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UTILIZING THE COMPLIANCE MANAGEMENT SYSTEM FRAMEWORK FOR VENDOR MANAGEMENT

PROTECTING CONSUMERS AND ADHERING TO CFPB GUIDELINES

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The regulatory atmosphere is evolving for the financial industry, and as the purview of the Consumer Financial Protection Bureau (CFPB) has grown, guidelines have become more expansive and critical. Two key issues that federal regulators continue to focus on (and have been the point of reference for breakdowns causing violations) during examinations are compliance management systems (CMS) and vendor management oversight. In turn, all regulated financial service entities (i.e., banks, credit unions, specialty finance companies, debt collectors, etc.) must be aware of their regulatory compliance responsibilities to protect consumers and avoid significant penalties.

The CFPB was established in 2010 as a part of the Dodd-Frank Act and initially focused on large banks that exhibited risky behavior that put consumers in financial danger. However, its focus has trickled down to smaller organizations, and nonbank specialty finance companies are now under the supervision of the CFPB, with heightened regulatory expectations. Many organizations have additional compliance demands and are subject to reviews that previously did not fall under the CFPB umbrella.

CURRENT AND EVOLVING RISKS

The current regulatory environment is more challenging than ever for several reasons. The expansion of CFPB guidelines has brought higher penalties, settlements and sanctions and increased risk of civil and criminal liability against compliance and business executives. Examples of these challenges include:

- Unfair, Deceptive or Abusive Acts or Practices (UDAAP) guidelines have become broader to discourage misleading and predatory practices, requiring careful management of marketing and social media campaigns and complaint management
- New mortgage servicing rules pose interpretation challenges, including updated metrics for determining qualified mortgages and customer's ability to repay
- Regulators require a comprehensive CMS to manage compliance demands and manage vendor and thirdparty risks

The penalties for noncompliance with CFPB guidelines can be severe, with fines, payments to affected customers and demands to immediately improve the compliance framework. A simple news search will show recent CFPB violations for a variety of organizations, including large banks, community banks, debt collectors and mortgage servicers for misleading and unlawful practices. Commonly, the violations are driven by a lack of vendor oversight for key functions that an organization has outsourced to reduce its risk due to a lack of knowledge and to help with synergies. The financial penalties can reach tens of millions of dollars, with the reputational damage having a lasting effect in many instances.

The CFPB's intent is to protect consumers, but the regulatory components may be unclear to those who need to comply. By implementing an effective CMS and expanding its usage to vendors, information and communication can help large and small organizations stay in compliance and thereby protect themselves, and customers, to the greatest extent possible.

USING A CMS TO MANAGE VENDOR RISKS

Vendor management is a significant element of an effective CMS, and oversight of this function has become a linchpin to receiving an adequate rating during a compliance examination. Through guidance and enforcement actions, this area has clearly become a focus for regulators with the increased use of service providers.

As entities work with more service providers to deliver products and services, oversight of those relationships becomes more difficult to manage. It is important for organizations to identify significant vendors and implement policies to manage them to avoid taking unnecessary risks with those that interact with consumers. Among other important technical responsibilities, organizations must perform due diligence to verify the compliance capabilities of vendors they work with to ensure consumers are protected. As the CFPB points out, the consumer chooses the organization, not the service provider, so the organization is required to manage those relationships very closely.

Not every organization has the same risks, so it is important to step back and identify how many vendors they do business with, how many consumers each touches and determine the potential risk of each relationship. Many organizations have not fully accounted for all of their vendors, prioritized them on a risk and priority basis and regularly updated this information. However, this is a key focus area for the CFPB, and it expects a framework to be in place that is appropriate for the size of the organization to identify third-party risks.

CMS ELEMENTS AND VENDORS

Board and senior management oversight: The board and senior management should set a strong tone at the top, communicating compliance expectations throughout the organization. These expectations should expand to the usage of vendors by the organization. Appropriate oversight and approval of vendors by the board should play a critical role within the organization. Receiving information (such as reporting) on those relationships is essential for proper oversight, as well as understanding evolving risks.

Compliance program structure: As with the expectations of the organization, the vendor's compliance programs should include appropriate policies and procedures, training, monitoring and corrective action. The program should be formal and in writing and administered by someone with regulatory compliance knowledge. Additionally, the control environment should be commensurate with the risk profile.

Policies and procedures should include sufficient detail and remain current, including all applicable regulations. They must be designed to prevent violations and detect and prevent risks to consumers for the services the vendor provides. Training should cover applicable regulations in a specific, current and consistent manner. Finally, they should have their own monitoring and corrective action designed to identify and address weaknesses.

Consumer complaint response: An effective CMS should ensure that a supervised entity is responsive and responsible in handling consumer complaints and inquiries. Intelligence gathered from consumer contacts should be organized, retained and used as part of an organization's CMS.

In turn, service providers should have appropriate processes in place to capture complaints received both on its services provided, along with complaints about the organization's products and services as an extension of its reporting requirements. This information is vital to overseeing the vendor's CMS and the organization's CMS to determine whether practices they employ could be construed as deceptive or unclear to a consumer. Several instances in CFPB consent orders have cited this breakdown in an overall CMS as being the cause of an organization's downfall.

Compliance audits: The audit function should review an organization's compliance with federal consumer financial laws and adherence to internal policies and procedures. The review should be independent of both the compliance program and business functions that include customer sales and service. An organization should review its service providers as part of its CMS or obtain information through an independent review, performed to confirm its compliance status. Receiving this independent confirmation will provide verification to the board and executive leadership that the vendor is performing according to its contract.

In other words, an organization should consider the vendor's compliance management program as an extension of its own. Vendors should demonstrate a strong regulatory compliance culture with effective policies and procedures, risk assessments, formal consumer complaint processes, monitoring and compliance reviews, corrective action measures and employee training.

The CFPB also has supervisory and enforcement authority over service providers, including on-site examinations. It is important to remember that if any vulnerabilities are discovered at a third-party service provider, the organization and its executives can be held liable and receive significant penalties.

Having a strong vendor risk management framework is important from a regulatory standpoint, but it is also critical from a business and reputational perspective. Vendors that exhibit vulnerabilities can lead to potential penalties, but also unhappy customers. An incident that is reported in the media or spreads within the industry can damage the organization's reputation and subsequent business if customers are harmed and information is at risk. For smaller organizations, that damage can be difficult to recover from.

VENDOR RISK MITIGATION QUESTIONS

An organization can address its level of vendor risk management by asking a series of key questions:

1. Does the organization have a risk management and due diligence process focused on vendor management?
2. Does the organization's due diligence process address the vendor's compliance management program?
3. Is there an overarching view on potential risks from vendors and UDAAP?
4. Does the organization's vendor management program focus on consumer protection?
5. Does the organization have a solid CMS to confidently respond to these questions?

If the answers to these questions are inconclusive or uncover red flags or vulnerabilities, organizations must take action. Often, they can identify risks and form an internal task force, allocating resources and developing an action plan to remediate them. In some cases, that plan may involve outside assistance from a consulting firm or advisors to implement a strategy to manage vendor risk on an ongoing basis. Many organizations may not have the manpower or experience to focus on another area of risk and regulation.

As mentioned earlier, the scope of consumer protection regulation is growing, with scrutiny shifting historically from larger financial institutions to other consumer financial product providers, such as specialty finance companies and debt collectors. It is a new environment, with a higher likelihood that as time goes by, the regulators will initiate a review to evaluate operations and relationships to ensure consumer protection. If an organization is attempting to be proactive and implementing vendor risk management processes, penalties may be avoided.

Organizations cannot afford to wait for regulators to come knocking or an incident to occur before developing and implementing a CMS with a strong focus on vendor risk management. Instead, they must be proactive in identifying issues before regulators find them or before they affect consumers. With the increased use of third parties, new risks are constantly emerging and organizations must be aware of their potential exposure.

The regulators are paying close attention to vendor relationships and levying penalties to noncompliant organizations. The risks are not the same at every organization, but each must allocate resources to ensure vendors do not expose consumers to harmful risks. Being proactive is good for business, good for customers and helps organizations remain compliant with regulations and avoid significant penalties.

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