banking and Finance.

Richard Neiman is the Vice Chairman of the Global Financial Services Regulatory Practice at PricewaterhouseCoopers LLP and the former New York Superintendent of Banks from 2007 to 2011.

Panelists

Sally Belshaw is the Deputy Comptroller for Large Banks at the Office of the Comptroller of the Currency (OCC) and she formerly served as Examiner-in-Charge at major national banks including

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1. The Clearing House is the oldest banking association and payments company in the United States, having been established in 1853. It is owned by the world’s largest commercial banks. The Clearing House Payments Company L.L.C. provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily and representing nearly half of the automated-clearinghouse, funds-transfer, and check-image payments made in the U.S. The Clearing House L.L.C. is a nonpartisan advocacy organization representing the interests of its owner banks on a variety of its important banking issues.
HSBC’s national banks, Bank One, and Huntington National Bank.

Tim Clark is a Senior Associate Director for the Board of Governors of the Federal Reserve System; he is in the Division of Banking Supervision and Regulation and his responsibilities include the Federal Reserve’s supervisory stress testing program.

Paula Dominick is the head of Global Compliance at Bank of America and prior to joining that firm she spent eighteen years at Goldman Sachs which included serving as head of Global Credit Research and Market Strategy.

Carol Hunley is an Executive Vice President and the Chief Compliance Officer at Santander Bank N.A., a subsidiary of Santander and she has over thirty years of banking experience.

Steve Kaplan is the Northeast Regional Director for the Consumer Financial Protection Bureau (CFPB) and he is the former Pennsylvania Secretary of Banking.

II. SUPERVISION AND ENFORCEMENT

Broome: How will regulators bring change and influence policy, through supervision or enforcement? What is the dynamic between the bank and the examiner?

Belshaw: First of all thanks to all of you for including me today. It is indeed an honor and I think it is important that we continue this kind of dialog. For 150 years the OCC has been a prudential supervisor and we have always used our supervision and suasion to implement policy and affect change in our banks. In large bank supervision, we took stock after the financial crisis and asked ourselves: What have we learned? What should we have done differently? What must we do differently going forward?

In addition to building financial strength in terms of capital and liquidity, we clarified via our heightened expectations the need for strong governance - strong audit and risk management functions. Compliance risk management is a key element of the risk management process. It is your compliance risk management people, processes, and results that really are what every single executive officer in your companies, every board member wants. Building a strong compliance process in a company of hundreds of thousands of people is a challenge - you will hear that described by some of the practitioners here today.
We are an agency of examiners who engage with our banks in much the same way that we always have. The dynamic between examiners and our banks, we hope, is always characterized by mutual, professional respect. Our examiners ask questions, understand the processes, and trust but verify. We spend a great deal of time doing that.

At the OCC our attorneys work for our examiners. The enforcement attorneys deal with the issues that we uncover and bring to them. When we have to go the enforcement route, which is only for the most serious matters, it is only when the supervisory suasion and the regular process that I talked about has not been effective.

Now, there may be a sense that this dynamic is changing. In a couple of instances I would agree that we have behaved a bit differently of late, especially where consumers are concerned. Foreclosure orders are an example; that process was not one where we discovered a problem and gave a good opportunity to correct it. We went pretty hard, pretty fast into an enforcement process. Situations where UDAP (Unfair and Deceptive Acts or Practices) concerns have come up, have been similar.

As bankers, you may feel on occasion that you did not get the opportunity to fix a newly-discovered problem, that you did not get that first bite at the apple. That has been the case at times, but that is not our goal. Supervision is our mission and we really only want to go to enforcement as a last resort.

At a recent meeting of our outside independent directors, I told them that self-identification is always the best approach. Being open with us when you find issues is critical. Even if an enforcement action ensues, the bank’s openness will always be considered as a mitigating factor in our response.

Clark: Sally Belshaw makes a lot of really good points. My starting place is that enforcement comes when policies and supervision have not been effective at achieving the behaviors that we want. The supervision process tends to have quite a large role in the interpretation and implementation of policy — it is a natural relationship between the two.

With respect to the compliance and supervision from the Federal Reserve, we established a new framework in 2012 for our supervision program for the largest firms. It is largely focused on a few areas:
resiliency, in terms of capital and liquidity under stress; recovery and resolution planning; and corporate governance.

Within the corporate governance side of things, a large emphasis is on the board of directors and senior management. They need to put in place effective processes and the right culture to actually allow for strong, effective compliance functions and other independent internal controls. These should be functions that have the ability to influence decision making at the firm and actually, hopefully get us to a position where these internal controls and our oversight can forestall the need for enforcement actions.

Kaplan: As a third regulator on the panel, there is a nuance, a difference, in the way the CFPB thinks about these issues. We think of supervision and enforcement as two different tools in our toolkit to accomplish our mission which is the protection of consumers. There are different circumstances where deploying one of those tools is going to be more appropriate.

I think we do have a preference for supervision as the others have expressed, but by its very nature, supervision tends to be a private matter between the regulator and the institution. There are times when the interests of consumers are better served by making consumers and the world aware of an area of concern. In those instances, we consider it to be more appropriate to use an enforcement tool and go public with the issue. Generally speaking, as Sally mentioned, this is limited to more serious matters – the matters where we think there is a need to inform the nation as a whole all at once, rather than going institution by institution.

Broome: Are there differences between an OCC exam and a CFPB exam?

Kaplan: I think there are. Initially, I suggest that there might not seem to be quite a lot of difference. I think the feel of an exam from the CFPB and the feel of an exam from the OCC or one of the other prudential regulators is similar. We issue information requests. We send teams on site. The team reviews documentation. They do analysis. They talk to staff at the institutions we are examining. In those ways I think we are all quite similar.

But in other ways the CFPB is different. We are different in part because our mission is a different mission. We do not have a safety and soundness mandate, so our primary concern is not for the
institution. We are in business to look after the interests of consumers in the marketplace.

For that reason we do not have as much of a need or incentive to look at a single institution soup to nuts in one fell swoop the way the traditional prudential regulators would. Prudential regulators have to decide where an institution is on a scale between very, very sound and in jeopardy of failure. We are more interested in looking at the world from the consumer’s perspective. That means looking at products that represent a risk to consumers at any given moment in history.

Relevant to the folks on the panel, it is important that we look not just at depository institutions, but also at a vast array of non-depository institutions. By so doing we seek to create a level playing field in which all purveyors of financial products to consumers can feel secure that someone else is not out there eating their lunch by skirting the rules. We think that prior to the creation of the CFPB that was happening all too often. Financial institutions that take deposits – banks and credit unions – were often suffering from what they objectively perceived as unfair competition from the shadow banking sector and less regulated organizations. We differ in who we regulate and we differ in our focus on individual product lines rather than a full exam at any given moment.

III. REGULATORY CHANGE MANAGEMENT

Neiman: Let’s talk now about regulatory change management. I think we will all agree that there has never been a time in our recent history when there has been a greater confluence of so many regulations and laws, both domestically and internationally, being proposed and implemented all at the same time. It is across business units. It is across every internal control function. It impacts banking and non-banking subsidiaries. It impacts corporate, capital markets, retail – across the board.

During the early response to the Dodd-Frank proposals three years ago, the process was driven by legal and compliance. It was reactive to the proposals and to the final rules. It was tactical, meaning it was focused on meeting the compliance dates.

What we have seen is a real shift, particularly among the global institutions like Bank of America and Santander, which are sitting here
with us. It is now much more global in perspective. It is much more business ownership than legal and compliance. It is much more proactive than reactive. I guess most importantly, it is more strategic than tactical, meaning that it is accessing the impact both of proposed and final rules on the institution’s business model, its product offerings, and which geographies it should be active in.

You just have to look at areas around subsidiarization to see the enormous impact that these global rules, particularly those including resolution and too big to fail, will have on fundamental business models. The rules impact whether an institution can actually operate through global branches or is forced to operate through subsidiarization. So I think we are both asking Carol Hunley and Paula Dominick to comment on, from Bank of America and then Santander, how you are managing this regulatory change.

Dominick: I think it is important to understand that the best compliance risk culture has to be owned by the businesses. This shift in the new rules that we were just talking about is actually very healthy. The regulatory shift should be anticipatory around rules that have not yet been written, but that we expect to be written, that we expect to be integrated into business processes.

Having the board of directors actually challenge and discuss and debate with regulatory rules in mind is beneficial for the institutions. We are building in a challenge function across all of the risk and control functions on the strategic plan before it even gets to the board. This means there is a healthy dialog with the business leaders on the compliance implications for potential expansion or contraction. This also forces us to address shifts in risk including credit risk and market risk. This is a healthy evolution of regulation change management, it is not that tactical piece that you talked about.

Neiman: And how does regulation change management relate to the compliance function? Are they related or are they separate?

Dominick: They are related. We call it the virtuous circle. Regulation change management is integral to the compliance program because as your rules change, as your perspective around the rules changes, those rules have to carry through every piece of your compliance management system. There is a whole machine now that is part of compliance that six or seven years ago did not look like this. Previously, compliance was more about advice and counsel.
Any shift in a rule has to flow through the entire machine. For example, a shift in a mortgage servicing rule has to flow through the whole mortgage origination machine; it is integrally connected into the compliance process. I do not think you can pull them apart.

**Neiman:** Carol, you are with one of the largest Spanish banks. You have a large global footprint; you have large commercial and retail operations here in the U.S. You have to deal with Spanish rules and U.S. rules. How do you manage this regulatory change globally?

**Hunley:** I manage the regulatory change here in the U.S. and I try to influence the way our parent thinks about compliance in Spain and globally. I think they are very receptive because they recognize that the U.S. regulatory expectations are generally going to be the standard. If you can meet that standard—and I am not sure we can check that box yet—but if you meet that standard you are generally in good stead globally. Our parent company has been extremely supportive of the compliance program here in the U.S.

Paula Dominick is right about the process for implementing specific rules; we have had a lot of different rules come down. I look back to 2009 when I presented to a board at a prior institution—it was the FCRA (Fair Credit Reporting Act) Red Flags implementation. I told the board there was good news and bad news: the good news is I think we did this very, very well; the bad news is I do not think we could implement two of these rules at one time. Implementing just the one rule was a very significant project, but now we are doing dozens of these Dodd-Frank rules at one time. It has been a paradigm shift in project management, in ownership, and in accountability. Frankly, the businesses that Paula talks about are a little shell shocked in terms of really accepting ownership for that compliance.

But, then there is also the heightened expectations that Sally Belshaw talked about. We are a recent addition to the OCC large bank program; we transitioned from a thrift two years ago. We had a lot of ground to cover in a couple of years and the heightened expectations is not necessarily about rules and legislation. Rather, it is a question of what a strong compliance, audit, and risk management framework looks like. I think we are all participating in a conversation about that, about how you put that in place. I think it is a great conversation, but one that I am not sure has reached the same point as the regulatory change process.
For example, look at the vendor management guidance that came out last week. Our organization has already discussed the guidance a great deal, but the changes permeate every facet of the organization. This shows us that regulation change management is not just about your strategic plans and challenging those strategic plans. You have to ask do those plans involve a third party? What resources are you going to bring to bear against that strategic plan, what compliance resources, what business resources? It is a real paradigm shift.

Neiman: Tim, Sally, how are the global banks doing in this area? Have you seen some of the best practices? Is there anything you can share with us? Could you give them a grade in managing this regulatory complexity that is sweeping the world?

Clark: I think that it is premature to comment on best practices. Obviously, there is a tremendous amount of complexity. There has been a lot of change around the world - jurisdictional challenges. What we have seen is that those responsible for guiding these organizations are taking this seriously. It has captured their attention in ways that it did not in the past. Perhaps that is because we have made the new rules so complicated and made compliance so difficult that there is no choice but for the heads of these institutions to become personally involved. So in terms of best practices, I would not want to go there, but have we seen movement in the right direction? Are we feeling that this is getting the right level of attention? I think we are moving in the right direction. That is a good thing and there is a lot of work still to do, but we understand how complicated it is.

Belshaw: I absolutely agree with that; it continues to be a work in progress. I feel like we have largely made it in terms of the financial strength enhancements. In many respects, I think that is easier than these more intangible shifts, changes in processes within your institution. What we look for is a commitment to reaching full compliance; we want to see appropriate plans. We evaluate if an institution is on track - that is what we are measuring and monitoring.

With some compliance issues it is not a simple matter of making a mistake. If you build a system that makes a mistake, then you are repeating that mistake millions of times. That is one of the keys that you have to test. As Paula said, you test your systems all the time to make sure you are not creating a big problem for yourself.
Clark: As an example, think of doing information technology once if you are going to do it for FATCA (Foreign Account Tax Compliance Act) and you are going to do it for AML (Anti-Money Laundering), you want to look at it across the board, what are those changes, so you are not dealing with a siloed situation.

Kaplan: That is exactly right. It is heartening to hear my colleagues from the two big institutions talking about building the fundamental machine that will accommodate this need to respond to so many issues at once. We spent a fair chunk of our first year of our existence doing CMS (Compliance Management System) reviews. We have drilled down and for us CMS is policies and procedures, it is training, it is monitoring and remediation, and management and board oversight - there are subcategories under each of those.

Without those fundamental systems in place, there is no capacity for an institution to respond to all the challenges that come up today. But if an organization has those pieces in place initially, then their capacity to respond is very strong. We worry a lot about CMS and I know that the large banks that we regulate do as well.

Dominick: The change management system is the foundation; it is exactly as Steve Kaplan said. If you do not have a well-designed foundation to accommodate change, there will always be things you can plan, but you cannot predict everything. The volume of change that Carol Hunley talked about and the foundation that Steve talked about, those are the starting point of any compliance management system. You have to be able to accept the volume of rule changes; there has to be a process by which to work through all these items. If you do not start with that foundation, with these building blocks, then when something happens that you have not planned for, you are not able to cope.

Every rule is like a pebble in a pond. Every rule is that little, little pebble in a pond that sends ripples across the organization. All those ripples travel across the organization; they morph and morph and morph in ways that are difficult to predict. Unless you can take each new rule through each system to the end, you will not know how that rule will affect the whole organization.
Broome: Let us move on to reputational risk. The first perspective I would like to get on this is how the compliance officers, Carol Hunley and Paula Dominick, mitigate reputational risk. How do you think about mitigating reputational risk and what actions do you take to that end?

Hunley: My personal opinion is that reputational risk has kind of morphed over time. Due to the recent volume of enforcement actions, I am not sure that a regulatory fine necessarily has the same reputational impact that it once had.

At our institution the conversation is first and foremost about culture. That is the foundation. You have to have a strong compliance and risk culture in the organization to be focused on things that can create reputational risk. As compliance officer, I am engaged in those conversations with our management and the board.

Additionally, it seems that reputational risk has become more granular, possibly because the CFPB has come onboard. We are starting to look at what are our customers saying to each other on social media. We are focusing more on customer and consumer feedback. So I think that the definition of reputational risk has changed.

The good news is we are talking about it; we are talking more about culture today than ever before. We are talking about it not only at the management level, but at the board level. The board is very interested in these topics; we know we have their attention and we know they are engaged in these conversations.

Dominick: You can see the way reputational risk has changed over the last six years. Originally, institutions tended to do a pretty good job of managing transactional reputational risk and underwriting reputational risk. We all had machines that worked very well around underwriting specific deals in the wealth management system, and product design. Where we have grown and changed is exactly as Carol Hunley said; the dialog has escalated much higher in the organization.

The other change we are seeing is that conversations about reputational risk are now based upon principles rather than rules. I take that as a sign that this culture is starting to change and morph and really take root. When you start thinking about the principle behind the rules you ask yourself new questions: What kind of reputation would this
create for your organization in the eyes of the end consumer? What would the end consumer say on the CFPB complaint hotline. Those kinds of conversations are much more robust than they have been in the past.

I also think you can tell the culture has shifted when the compliance and risk teams have a veto in the reputational risk committee. If you get one control partner that says, "No, I vote against. I do not think this is a good idea," that sends everybody back to the drawing board. Once the business understands that point of view, they do not even bring these proposals forward. That means that now the number of reputational risk committees may be fewer than previously because the business has been enculturated with this concern for reputational risk. That is when you start to see the cultural shift.

**Broome:** And from a regulatory perspective, how do the regulators sitting up here today define reputational risk and how do you measure it?

**Clark:** That is a huge question. It is hard to define; it is even harder to measure. Reputational risk is very behavioral. For example, since I was introduced as a former professional musician, lots of people will probably think, "Tim Clark, he is that supervisor that used to be a professional musician."

**Neiman:** A whole new perspective.

**Clark:** Just to be clear Richard, I am completely comfortable with that reputation. But my point is that people form an opinion of institutions just as they form an opinion of other people, and that reputation is very important.

On the compliance side there is a huge role for reputational risk; it is important to have the ability to impact decision making. I am hearing others talk about creating the culture that makes for better decision making. That goes beyond just compliance. It is at a much higher level of the firm; that is where thinking about the importance of reputation really matters.

I am less concerned with measuring reputation. I think firms should be aware of their reputation, and if their reputation suffers, aware of how that may impact their financial condition. We are living in a period right now where public trust in the banking system is not at a high point. To address that, institutions need to dedicate efforts to providing good services for clients, good services for customers. They
need to understand how participation in various markets can impact the functioning of those markets. Most importantly around this there needs to be a control framework that allows you to manage your reputation.

**Belshaw:** Once you have damaged your reputation in any way, it is very, very hard to rebuild it. It is much easier going the other direction. That has been clear since the financial crisis. With institutions as well as with regulators we are working to get that good reputation back.

For something telling, look at our supervision by risk framework which was implemented many, many years ago. When we designed that, we included reputation risk and I can remember people saying to us at that time, “Why is that a concern of yours? Why is that even your business?” I doubt that anyone would even think of asking that question today since it is so critical to the soundness of an institution.

I also harken back to a memory from long ago where a banker once asked me, “What level of violation is acceptable?” And people said to me in the meeting that my face spoke volumes. I said, “None. You must shoot for none because inevitably there will be some mistakes.” And I doubt that question would be in anyone’s mind today. I do not mean to suggest that we have a zero tolerance for mistakes, but clearly you do not plan to shoot for a certain level of non-compliance.

**Kaplan:** I would suggest to you that Tim Clark’s and Sally Belshaw’s comments are significant because each noted that reputation risk is inherently a safety and soundness consideration. It is risk to the organization.

It also highlights the way different regulators have come to use similar terms. When the CFPB talks about risk, we are talking about risk to consumers. When the prudential regulators have spoken about the various kinds of risk, they are talking about the risk to the institution. Although we are using similar language, we do not mean exactly the same things when we use those words.

From the CFPB’s point of view, as a safety and soundness consideration, we do not spend a lot of time concerned with reputational risk. We think that is the province of the prudential regulators and the institutions themselves. From our point of view, the best and easiest way to safeguard your reputation in the marketplace is by doing what we promote: treating customers fairly and making the products and
services that they need to live twenty-first century lives available to
them at prices that they can afford to pay.

V. Compliance Operations and Structural Change

Neiman: There was some reference to the enforcement panel
earlier today where there was a lively discussion around how regulation
by enforcement seems to be the dominant approach to changing
behavior and assuring compliance at our largest financial institutions.
The panel pointed to increasing fines, with each fine being the floor for
the next fine.

This is in contrast with the more traditional prudential approach
when matters were initially identified and addressed in the examination
and supervisory process with non-public actions that were only
escalated depending on the level of severity or the degree of non-
compliance. I actually heard from my former agency, now known as
the New York Department of Financial Services, that the earlier,
prudential approach did not work to change practice, so they moved to
try a different approach, much more enforcement oriented.

The question is how is this environment changing how firms
organize, how they staff compliance departments, how they establish
priorities? A lot of these issues are not arising from the examination
process. They are arising from the headlines; they are arising from
whistleblowers and other referrals. I think it would be interesting to
hear both the industry perspective and also the regulator’s perspective.
Let us start with Paula Dominick.

Dominick: One important thing is to be ahead of potential
problems. This has required an explosion of monitoring and testing.
The biggest jump in our staffing has been around monitoring and testing
- more so testing than monitoring. We all do a certain amount of
monitoring in our routines, but the actual testing has brought a lot of
new work and a lot of new staff. Testing includes defining a testing
program, the scope, the script, the exceptions, whether you do it
through technology, whether you do it through people – all those pieces
require new staff be brought on board.

We do something else that is important: every time there is a
large enforcement action, we actually dissect it to scrutinize our own
operations. For each major enforcement action, we look at all the
components of it, look at every one of our practices, and do a compare and contrast. Every time we start a new risk assessment and then run it through the machine and actually look at whether or not we need any kinds of compliance enhancements. That is normal for us now. If you went back three, four, five, six, seven years ago, that would not have been routine.

You have to make sure there are enough people in the compliance function that can take an enforcement action apart with the help of our legal partners. We do a lot of hand in hand work with our legal department to look at enforcement actions. We need to make sure that we understand what they mean; then we decide whether or not our compliance system is up to that next rung, whether or not there are any additional enhancements required. We have to answer the question of whether or not our current system captures the risk that lead to the enforcement action.

Neiman: And that testing, is that being done centrally by business function, by legal entity, by . . .

Dominick: That is the $64,000 Question. We have a little bit of a hybrid. We have quality control and quality assurance that are each required by the line of business. They are required to make sure that their processes are compliant and sound with respect to operational risk.

Compliance does ongoing monitoring as well as spot testing within the compliance function. Some of our testing is actually centralized. We have a centralized consumer testing function; it covers the mortgage piece, it covers all of the other consumer tests and it is a good way to cross fertilize. We have that all centralized. The banking and markets is essentially centralized as another testing unit. We have a requirement that the businesses know their process and they do their own testing and then we have a testing function as well from a compliance perspective.

Neiman: So Carol, how do you organize compliance?

Hunley: Our organization is similar, but a bit of a smaller scale than what Paula described. We have a centralized compliance testing unit and we have significantly increased our compliance staff over the past two years. But probably the biggest shift that we have at our organization is not in compliance per say, but in the line of business. The business line is building that quality assurance because I cannot hire enough people to monitor and to test and to keep people from doing
the wrong things. It has to be imbedded into the business and that is the journey that we are on right now.

**Dominick:** Yes, that is absolutely correct. There are not enough compliance people to test all of these things every minute of every day. If the business does not have their operational process correct there is not enough testing that Carol Hunley and I can do to catch everything that happens. The business has to own their risk, just like they own their credit risk and their market risk; they have to own their compliance risk as well.

**Hunley:** The paradigm shift that we are talking about is very costly. It has been a significant investment and I am not sure that we as an industry have caught up with the size of that investment.

The other issue on the recent enforcement landscape is product line abandonment. I think some of the big banks are saying, “You know what? It is just not worth it. We will get out of this product, or that product, or that product, and anything that smells like that product.” That is creating consumer harm in another way. Steve Kaplan talked about the shadow banking system and I think there may be another shadow banking system that pops up that offers all these products that we are all getting out of.

**Neiman:** Some could possibly be delivered online and at lower costs.

**Dominick:** On the innovation question, one of the tenants of the CFPB is to make sure that we are all innovating around consumer products. We had this conversation in with regulators. As compliance executives, we are not going to let our institutions get even close to the line. So as they try to innovate, we are trying to look where that line is going to be and hold them far enough back from the line. I am not suggesting that innovation has in any way stopped or halted, but there is a lot more discussion around it because of the compliance risk.

**Hunley:** I was in an innovation seminar given by our parent company. It was training and I was the one saying, “Cannot do that. Nope, not in the U.S. Cannot do that.”

**Kaplan:** I think that we are very sensitive to exactly the point you are trying to raise. We understand that if our goal is to protect consumers in the financial services marketplace that there are two components to that; the first is to make sure that consumers are treated fairly when they do business, and the second is to make sure that they
have access to the products and services that they need at a cost that they can afford. And we recognize the need to temper our goals around the fairness piece with the possibility that too costly an approach could result in consumers not having specific products available. We are very conscious of that.

Having said that though, I would suggest to you that when I was introduced to financial regulation in the Spring of 2007, the Dow was about 14,000. By March of 2009 the Dow was about 6,500 - that was a pretty costly thing also. What we are trying to do is balance what we believe is the more temperate, more modest cost of getting the system on a bit better footing against those dramatic, cataclysmic costs that we, the people in this room, lived through just a few years ago.

Neiman: Tim Clark, Sally Belshaw, when we see these extraordinary fines, I do not think the public appreciates the level of resources, of systems, of people that have been dedicated to these compliance areas. Can we get your perspective on that?

Belshaw: We certainly appreciate that - I have seen the quantity and quality of compliance and risk management staff increase dramatically in our institutions. Some of this is, as Paula Dominick described, a result of examining the public actions that have come out on specific institutions and saying, “Can I meet that standard before I am subject to it as well and bear the cost that will go with a fine?”

In one case in particular—I will not mention a name—but the way we arrived at a specific fine related to what we believed the institution was intentionally doing to cut costs associated with compliance. We recognize compliance is costly, but you cannot afford not to do it well if you are going to be in the business.

Right now, particularly with respect to BSA/AML there is a lot of dialog around the OCC telling institutions not to do business with specific clients. That is absolutely not the case. But in our examinations, we review specific client relationships, and if we determine that a bank is not managing that relationship or that risk appropriately, we point that out. The option is, de-risk or manage it properly and that is always the choice of that institution, recognizing there are business costs that go with doing that.

Clark: I agree with everything that Sally Belshaw just said and

2. Bank Secrecy Act/Anti-Money Laundering
I am going to take a slightly different direction. I think we have all recently learned the important consequences that can result from risk management failures. Those consequences can be to an individual institution or much, much broader than that.

I see supervision and enforcement as two parts of the same thing. We have put in place incentives for firms to actually internalize the costs that are necessary for them to meet the regulations and the rules. They benefit from the ability to operate in that market space and they have compliance costs that they need to pay. If a regulator cannot get where it needs to go through supervision, enforcement follows.

Supervisors tended to try a bit softer approach in the past; they learned some very hard lessons, and they understand now that incentives can be strongly helped along by enforcement actions when you cannot get things done in other ways. Enforcement actions are a useful tool that we hope we do not have to get to. The firms, first and foremost, are the first line of defense to stop problems from happening.

The supervisors working with the firm can also help if there is a problem. But if we have not gotten there through those two things, enforcement actions are a very good way to capture the imagination of people about what might happen so that they will be incented to stop the problem from occurring in the first place.

Neiman: The examination process has shifted and become more forward thinking rather than being static in time. When you think about examinations traditionally and you compare that to what we are doing today, the new rules of stress testing, contingency planning, capital planning; it is a much different focus. Eventually, I am sure that these will be incorporated into our CAMEL (Capital, Assets, Management, Earnings, Liquidity) and ROCA (Risk Management, Operational Controls, Compliance, and Asset Quality) ratings under management and possibly compliance.

Clark: We are pushing very hard on the capital and liquidity side. I think it applies everywhere and it is a direct result of understanding that you need to be thinking about how things can manifest from activities you are engaged in and not just looking back at how they did actually play back in reality.

Belshaw: I think we have seen very poignant examples of that looking back to the foreclosure mess – FCM, that is what we call it. Perhaps all of us should have seen that coming. We knew that the level
of foreclosures was going to increase given the economic situation. We knew that companies were going to do something to address a skyrocketing volume that they were not prepared to handle.

To every compliance officer, if you examine your strategic plan, focus in on anything that will be growing dramatically. That should be a key showing you where you want to focus your attention; there is great potential for that to get messed up. Using people who were motivated to get a ton of volume done quickly, that should be a red flag that there might be some reason to cut corners. Third-party outsourcing, its dramatic increase, is an appropriate response for a business addressing how they may cover something on a temporary basis or not so temporary basis. But we have seen clearly you do not give up one speck of the responsibility for how that party performs on your behalf even though you are paying them to do it. Presuming that they have some expertise - I think that is a very dangerous presumption.

Dominick: At board meetings and at audit committee meetings, the question is asked, “Do you have enough people?” and “Do you have the right people to accomplish what you need?” That question is asked every quarter. There is a heightened awareness of the issue of appropriate staffing. The conversation is not just about having enough people, it is about having the right kind of people to execute the compliance program. That is asked over and over again.

Hunley: Of course the challenge is where do we find them because we are all looking for them.

VI. SENIOR MANAGEMENT AND BOARD ENGAGEMENT WITH COMPLIANCE

Broome: Should we talk about senior management engagement and board engagement with the compliance function? How does the board engage and how does senior management engage in the compliance function from your observations?

Neiman: Earlier this morning at the corporate governance panel, Professor Joseph Grundfest of Stanford Law School recommended having two types of directors: compliance directors and operational directors. There would be a set number of directors responsible on the board for compliance - an interesting proposal.

Broome: So Paula Dominick and Carol Hunley, what is your
Dominick: From our perspective there is already active engagement with the board; there is lots of dialog. We report our compliance risk to the audit committee. I sit on the enterprise risk committee. Our governance channels through the audit committee.

In the audit committee, there is an equal amount of conversation on compliance risk as there is on audit reports. So the volume of compliance items that these boards have to actually handle is significant. The scope, the complexity, the discussion on rules – there is a question of how much detail you want to present to the board. You cannot give them too much or they get lost in some of the detail. You have to be able to have the board engage in a dialog. That includes explaining why you are bringing an issue to the board. You also have to give them the appropriate context so that when members of the board are alone with the management team, board members can lean in if they need to.

There has been a shift; I think the amount of compliance items that are going up to the board has grown exponentially. There is a robust dialog around other companies’ enforcement actions.

Hunley: I have added a function just for reporting because we report to every board and every board committee, if I am not mistaken. We are reporting everywhere so everybody is talking about compliance.

Dominick: With respect to reporting, consider the challenge presented at major firms. How do you find out what everybody is doing, grab all of those transactions or all those exceptions to all those policies and rules with 240,000 people and figure out how to synthesize and summarize that into half an hour or forty minutes to present to a committee?

We get asked by the OCC what framework we use to decide whether or not to escalate an issue to the board. That decision process has become less of an art and more of a science. But I think it has to be a balance of both; you have to be able to articulate to your regulators after the fact why you took the course of action that you did.

Kaplan: Earlier I was talking about the significance that the CFPB places on CMS. One of the pillars of an effective compliance management system is the appropriate level of involvement of both senior management and boards.

We try not to be unduly prescriptive because we think there are
a lot of ways that you can accomplish this goal. But at the same time we think that some level of training and awareness of board members is an appropriate thing. On some regular and consistent basis there should be compliance reporting up to that level. It can be at the committee structure or it can be at the full board structure. Sometimes most of the reporting is done at a subsidiary board rather than at a parent board but that will vary from circumstance to circumstance. But as a general proposition we consider it to be critical for the board to be involved.

Back to the point that Carol Hunley was making earlier; ultimately, the ability to execute against these responsibilities comes down to resources. We are all challenged for resources but it is the board that can make the decision about how to allocate those resources.

VII. HEIGHTENED EXPECTATIONS AND REGULATION

Neiman: I have a question for our regulators. We have heard the term “heightened supervision” or “heightened expectations.” From the regulatory perspective, can you provide us with a clear understanding of what heightened expectations are with respect to these key functions?

Belshaw: Well I suspect that question is for me because the OCC came up with heightened expectations. And it is hard to articulate in a matter of minutes what that means; we have spent several years trying to get clarity around it. It does not relate to just a level-one rating within the CAMELS (Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk) rating system.

It relates to five specific areas where we have specified what we think needs to improve. Articulation of risk appetite throughout the organization is one; that goes from the board all the way through the organization. We have talked about the sanctity of the charter because the national bank charter is what matters to us. We have talked about the increase in the quality of risk management and auditing. We determined after the financial crisis that all of our mega-institutions have “satisfactory” ratings in those categories. Across the entire spectrum of an organization there may be pockets that were rated differently, but as a whole each firm was rated as satisfactory.

But satisfactory was obviously not good enough to protect them from financial harm. We have said that it has to be strong. Now we are
looking at that trajectory, that plan for our organizations to achieve that level of assessment. Some have already gotten there, but many more still have a ways to go.

Clark: From our perspective, heightened expectations comes in as part of the Dodd Frank Act. There are heightened expectations for systemically important financial institutions and for the largest banks. We take that very seriously and support it completely. What does that mean for supervision? It means that we expect the largest, most systemically important financial institutions to not simply meet the minimum standard but be well above that minimum standard. We expect them to have leading practices in key areas.

It also means that we are less patient in the past than we might have been. If we find a firm does not have strong compliance practices, we will do what we can to encourage firms to increase and strengthen their practices in order to meet these stronger expectations.

Kaplan: I am not sure that we have been around long enough to have heightened our expectations. We like to believe the fact that we exist has heightened everyone else’s expectations.

VIII. CFPB EXAMINATION AND CONSUMER COMPLIANCE EXAMINATION

Broome: Steve Kaplan, you did talk a little about the consumer exam process and how it is focused on products more so than entities. Is there anything else you want to add about that process? Then I want to go to our other regulators and ask them that given that the CFPB is there for the largest financial institutions, what role do your organizations still play in the consumer compliance examination?

Kaplan: Just briefly, we have invented some vocabulary in our short lives. We organize our supervisory activities around product lines - we call them IPLs, institutional product lines. When we go into an institution we could be looking at, say, mortgage origination. We might be simultaneously looking at depositories and non-depositories that both originate mortgages; we are making sure the standards are achieved across the board when we look at one of these individual product lines.

We look at it in light of the transferred responsibilities that came to us under Dodd Frank. That includes responsibilities for enforcing against the largest banks and non-depositories compliance with things like TILA, RESPA, TISA, Fair Credit Reporting Act, Fair Debt
Collection Act, ECOA, HMDA, UDAAP, etc.

We also enforce some things jointly with the FTC, areas for which they are responsible for promulgating regulations, an example being the telemarketing sales rule. Our jurisdiction on the depository side is that we are the primary consumer compliance regulator for banks with assets of at least ten billion dollars and members of the corporate families of those institutions.

We go into these organizations most often to review a particular product line but there are times when efficiency and economies of scale suggest that we do a fairly broad number of IPLs simultaneously. At times those are adequate to produce what we call full scope point in time examination and result in a reported examination and a rating for that institution.

For other institutions where we do not do full scope point in time examinations, we issue supervisory letters that reflect our findings on the individual products that we have looked at. In those institutions, from time to time, we will create something called a rollup which is a reported examination that takes into account all of the individual product lines that we have looked at over a given period. That rollup could be issued as frequently as every eighteen months and perhaps maybe not for several years depending on the number of product lines that we have looked at.

**Broome:** So Tim Clark and Sally Belshaw what do you still look at?

**Belshaw:** Perhaps we should have asked Barney Frank, who spoke this morning, why a few specific consumer regulations were left with the OCC. We have a few left, but primarily we will rely to the extent that we can, on the work that the CFPB is doing in our largest institutions.

We do still have responsibility for a consumer compliance rating and in our supervision by risk we still assess compliance risk management. That rolls up into many of the things that we talked about today with respect to overall risk management and management of the institution. This continues to be a focus of ours although we are not necessarily examining for all of the consumer regulations the way that we used to. From a compliance standpoint we still have responsibility for BSA/AML compliance. Also, the Community Reinvestment Act is still our responsibility, so there are still plenty of things within the
compliance domain that we have supervisory responsibility for.

Clark: I am not actually a part of the Division of Consumer Compliance Affairs at the Federal Reserve so I do not want to go into the list of things that Steve was weighing out because I am sure I would get a few of them wrong. Obviously the Federal Reserve continues to have a number of responsibilities associated with consumer compliance. State member banks are one area, but there are a number of other areas. Probably the more important point is that we work with the CFPB, we learn from the CFPB and their work, and our responsibilities at the holding company consolidated level are going to be informed by the work that they do as we think about the overall firm wide compliance program and its effectiveness.

Kaplan: And I think it is worth noting that there is a great deal of emphasis in all our organizations on collaboration and cooperation across these overlapping responsibilities. I happen to be the point person at the CFPB for just that role. I talk regularly to your colleagues about how we can better accomplish the ultimate goal of the various government agencies by coordinating and sharing. In significant part, this collaboration is meant to reduce the burden that all of our activities represent for the institutions that we regulate.

Neiman: I think we have a few minutes for questions if there is one from the audience.

Audience Member: The question came up at the prior panel about the reporting line for the Chief Compliance Officer. Should it be the CEO, the General Counsel, or another member of management? Does anyone on the panel have any thoughts they can share?

Dominick: There are different designs. Some of my competitors report to the Chief Risk Officer. I happen to report to the General Counsel and I’ve had conversations with both the Fed and OCC on this point. I think as long as there is a stature in the organization, as long as there is credible respect for the compliance function, and as long as you have a risk approach, you are good. There is some concern with reporting to the General Counsel that you just have a legal approach to compliance. Compliance is a risk and as long as you have that risk-reward dynamic in everything you analyze and look at, rather than a strict legal interpretation I think it could work.

It depends on how the broader company is organized. You have to make sure wherever you go there is stature. If you do not have that
stature, then you do not have that credible challenge. If you do not have that credible challenge, then you cannot affect the culture of compliance within the organization. It really depends on making sure that wherever compliance is, it has that stature.

**Neiman:** Earlier, Tom Baxter went over the various reporting lines. There was no right one; they could all be acceptable including the CRO, the CEO, the General Counsel, or general auditors.

**Belshaw:** I think that would include all of us. Exactly—well said.

**Neiman:** I want to thank everybody. You can see from the quality of the interaction both from the regulatory side as well as the bankers side that we were very fortunate to have this panel join us today. Please join me in thanking them.