

Building a Better Compliance Management System

By Clinton R. Rockwell and Andrew P. Pennacchia



Why Read This?

- Covered entities may be subject to regulatory and financial risk if they fail to maintain a compliance management system that meets the CFPB's expectations
- This article provides practical guidance on structuring and maximizing the effectiveness and efficiency of a CMS

The change in leadership and direction at the Consumer Financial Protection Bureau has prompted many providers of consumer financial services to question the importance of a rigorous, well-coordinated compliance management system. Changing emphasis and easing back — and saving some time and expense — is a particularly tempting option at a time when the CFPB leadership has attested that it will no longer “push the envelope” and aggressively assert its supervision and enforcement authority. But covered financial institutions have compelling reasons to maintain a steady focus on CMS, which can:

- Prevent legal violations and consumer harm — both concerns of current CFPB leadership
- Limit scrutiny by states, as enforcement moves in their direction
- Prepare the institution for the inevitable swing of the pendulum back toward enforcement

A strong CMS remains a key component to the long-term success of any company subject to CFPB supervision and enforcement.

The CFPB has said that CMS assessment is one of its most important responsibilities,ⁱ which is why nearly every CFPB examination or targeted review includes one.ⁱⁱ So far, the bureau largely has refrained from imposing civil money penalties for general CMS deficiencies uncovered during initial examinations — though it typically requires covered entities to remediate deficiencies quickly. Remediation is a costly endeavor that generally requires cross-departmental enhancement initiatives that can detract from everyday business responsibilities, harming profitability and progress toward strategic objectives.

The CFPB's public enforcement actions and its regular Supervisory Highlights make clear that companies are still struggling to develop a CMS that fulfills the bureau's expectations. Shortcomings are occasionally attributable to a failure



Who Should Read This?

Entities that are subject to the CFPB's supervision and enforcement authority

ⁱ Consumer Fin. Protection Bureau, Supervisory Highlights: Fall 2012, p. 4 (Fall 2012), http://files.consumerfinance.gov/f/201210_cfpb_supervisory-highlights-fall-2012.pdf.
ⁱⁱ Consumer Fin. Protection Bureau, Supervisory Highlights, Summer 2013, p. 6 (Summer 2013), http://files.consumerfinance.gov/f/201308_cfpb_supervisory-highlights-august.pdf.

to devote sufficient resources or to provide appropriate oversight of service providers, but given the substantial resources and collaboration required to build and maintain each component of the system, it is not hard to see why maintaining an operationally sustainable CMS that satisfies the CFPB is a challenge.

THE CFPB'S EXPECTATIONS

The CFPB grants companies flexibility in managing and executing a CMS that best suits their size and range of products and services. That said, the CFPB expects two interdependent control components: board and management oversight and a compliance program.ⁱⁱⁱ

BOARD AND MANAGEMENT OVERSIGHT

The board of directors or senior management (typically executives and their designees) must develop and administer a CMS that facilitates compliance with federal consumer financial laws and other relevant federal, state, and agency requirements (taken together, the entity's legal requirements) and also identifies and minimizes the risk of consumer harm associated with failure to satisfy the legal requirements.^{iv} The CFPB expects senior management to:

- Allocate sufficient resources — including staffing, capital, and technology — to the CMS
- Track changes to legal requirements and enhance the CMS as necessary to address changes
- Identify compliance risks and promptly implement and track appropriate corrective action
- Contemplate regulatory risks associated with new products and services and complete any necessary CMS enhancements prior to offering them^v

COMPLIANCE PROGRAM

The compliance program component of a covered entity's CMS includes the controls that the entity uses to prevent or reduce regulatory violations, and protect consumers from the harm that noncompliance may cause. CFPB's expectations include:

- (a) Written policies and procedures: The CFPB is likely to view an entity's written policies and procedures as sufficient if the entity designs them to detect and minimize violations and associated risks of consumer harm, and if employees use them as a reference in their day-to-day activities.^{vi}
- (b) Training: A compliance training program should (i) be customized for each employee based on responsibilities; (ii) sufficiently address the legal requirements that apply to the entity; and (iii) further reinforce and help implement the standards and principles in the entity's compliance policies and procedures.^{vii}

ⁱⁱⁱ See Consumer Fin. Protection Bureau, CFPB Supervision and Examination Manual, Manual V.2, p. CMR 1-2 (Aug. 2017), https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201708_cfpb_supervision-and-examination-manual.pdf.

^{iv} *Id.* at CMR 3-4.

^v *Id.* at CMR 4-5.

^{vi} *Id.* at CMR 7.

^{vii} *Id.* at CMR 9.

- (c) Monitoring: On an ongoing basis and in a risk-focused manner, companies should monitor and assess their and their service providers' compliance with legal requirements. The findings should be reported to, among others, senior management.^{viii}
- (d) Compliance audit: Audits should (i) inform senior management whether the entity's policies and procedures are being implemented to the board's standards for compliance and consumer protection, and (ii) address the entity's level of compliance with legal requirements. Personnel or third parties that conduct the audits should be independent of the compliance function and business units.^{ix}
- (e) Consumer complaint management — Companies must maintain a process that ensures that consumer complaints are (i) promptly addressed and resolved and (ii) tracked and analyzed on a continuous basis to identify systemic compliance deficiencies and business practices that lead to consumer harm.^x

COMPLIANCE PROGRAM

It is not easy to develop and maintain a CMS that incorporates the controls that the CFPB requires. The following are some strategies that may help:

- *Establish a risk assessment process to determine the scope and frequency of monitoring initiatives and audit activity.* A covered entity should complete a risk assessment at least once a year that includes service providers and prioritizes for frequent and detailed reviews the legal requirements that pose the greater level of potential risk (e.g., regulatory, monetary, operational, and/or reputational). The assessment should yield a residual risk rating for each service provider and legal requirement by comparing the inherent risk to the controls the entity has developed to mitigate these risks and potential consumer harm. Companies should schedule monitoring and audit initiatives based on the residual risk ratings.
- *Develop compliance policies and procedures that provide employees with guidance on satisfying relevant compliance-fulfillment functions.* Policies and procedures that merely regurgitate legal requirements will not lead to a consistent level of compliance. They must also provide specific guidance for business units and support personnel to satisfy compliance-fulfillment functions. If an assigned function requires the use of an automated system or other resource (e.g., loan origination system), the guidance should provide instructions regarding accessing the specific information, documentation, etc.

The CFPB has said that CMS assessment is one of its most important responsibilities, which is why nearly every CFPB examination or targeted review includes one.

^{viii} *Id.* at CMR 10-11.

^{ix} *Id.*

^x *Id.* at CMR 13-14.



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- *Transactional testing.* Covered entities that periodically test their business activity and controls will be in a better position to identify systemic compliance deficiencies and potential consumer harm. A CMS likely will not be effective if the company is not identifying risk in a manner similar to the CFPB's transaction testing. Testing (as distinct from monitoring) enables the company to assess its level of compliance with legal requirements and the controls developed to facilitate compliance on a transaction-by-transaction basis. While monitoring should be a key aspect of a CMS, it typically involves assessing the fulfillment of a specific compliance function, rather than the broader evaluation of controls that focused testing provides. Thus, periodic testing is an effective means of identifying problematic trends and determining their root cause. Although the CFPB's recently enhanced Supervision and Examination Manual does not specifically identify compliance testing, the bureau has previously alluded to the need to include compliance testing within the CMS framework.^{xii}
- *Get more from the audit function.* The audit function should assess the overall effectiveness of the CMS. The CFPB's independence requirement uniquely positions the audit function to provide an unbiased opinion of the CMS's effectiveness to senior management. Audit staff should evaluate whether CMS personnel groups are performing their assigned fulfillment functions in a manner consistent with the standards that senior management has established. While some observers regard this process as an inefficient "checking of the checkers," it is the type of proactive self-assessment that the CFPB is likely to acknowledge during CMS evaluations.
- *Document senior management's CMS activity.* Senior management is ultimately responsible for implementing and maintaining a successful CMS, and should document its CMS-related actions in meeting minutes, internal memorandums, and bulletins. The CFPB will ask for this type of documentation; companies that produce little or nothing will likely face questions from the bureau about the overall effectiveness of its CMS.

^{xii} Consumer Fin. Protection Bureau, Supervisory Highlights Consumer Reporting Special Edition, Issue 14, Winter 2017, p. 13, 21 (Mar. 2017), http://files.consumerfinance.gov/f/documents/201703_cfpb_Supervisory-Highlights-Consumer-Reporting-Special-Edition.pdf; Consumer Fin. Protection Bureau, Supervisory Highlights Mortgage Servicing Special Edition, Issue 11, p. 3 (Jun. 2016), http://files.consumerfinance.gov/f/documents/Mortgage_Servicing_Supervisory_Highlights_11_Final_web_.pdf.