



COMPONENTS OF AN EFFECTIVE COMPLIANCE PROGRAM

COMPONENTS OF AN EFFECTIVE COMPLIANCE MANAGEMENT PROGRAM

Introduction

The Office of Thrift Supervision (OTS) expects that savings associations will monitor and assess their compliance with various civil rights, consumer protection, and public policy laws and regulations, and take appropriate corrective action to remedy identified violations or operational deficiencies.

Sound compliance management, like other areas of operational management, is predicated on establishing a comprehensive program of risk controls and reviews. Compliance risk is the current and prospective adverse impact on earnings, capital, and market viability, as well as on investor, customer and regulator relationships arising from violations of, or nonconformance with laws, rules, regulations, industry practices, internal policies and procedures, ethical standards, or customer service goals. It is a risk that could expose the institution to fines, civil money penalties, litigation costs, payment of damages, diminished reputation, erosion of consumer trust, reduced franchise value, and restrictions on future business opportunities. Therefore, it is important that the institution actively manage this risk from the board of directors' level through senior and middle management down to frontline staff.

An effective compliance management strategy is one that reduces risk, promotes operational efficiencies and fosters high quality customer service. There are many ways to accomplish this, so each institution must develop a program tailored to its organizational and business unit structure, business strategy, complexity of operations, market, products offered, and staff expertise. While the sophistication of compliance programs will vary by institution, risk management and customer service should be the guiding principles in developing and implementing your compliance management program.

It is the priority of OTS to encourage institutions to tailor compliance management programs to their circumstances and make them self-monitoring, self-assessing and self-correcting. Ultimately, our goal is to have you working S-M-A-A-R-T.



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Fundamental Components of a Compliance Management Program

The fundamental components of a customized compliance management program are:

<u>S</u> ystems	The embodiment of task-specific procedures and internal controls that ensure that transactions are conducted and recorded in compliance with legal obligations and customer service goals.
<u>M</u> onitoring	The process of supervising the day-to-day or week-to-week functioning of your compliance systems to assure real time execution in accordance with your program standards.
<u>A</u> ssessment	The periodic review of system records and operations to identify transactional violations and program deficiencies.
<u>A</u> ccountability	The arrangement of responsibility, authority and reporting relationships that provides direction to staff for implementing institution compliance policy and appraises senior management and the directors about compliance program performance.
<u>R</u> esponse	The process of addressing consumer complaints, remedying regulatory violations, amending procedures and controls, correcting internal oversight deficiencies and implementing policy and system revisions or updates.
<u>T</u> raining	The communication of compliance policies, procedures, directives, regulatory requirements, product information and service goals, including maintaining staff expertise.

OTS encourages institutions to develop, adopt, and implement a compliance management program that covers these six components. Your version of working S-M-A-A-R-T will vary depending upon your institution's size, staff resources, business strategy, operational complexity, market demands and risk profile. It is the responsibility of the institution's board of directors, senior management and compliance officer to customize its program to meet the circumstances of its own business activities, as well as those activities conducted through any subordinate entities. When devising your program, you should evaluate your organizational options in light of the best practices of your thrift peers and other business competitors.

A description of your compliance program should be set forth in a written document such as a policy statement or plan that articulates the objectives of the program and how the institution will achieve them. This statement or plan is the starting point for an internal environment that emphasizes the importance of operating in accordance with compliance obligations. It should match the fundamental components with institution operational cir-



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circumstances and resources and clearly delineate relevant roles and responsibilities for executing the program. The board of directors should approve an institution's compliance policy statement or plan and maintain its consistency with the institution's overall strategic direction and business plan.

Systems

Your compliance systems embody the task-specific procedures and internal controls that ensure your banking operations occur in a manner that satisfies your legal obligations and customer service goals.

Procedures describe the methodology for conducting an activity and integrating it into the daily functions performed by staff in fulfillment of your business operations. Generally, the degree of detail or specificity of the procedures varies based on the size of the institution, the complexity of its business, and the expertise of existing staff. Centralized operations will be different from decentralized ones. A large operation with varied products and numerous employees with differing assignments will require more extensive and formal procedures to control consistency of service delivery. In contrast, a small institution with an uncomplicated business plan, hands-on management and a seasoned staff may operate effectively with simplified procedures.

Compliance system procedures can take different formats. They may be contained in written manuals, checklists, flow charts, vendor contracts, operating routines, data entry practices, transaction forms or record keeping requirements. Whatever format they take, they generally must:

- establish operating standards ensuring compliance with applicable regulatory requirements and internal policies;
- be adapted to reflect the thrift's particular products and services;
- control front and back office functions of the institution's operations;
- clearly assign responsibility for execution of specific steps for developing and delivering products and services;
- be understandable to those employees or agents with responsibilities;
- provide for uniformity and consistency;
- generate records sufficient to support monitoring and self-assessment; and
- promote efficiency and good customer service.



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Effective recordkeeping is an integral part of a comprehensive compliance system for several reasons:

- records are the legal evidence of products delivered or services transacted;
- records document compliance with system controls or regulatory obligations; and
- some regulations require retention of records for specific periods.

Records enable the institution to fulfill other components of its compliance management program. They facilitate monitoring of system standards and provide the requisite paper trail that permits self-assessment reviews.

Compliance systems should also reach product and service development. They should be reflected in product design, marketing plans and roll-out strategies. This will enhance the institution's ability to manage new product compliance obligations from the beginning.

Monitoring

Essentially, monitoring is workflow supervision integrated into daily activities of each department or business unit to assure real-time execution of compliance responsibilities in accordance with program standards.

As opposed to system controls that direct line staff actions, monitoring is a form of control used to supervise operational performance. These day-to-day controls are incorporated into the workflow and may include manager signoffs, listening in on employee/customer interactions, automated reconciliations, verifications of input against source documents, or pre-closing reviews. Especially critical points for monitoring are where a transfer of documents or responsibility occurs and prior to any action that may be difficult to reverse (such as loan closing) or that will have systemic impact (such as input of index information.)

Monitoring involves a continuous process of collecting and analyzing information on compliance performance within a particular manager's area of responsibility. To provide useful feedback, you should track the results of monitoring activities. This will allow management to identify trends and to correct systemic, procedural, or training weaknesses on an ongoing basis.

Compliance monitoring should include a role for feedback from your consumer complaint process. This is useful because many complaints arise in the course of completing transactions and may afford an early indication of operating weaknesses in a particular department or business unit. Managers should consider consumer appeals from their staff's decision-making, not a nuisance, but an opportunity to confirm that compliance performance is meeting expected standards.



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When an institution outsources business operations or relies on third party delivery of products or services, thorough monitoring controls become the institution's first line of defense against compliance risk. In these situations, you should pay special attention to obtaining complete information about service provider activities and to establishing real-time scrutiny of that information from a compliance standpoint.

Assessment

Assessments are periodic reviews of system records or operations to identify regulatory violations and program deficiencies. Regular self-assessments or self-evaluations afford management an opportunity to step back from day-to-day operations and evaluate them against institution policy goals and objectives. An institution should conduct an appropriate level of self-assessment within its compliance management program.

A good self-assessment will underscore your institution's compliance management proficiency. A comprehensive program of self-assessment contains several elements: Risk scheduled reviews, independent self-evaluations of past performance including select transactions, and appropriate use of testing methodology.

Risk scheduled reviews

You should plan assessments using a risk-sensitive approach. This means that an institution should have a thorough understanding of its compliance risk allowing it to prioritize the scheduling of transactions or operations for evaluation over time. Within the course of a two or three year period, the institution's self-review schedule should cover all sources of compliance risk and establish a frequency for particular reviews that varies depending on the magnitude of risk assigned to different functions or activities during the period. In other words, some reviews should be conducted biannually, some annually and others (the least risky) biennially or triennially. You should revise compliance review risk-sensitive frequency schedules as the institution launches new products, as underlying systems are modified, as staff or management expertise changes or as new legal obligations become effective.

Independent self-evaluation

A self-assessment program consistent with the complexity and diversity of the institution's operations should:

- be a formal periodic process distinct from day-to-day monitoring;
- be organized and conducted with sufficient scope and frequency in accordance with a risk-sensitive analysis of operations;
- compare policies, procedures, forms, and disclosures with regulatory and other requirements;



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- evaluate transactions against procedures and legal and regulatory requirements;
- address all products and services offered by the institution;
- cover all operations, departments, and branches, including any thrift business operations conducted through or by subordinate organizations, affiliates, and /or third party vendors;
- identify regulatory violations in the institution's transactional record;
- disclose deficiencies or potential weaknesses in the overall compliance management program;
- be supported by accurate and comprehensive work papers;
- require written reports to senior management and the board detailing significant findings (deficiencies), conclusions and recommendations for corrective action; and
- include a follow-up reporting process ensuring initiated corrective action is monitored for effectiveness.

Management should assign responsibility for conducting self-evaluations after consideration of the need for independence and competence of the person(s) doing the reviews. In smaller institutions, it is often not possible to achieve a completely independent review since the requisite expertise may be vested in the compliance officer or other senior officer with direct responsibility for the underlying functions being reviewed. You can address or counter-balance a lack of independence by making appropriate use of internal or even external audit, taking care to assure that the standards of review are clearly articulated. Typical audit standards based on material impairment of finances or functions establish thresholds for performance that are not sufficiently demanding for compliance self-assessment.

Another option for obtaining the desired degree of reliability in your self-assessment when the compliance officer is reviewing his or her own work, is to emphasize the importance of independence in the institution's general counsel or board committees that may oversee the compliance officer's self-evaluation work product.

Transactional analysis

As part of the institution's self-assessment schedule, institutions should conduct an analysis of selected transactions covering the business activities and product lines of your institution. The transactions sampled must be sufficient to support a reliable judgment about the compliance performance of the operations evaluated.

Transaction analysis work papers that are prepared, retained, and made available for review by OTS examiners will streamline and expedite the OTS oversight process. Work papers should clearly document and identify the:



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- Scope of the analysis;
- Date of analysis;
- Person performing the analysis and the person reviewing it;
- Rationale used to select samples for testing;
- Sampling method or other procedures used;
- Time period covered;
- Functions, activities and/or products reviewed;
- Size of the sample and identification of files or accounts reviewed;
- Any summaries or spreadsheets used to record reviewed file or account information;
- Results of transaction analysis; and
- All substantive conclusions and recommendations.

For maximum efficiency, the transaction analysis conducted should emulate the examination standards established by the OTS or FFIEC for the compliance obligations being evaluated. The scope and frequency of any violations identified by the review should be recorded. Report system or monitoring deficiencies in accordance with your internal compliance governance process.

Testing

“Testing” is a method of self-assessment. Unlike self-evaluation methods predicated on a retrospective analysis of transaction records or other operational activity generated in the normal course of business, testing generally runs controlled inputs through institution systems to measure associated outputs. Mystery shopping is an example of “testing.” Testing can be a valuable self-assessment tool, particularly when reviewing operations that are difficult to capture in a “paper trail,” such as oral sales presentations.

Accountability

Accountability comprises the arrangement of responsibility, authority and reporting that provides direction to staff for implementing compliance policy and appraises senior management and the directors about compliance program performance.

Effective compliance management begins at the top, with the board establishing direction to be carried out by senior management throughout all levels of the institution. They in turn can assign responsibilities to a compliance officer, department or line managers, and employees directly responsible for administering and carrying out the program. This ensures a sense of ownership in the compliance program at all management and staff levels within the institution’s organizational structure.



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The Board of Directors' Role

The role of the institution's board is to provide governance, guidance, and oversight. In fulfilling its role, the board needs to:

- possess a general awareness of various consumer protection and public interest laws and regulations significant to the institution's business;
- adopt and maintain a written compliance policy statement or plan that covers the six essential components of a comprehensive compliance management program;
- promote the environment for compliance ensuring it is a high-priority built-in to all departments or business units, including subordinate organizations;
- delineate relevant staff roles and responsibilities for carrying out compliance policy including defining and appointing a compliance officer;
- study and respond to reports on compliance program performance;
- maintain an awareness of peer and competitor best practices for managing compliance;
- allocate sufficient institution resources for accomplishing your comprehensive compliance management program; and
- ensure material compliance deficiencies are promptly and effectively addressed and corrected.

In discharging its compliance oversight responsibilities, the board needs to receive and diligently review periodic self-assessment or exam reports evaluating the effectiveness of the program. The board should study and discuss these reports and other relevant information concerning the institution's compliance management program before taking any action with policy ramifications.

Senior Management's Role

Along with the board of directors, senior management plays a significant role in developing and implementing an effective compliance management program. In its role, senior management should be responsible for:

- establishing comprehensive compliance procedures and internal control mechanisms;
- hiring, developing, and overseeing a qualified staff;
- ensuring primary objectives of the program are fully realized;



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- establishing and promoting the tone and climate for department or line management and personnel of the individual business units to support a positive compliance and control environment;
- maintaining a heightened level of regulatory awareness of the substance of laws and regulations corresponding to their areas of responsibility;
- self-monitoring, self-identifying and self-assessing compliance risks, weaknesses, and exceptions in their area(s) of responsibility; and
- identifying weaknesses in staff performance and recommending training to correct these.

Senior management should also be cognizant of their individual training needs in compliance related areas. Because of a constantly changing market and regulatory environment, they should seek out continuing education opportunities to keep abreast of current compliance issues and developments that affect their area(s) of responsibility. Trade group committees, conferences, and workshops presented by financial regulators, and industry publications are valuable sources of information.

Designation of Compliance Officer

One of the most important factors of a successful program is the designation of a compliance officer responsible for the administration, oversight, and direction of the program. No matter what size institution, someone must take on the responsibilities of a compliance officer.

Regardless of how the institution structures this position, it must ensure the person possesses proficient knowledge and expertise to interpret consumer protection, fair lending, and other public policy laws, and have an overall understanding of the institution's operating structure.

The position calls for sufficient autonomy and independence to implement and administer the program and the authority necessary to report deficiencies and implement corrective actions. It is essential the authority, duties and responsibilities of the compliance officer include accessibility and accountability to the board and senior management.

The authority granted to a compliance officer should include the ability to:

- Cross department lines;
- Access all areas of operations (including those conducted through subordinate organizations);
- Formulate internal compliance standards for systems;



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- Formulate corrective action/changes in policies and procedures; upon discovering deficiencies;
- Initiate follow-up measures to ensure any corrective actions recommended are correctly implemented; and
- Have complete and direct accessibility to the board and senior management.

General Counsel's Role

One area of responsibility often times overlooked by the institution is the role of general counsel in a compliance management program. General counsel commonly assists in the interpretation of new laws and regulations and renders legal opinions or advice on a variety of compliance related matters that influence the institution. Additionally, depending on the institution's operating structure, general counsel is called upon to provide legal advice in areas such as loan documentation, contracts with third-party vendors, and consumer complaints. A thrift should make appropriate use of its legal resources in connection with its compliance management program.

Response

Response is a concept that embraces addressing consumer complaints, remedying regulatory violations, amending procedures and controls, correcting internal oversight deficiencies (in monitoring or self-assessment), and implementing policy revisions or updates.

Whenever compliance violations or deficiencies arise, the compliance officer and/or management needs to take prompt corrective action(s). Corrective action ensures that specific violations or deficiencies are resolved in a timely manner and prevent reoccurrence of compliance violations. No amount of monitoring, self-assessment or independent testing is beneficial unless followed by prompt, effective corrective action to eliminate deficiencies.

Responsibility for developing and implementing corrective action must be clear, proposed actions should be realistic and sufficiently specific to verify, and reasonable priorities and timeframes for their accomplishment should be established. Make responsible functional management accountable for the assimilation and effectiveness of any corrective actions in their areas.

Proposed corrective actions should be:

- appropriate and address identified issues and their underlying causes in an effective and efficient manner;
- timely to avoid increasing the institution's risk exposure;
- feasible;



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- consistent with customer service goals;
- used to modify internal compliance controls and procedures to prevent further violations; and
- included in training staff working in operational areas where the deficiencies and/or violations occurred.

A corrective action process does not end with proposals for corrective action. Subsequent reviews should be conducted by the compliance officer to ensure that:

- corrective actions have, in fact, been implemented;
- implementation of corrective action is within the established timeframes;
- corrective action is effective; and
- underlying causes have been resolved to prevent recurrence.

Senior management and the board of directors must be careful to portray self-identification of regulatory violations, procedural exceptions and control weaknesses as favorable performance attributes as long as they are accompanied by self-correcting actions or strategies.

Training

Training covers both the development and maintenance of staff compliance expertise, as well as, the communication of institution policies, procedures, directives and goals.

A comprehensive ongoing training program is conceivably the best tool the institution has in preventing adverse consequences in compliance. It is essential to maintaining a sound compliance program. The purpose of a compliance-training program is to ensure relevant legal, regulatory requirements and procedural guidelines are clearly communicated to management and staff level personnel.

Training should include communicating and disseminating information on new or amended laws and regulations, new products and services, as well as changes in internal procedures or systems. This ensures personnel maintain a necessary level of compliance expertise and proficiency and enables employees to understand their role in the program and to seek assistance as needed. Furthermore, this type of communication integrates relevant compliance information into business planning and operations so the board and senior management may consider any compliance implications in their strategic planning.

Ideally, you should conduct compliance training in accordance with a well-planned and monitored cycle meeting the institution's needs. In formulating this plan, it is useful for management to think of training as part of a continuous learning cycle.



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The training cycle includes:

- Introductory training for new employees;
- Periodic training for existing employees to enhance and reinforce compliance concepts;
- Job advancement training prior to or upon promotion or assumption of increased responsibilities to ensure staff has the required expertise to perform their new duties;
- Training to introduce changes in policy, procedures, new products, or regulatory/legal changes;
- Corrective or remedial training for individuals and departments, based on results of internal compliance reviews; and
- Training to provide senior managers and directors with a broader perspective on existing risks and consequences as well as emerging compliance issues.

Training also contemplates supporting the development and maintenance of expertise in the compliance officer and professional staff to ensure that they can perform at their respective requisite levels of competence and can identify changing obligations and evolving best practices.

You should consider periodic testing of employees and management on their knowledge, to ensure they understand the subject matter and to monitor training effectiveness. Keeping track of employee training allows the institution to monitor staff preparedness to meet institution compliance expectations.

Conclusion

OTS encourages all institutions to work S-M-A-A-R-T. Establishing and executing a comprehensive compliance management program is the key to realizing customer service goals and risk reduction strategies.