PRESENTATION

LIVE FROM THE TRENCHES: HOT EXAM ISSUES

Thursday, April 28, 2016

Presented by Baker Donelson attorneys:

Steve Eisen (sjeisen@bakerdonelson.com)

Mark Miller (mlmiller@bakerdonelson.com)

FDIC HIGHLIGHTS THEIR EXAM CONCERNS

- Emerging issues or new strategies
- Policy weaknesses
- Repeat examination recommendations or regulatory issues
- Significant noncompliance with laws and regulations or nonconformance with regulatory guidance
- Interest rate risk
- Cyber-security
- Concentrations of credit

OCC HIGHLIGHTS THEIR EXAM CONCERNS

- **Business model and strategy changes**
- **Compliance**
- **Credit risk and loan underwriting**
- **Cybersecurity and resiliency planning**
- **Interest rate risk**

GOVERNANCE AND OVERSIGHT

CREDIT UNDERWRITING

CYBER THREATS

OPERATIONAL RISK

BANK SECRECY ACT/ANTI-MONEY LAUNDERING

COMPLIANCE


I DON'T ALWAYS TALK COMPLIANCE
BUT WHEN I DO IT'S IN A DIFFERENT LANGUAGE

INTEREST RATE RISK

FAIR ACCESS


RELIGION
GENDER
NATIONAL ORIGIN
MATERNITY LEAVE
DISABILITY INCOME
RACE
SCAN HERE FOR
MORE INFO

MATTERS REQUIRING ATTENTION

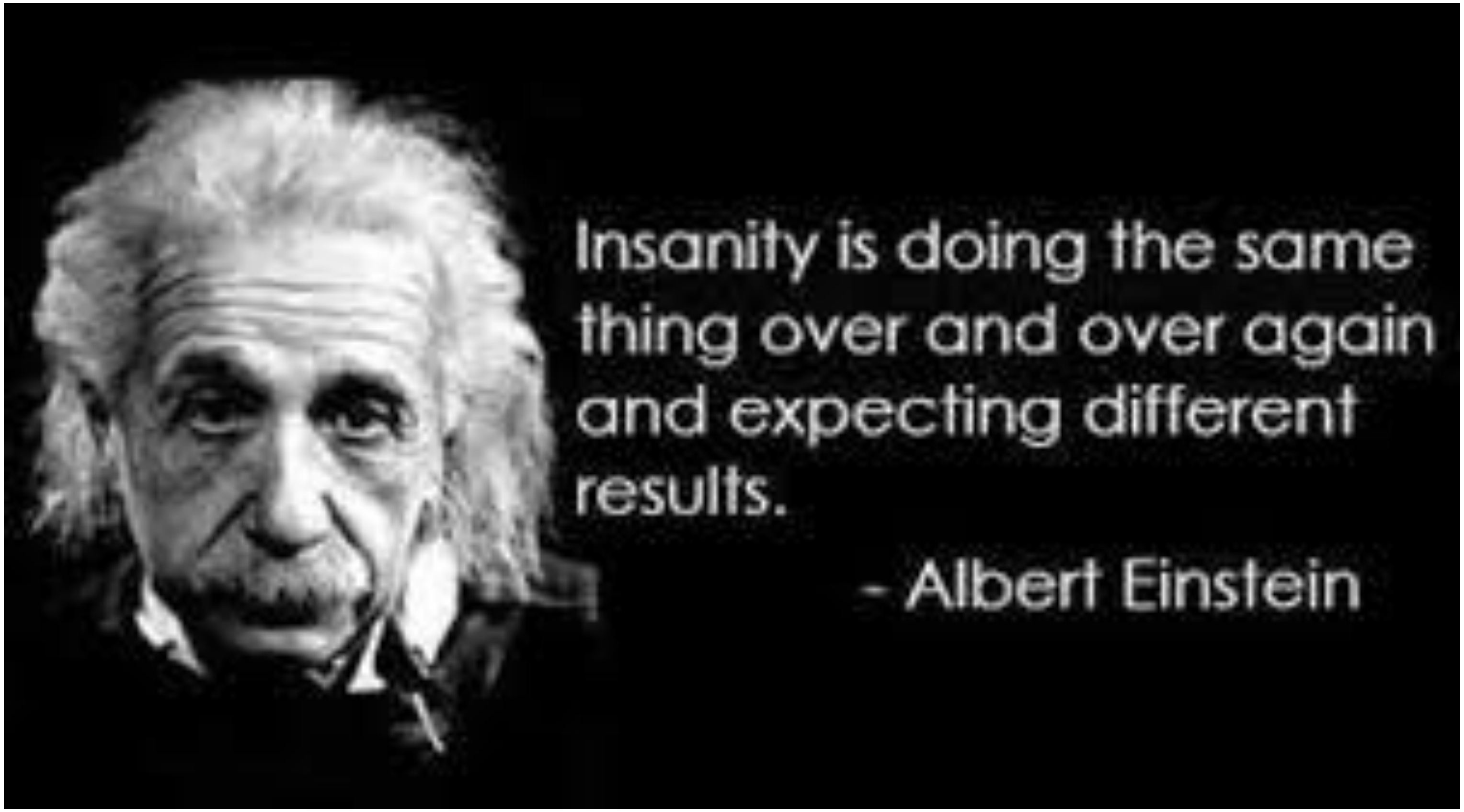
INDUSTRY OUTREACH

TAKEAWAYS

POLICIES AND PROCEDURES

CONTRACTS WITH VENDORS

PRIOR MRAs


Insanity is doing the same thing over and over again and expecting different results.
- Albert Einstein

TRAINING


SKIPPED THROUGH THE
ONLINE COMPLIANCE TRAINING...
STILL GOT 100%
ON THE FINAL EXAM!

NEW PRODUCTS AND STRATEGIES

COMPLIANCE MANAGEMENT SYSTEM

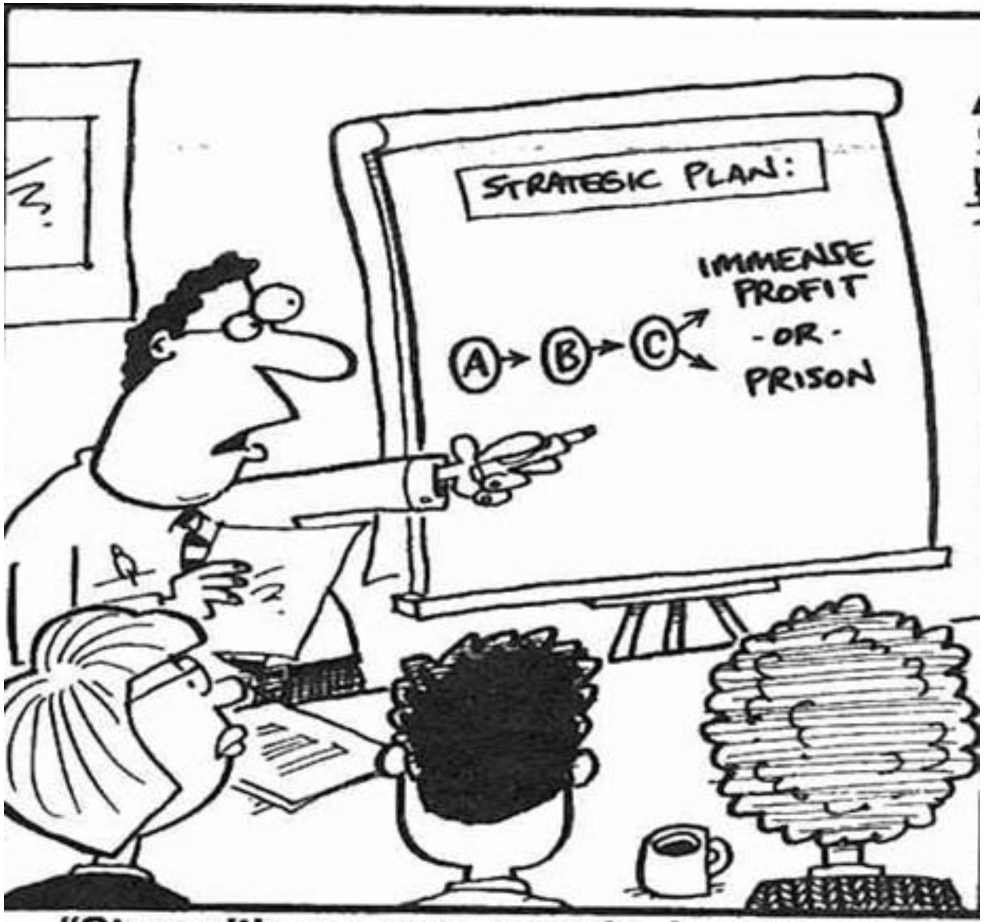
INCIDENT RESPONSE PLAN FOR SECURITY BREACHES

CONSTANT VETTING OF ALLL

COMPENSATION PLAN REVIEW

"There now, that wasn't too difficult was it!"

STRATEGIC PLAN



"Stay with me now, people, because in step C, things get a bit delicate."

PRESENTATION

LIVE FROM THE TRENCHES: HOT EXAM ISSUES

Thursday, April 28, 2016

Presented by Baker Donelson attorneys:

Steve Eisen (sjeisen@bakerdonelson.com)

Mark Miller (mlmiller@bakerdonelson.com)

LIVE FROM THE TRENCHES: HOT EXAM ISSUES

Join us for a webinar discussing the hot issues we are seeing in current financial institution exams. We'll touch on some of the more common matters requiring board attention including criticisms of management and governance issues, policies and procedures, risk management, compliance, disaster prevention and recovery plans, repeat offenses, and vendor management, among others. Key takeaways will be presented to attendees for use in preparing for their own upcoming exams.

Thursday, April 28, 2016

1:00 – 2:00 p.m. CDT
2:00 – 3:00 p.m. EDT

Presented by Baker Donelson attorneys:

Steve Eisen (sjeisen@bakerdonelson.com)
Mark Miller (mlmiller@bakerdonelson.com)

Banking Regulators Highlight Their Major Examination Concerns:

1. FDIC Highlights- Matters Requiring Board Attention (MRA) - FDIC Supervisory Insights April 2016, p. 16, In particular, when reviewing the report of examination, directors should pay heightened attention to any Matters Requiring Board Attention (MRA) cited by examiners. MRA are intended to highlight and prioritize for directors the most important or immediate examiner concerns and criticisms. Examples of MRA include, but are not limited to:

(a) Emerging issues or new strategies with which the board needs to be more proactive in establishing policy and risk management parameters;

(b) Policy weaknesses that, if left unaddressed, could increase the risk profile or adversely impact the condition of the institution, or impair senior management effectiveness;

(c) Repeat examination recommendations or regulatory issues that have continued to escalate in importance; and

(d) Significant noncompliance with laws and regulations or nonconformance with regulatory guidance.

When we (the Tennessee Bankers Association Government Relations Committee) visited with Doreen Eberley, Director of the Division of Risk Management Supervision at the FDIC, last May in Washington, she indicated the following examination issues:

- Interest rate risk - a 0.65 rate increase in 2013 wiped out all gains, liquidity is key
- Cyber-security - much regulatory guidance on this, practice preparedness, be in constant contact with law enforcement also for guidance, practice "cyber hygiene"

- Concentrations of credit - not inherently bad but needs to be managed properly, "by definition, community banks are concentrated"

2. OCC Highlights - The OCC issued its semiannual risk assessments for federally chartered financial institutions on Dec 16, 2015, (the "OCC Report"). Comptroller Thomas J. Curry in this report as well as the Fiscal Year 2016 Operating Plan of the Committee on Bank Supervision (CBS) (http://www.occ.treas.gov/news-issuances/news-releases/2015/nr-occ-2015-130a.pdf) indicated that "While the objectives are similar for Large Bank Supervision and Midsize and Community Bank Supervision, CBS managers will differentiate the size, complexity, and risk profile of the banks when developing supervisory strategies. The OCC will adjust supervisory strategies as appropriate during the fiscal year in response to emerging risks and supervisory priorities. For FY 2016, the development of supervisory strategies focused on the following priority objectives:

- Business model and strategy changes
- Compliance
- Credit risk and loan underwriting
- Cybersecurity and resiliency planning
- Interest rate risk

more details from the CBS…

• Governance and oversight: Assessing business model and strategy changes and their risks, focusing on bank governance and risk management practices, to ensure compliance with the final guidelines for heightened standards and to identify substantive gaps. Examiners should ensure that any gaps are clearly documented and communicated and that management has committed to appropriate time frames to close the gaps. [*midsize and small bank language in brackets:* Governance and oversight: Assessing business model and strategy changes and reinforcing the importance of sound corporate governance appropriate for the size and complexity of the individual bank. A specific focus will be on determining the adequacy of strategic, capital, and succession planning. Examiners will assess whether the plan is appropriate in light of the risks in new products or services. If applicable, examiners will assess the bank's merger and acquisition processes and procedures.]

Note: The on April 5, 2016, issued (FIL-23-2016) a special corporate governance edition of its "Supervisory Insights" entitled "A Community Bank Director's Guide to Corporate Governance: 21st Century Reflections on the FDIC Pocket Guide for Directors." This special edition highlights key governance concepts, roles, and responsibilities of directors and senior management, and discusses how FDIC examiners evaluate governance at community banks. A list of resources, with links to regulations, guidance and training materials, is included to help community bank directors fulfill their duties.

• Credit underwriting: Reviewing commercial and retail credit underwriting practices, especially for leveraged loans, indirect auto loans, and commercial loans, sectors that have experienced higher growth and weakening underwriting standards. Examiners will continue to assess banks' efforts to mitigate risk for home equity lines of credit approaching end-of-draw periods. [Credit underwriting: Evaluating underwriting practices on new or renewed loans for easing in structure and terms. Reviews will focus on new products, areas of highest growth, or portfolios that represent concentrations. Examiners will continue to assess banks' efforts to mitigate risk for home equity lines of credit approaching end-of-draw periods.]

• Cyber threats: Reviewing banks' programs for assessing the evolving cyber threat environment and banks' cyber resilience. Examiners will use the new Cybersecurity Assessment Tool4 in conjunction with information security and operational risk supervisory activities. [Cyber threats: Reviewing banks' programs for assessing the evolving cyber threat environment and banks' cyber resilience. Examiners will use the new Cybersecurity Assessment Tool.]

• Operational risk: Assessing information security and data protection, model risk management, and third-party risk management, including risks associated with third-party relationships.5 OCC supervisory staff members evaluate bank management's plans to respond to increasing operational risk resulting from the introduction of new or revised business products, processes, delivery channels, or third-party relationships. [Operational risk: Assessing information security and data protection, model risk management, and third-party risk management, including risks associated with third-party relationships.7 OCC supervisory staff members will evaluate bank management's plans to respond to increasing operational risk resulting from the introduction of new or revised business products, processes, delivery channels, or third-party relationships.]

• Bank Secrecy Act/Anti-Money Laundering: Assessing effectiveness of Bank Secrecy Act/Anti-Money Laundering programs and controls to address evolving money-laundering schemes, the rapid pace of technological change, and overall money laundering and terrorist financing risks. [Bank Secrecy Act/Anti-Money Laundering: Determining whether banks have effective Bank Secrecy Act/Anti-Money Laundering programs and controls to address changing customer profiles, evolving money-laundering schemes, the rapid pace of technological change, and the overall risk that money laundering and terrorist financing activities create.]

• Compliance: Developing and implementing plans for assessing compliance with new regulatory requirements, including those related to capital, liquidity, trading activities, residential mortgages, and risk retention. Emphasis will be on the following: Compliance: Evaluating adequacy of compliance risk management and assessing banks' effectiveness in identifying and responding to risks posed by new products, services, or terms. Examiners will also assess compliance with the following:]

> – Assessing compliance management systems to determine operational and compliance issues arising in connection with the integrated mortgage disclosure under the Truth in Lending Act of 1968 and the Real Estate Settlement Procedures Act of 1974. [– new requirements for integrated mortgage disclosure under the Truth in Lending Act of 1968 and the Real Estate Settlement Procedures Act of 1974.]
>
> – Continuing to share information and coordinate examinations with the Consumer Financial Protection Bureau to assess overall compliance with consumer laws,

regulations, and guidance. [– relevant consumer laws, regulations, and guidance for banks under $10 billion in assets.]

– Determining compliance with the Flood Disaster Protection Act of 1973 and the Servicemembers Civil Relief Act of 2003, focusing on adequacy of enterprise-wide compliance risk management. [– Flood Disaster Protection Act of 1973 and the Servicemembers Civil Relief Act of 2003.]

– Assessing banks' effectiveness in identifying and responding to risks posed by new products, services, or terms.

• Interest rate risk: Focusing on management of interest rate risk to ensure that banks properly assess vulnerability to changes in interest rates. Emphasis will be on banks' ability to accurately assess nonmaturity deposit changes under varying model scenarios. [Interest rate risk: Evaluating management of interest rate risk including the ability to accurately identify and quantify interest rate risk in assets and liabilities under varying model scenarios.]

• Fair access: Assessing banks' efforts to meet the needs of creditworthy borrowers and monitoring banks' compliance with the Community Reinvestment Act and fair lending laws and regulations. [Fair access: Assessing banks' efforts to meet the needs of creditworthy borrowers and to monitor banks' compliance with the Community Reinvestment Act and fair lending laws. Examiners at banks with more than $500 million in assets will continue to use the Fair Lending Risk Assessment Tool in their fair lending assessments.]

• Matters requiring attention (MRA's) and enforcement actions: Ensuring effective, timely, and consistent application of guidance for matters requiring attention and enforcement actions. This work includes assessing and validating that requirements for matters requiring attention (MRA) and enforcement actions are met and that concerns are addressed and the MRA/action is closed or terminated in a timely manner. Examiners-in-charge will clearly communicate any additional actions needed to satisfy the requirements. [Matters requiring attention and enforcement actions: Ensuring effective, timely, and consistent application of guidance for matters requiring attention and enforcement actions. This includes assessing and validating that requirements for matters requiring attention and enforcement actions are met and that concerns are addressed and the action/MRA is closed or terminated in a timely manner. Examiners-in-charge will clearly communicate any additional actions needed to satisfy requirements.]

• Industry outreach: Conducting outreach sessions with the industry and other appropriate parties to present OCC perspectives on emerging issues, explain new policies and regulations, clarify supervisory expectations, and provide bankers opportunities to discuss their concerns with regulators and peers. [Industry outreach: Conducting outreach sessions with the industry and other appropriate parties to present OCC perspectives on emerging issues, explain new policies and regulations, clarify supervisory expectations, and provide bankers opportunities to discuss their concerns with regulators and peers.]

<u>Takeaways:</u>

(a) Policies and Procedures - Review to ensure that they meet regulatory guidance. Are written policies and procedures current and is there a system in place to track needed modifications? Are the policies and procedures easily available to the employees who need to be following them?

(b) Contracts with Vendors - review for cybersecurity issues, including liability and insurance allocation of risk. See recent regulatory guidance on doing business with third party vendors to analyze compliance and other risks of using third parties. Do not assume you can sue the vendor for your liability to a customer (ask Target's bankers about that). Document due diligence performed on "critical vendors," which might include onsite visitations, third party audits and monitoring, review of vendor's own policies and procedures and internal controls, detailed contract review, and risk-scoring.

(c) Prior MRAs - review MRAs from prior exams and make sure you are ready to explain verbally and in writing your compliance with the MRAs, as well as the procedure you used to vet the MRAs previously with the regulatory agencies. Make sure promised remedies have been addressed. Avoid repeat offenses.

(d) Training - Begin at the top with Board training being an ongoing process of the Board; consider having some amount of Board training, even if a very short discussion, on each Board meeting agenda. Document the training available to all critical employees, how the institution verifies the knowledge learned, and how the institution has a secondary level of training for employees who must fill in for absent employees. Document the training records and have samples of training materials available for the examiners.

(e) New Products and Strategies - have documented analysis performed on compliance and risk analysis, as well as mechanisms being used to monitor and audit; be prepared to show sufficient expertise in any new business lines, marketing procedures, and new operation strategies.

(f) Compliance Management System - Have a documented Compliance Management System, which should include establishing compliance responsibilities and how those responsibilities and the institution's priorities are communicated to employees. Ensures that responsibilities are incorporated into day-to-day practices. Review the process and take corrective action (employee training and monitoring) if necessary. Avoid criticisms of staffing shortages for particular compliance responsibilities.

(g) Incident Response Plan for Security Breaches - have an incident response plan in place and make sure management is trained on its implementation. Have outside experts readily available for implementation such as attorneys, forensic specialists, and law enforcement connections. Stay abreast of the changing law on both the federal and state level and keep the plan current.

(h) Constant Vetting of ALLL Calculation and Methodology - no matter how many times institutions are criticized for their ALLL methodology and think they have made the changes required by examiners, the next set of examiners seems to come right back and suggest another, better method. By constantly vetting the methodology with regulatory agencies and their staff, an institution may be able at least to minimize the aggravation and frustration with this process. Work with your outside accounting advisers to stay abreast of changes, especially in light of proposed new FASB Current Expected Credit Loss standards.

(i) Compensation Plan Review - both with respect to an institution's own employees and with respect to the payment of third parties, institutions and their Boards need to properly document and justify their compensation arrangements. Improper incentives to loan officers are being scrutinized, as well as payments to third parties that might be deemed illegal kickbacks under RESPA, for example (ask PHH Corp). Also, make sure that compensation is actually paid in accordance with the written agreements. (NCUA released joint new executive pay compensation rules April 21, 2016, and FDIC Board approved April 26, 2016 - applies to different levels of banks >$1 billion - requires various levels of deferral of incentive pay and clawbacks)

(j) Strategic Plan - document your strategic planning process. Do not just use an off-the-shelf plan. Make sure your Board is familiar with the Plan since they may be asked questions about the plan by the examiners.