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To the Point!

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OCC Guidance on Third-Party Risk Management "Life Cycle"

On October 30, 2013, the Office of the Comptroller of the Currency (the *"OCC"*) issued Bulletin 2013-29 (the *"Bulletin"*) establishing a Third-Party Risk Management "Life Cycle" for assessing and managing third-party relationships. The Bulletin rescinds previous OCC Bulletin 2001-47 and OCC Advisory Letter 2000-9 on third-party relationships and risk (the *"Prior Guidance"*) but supplements other previous OCC guidance that is listed in Appendix B to the Bulletin. Banks should adopt a vendor management program, or update their existing vendor management programs, to include the regulatory guidance provided in the Bulletin, or management may be subject to criticism as set forth in the Bulletin.

Overview of Life Cycle

Concerned with the quality of bank risk management programs for third-party relationships, the OCC outlined the requirements for an effective third-party risk management program to keep pace with the increasing risk and complexity of such programs. A discussion of those risks is set forth in Appendix A of the Bulletin. The OCC states that failure to properly implement a program that reflects the complexity of a bank's third-party relationships can result in threats to a bank's safety and soundness. The primary categories of activities are presented as a "life cycle" that should be incorporated into a bank's vendor risk management program and designed to allow a bank to manage the bank's risk commensurate with the level of risk and complexity of the third-party relationship. Briefly, these steps include:

Planning: A bank's documented plan should consider the inherent risks, outline the strategic purpose, and detail how the bank will select, assess, and oversee the third party to verify compliance with agreement requirements, such as information security and compliance with applicable law. The focus should be on assessing a potential relationship and its risks prior to making the decision to use a third-party, a decision which must be approved by the bank's board of directors when critical activities are involved.

Due Diligence and Third-Party Selection: In addition to the usual concerns regarding information security compliance and financial condition, the OCC emphasizes that banks must evaluate a third party's legal and regulatory compliance capabilities, incident reporting responsibilities, and reliance on subcontractors, among other requirements. The OCC provides guidance for each category of concerns that should be considered and included in the bank's due diligence program.

Contract Negotiation: The OCC included many of the same contract requirements in the Bulletin as in past guidance; however, the OCC was more direct in expressing that certain terms must be included. These include these specific requirements for the bank to include in its contract with the third party: the "Right to Audit and Require Remediation," "Default and Termination Rights," and considerations when working with "Foreign-Based Third Parties."

Ongoing Monitoring: Required for the duration of third-party relationships, management must monitor the third party's activities and performance under the terms of the agreement. Particular attention should be paid to the quality of controls, whether service levels are achieved, and whether the third party can appropriately remediate complaints, including from bank customers.

Termination: The bank should have adequate remedies upon termination and the ability to transition services to another service provider seamlessly, including moving services in-house in there are no alternatives.

Lifetime Risk Management Process

The OCC emphasized the process elements that are critical to risk management for the duration of each third-party relationship. The OCC emphasized that the following activities must be performed consistently through the life cycle to manage those risks:

Oversight and Accountability: A bank's board of directors (or committee) and senior management are responsible for an enterprise-wide program to oversee third-party vendor risk management. Third-party relationships must be in line with the bank's strategic goals and remain so during their life cycles. If not already covered as part of the bank's vendor management program, appropriate policies, procedures, and management accountability responsibilities must be put in place to effectively manage and document these third-party life cycles.

Documentation and Reporting: Third-party relationships must be appropriately documented and reported to the board of directors and management. The reporting requirements should include the results of regular performance reports and independent reviews of the bank's overall risk management program.

Independent Reviews: The Bulletin specifically sets forth a requirement to undertake periodic independent reviews of the bank's third-party risk management process. The goal of independent reviews is to verify that the third-party relationship continues to align with the bank's business strategy and that risks are managed and in compliance with contractual requirements. Results of these reviews should be analyzed by senior management and addressed timely and appropriately.

Broader, More Detailed Requirements

While the Bulletin might be viewed in part as only updating and clarifying existing guidance from the OCC, the Bulletin is broader in scope than previous guidance and includes specific requirements for a bank's third-party management program that were not in the guidance it replaces. Among these, it is important to recognize that the Bulletin includes a bank's obligation to: (i) effectively document and undertake a plan as a first step in the third party risk management process, (ii) require incident reporting and management programs as part of due diligence and the third-party's obligations, and (iii) establish strong termination rights in order to exit the relationship as an effective way to manage a third-party relationship that no longer meets the bank's requirements or risk management profile.

Also noteworthy is that the Bulletin includes those items that examiners should review when on-site, and concludes that management may be deemed less than satisfactory if a bank's third-party vendor management program does not meet the guidelines contained in the Bulletin. The Bulletin also clearly states that the OCC will, when necessary, investigate and examine the activities of a third party itself and pursue enforcement actions against the bank or its third party for unsafe or unsound banking practices by either party.

Banks should review the Bulletin and take steps to update their third-party vendor risk management programs to incorporate the guidance in the Bulletin as necessary.

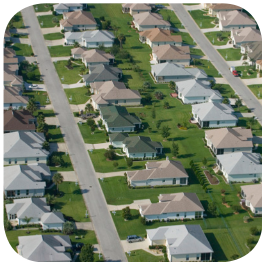
Interagency Statement on Fair Lending

On October 22, 2013, the Consumer Financial Protection Bureau, Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and the National Credit Union Administration (collectively, the *"Agencies"*) released an interagency statement addressing fair lending liability under the disparate impact doctrine by originating only Qualified Mortgages (*"QMs"*) as defined under the Ability-to-Repay/Qualified Mortgage rule (the *"ATR Rule"*) (the *"Joint Statement"*).

The Agencies view the requirements under the Equal Opportunity Credit Act (the *"ECOA"*) and the ATR Rule as compatible and do not anticipate that offering only QMs would, absent other factors, elevate a supervised institution's fair lending risk. The Agencies expect creditors making product offerings to "consider demonstrable factors that may include credit risk, secondary market opportunities, capital requirements, and liability risk."

From the Agencies' perspective, the ATR Rule presents a situation that is not substantially different from what creditors have historically faced in developing product offerings or responding to regulatory or market changes. As examples, the Agencies cited some creditors' decision to stop offering "higher-priced mortgage loans" after July 2008 and loans subject to the Home Ownership and Equity Protection Act after 1995.

As part of an assessment of fair lending risk under the ATR Rule, we recommend supervised institutions to review loans made during the past few years and determine which loans would not meet QM standards. We recommend further analyzing those loans that would not meet QM standards to: (1) determine whether such borrowers are in a protected class; (2) remove non-QM loans from HMDA data and determine changes in ratios; and (3) determine whether such non-QM loans are in minority areas. Based on the results of such an analysis and consideration of other risk factors, supervised institutions can make decisions and adjustments on their business models and product offerings to ensure compliance with ATR Rule and the ECOA.



Mortgage Rules Update: CFPB Guidance and Interim Final Rule for Certain Mortgage Servicing Rules

On October 15, 2013, the Consumer Financial Protection Bureau (the *"CFPB"*) issued Bulletin 2013-12 (the *"Bulletin"*) on certain aspects of the 2013 Real Estate Settlement Procedures Act (Regulation X) and Truth in Lending Act (Regulation Z) Mortgage Servicing Final Rules (the *"Rules"*) to provide specific guidance on: (1) how servicers should identify and communicate with any successors of a deceased borrower, (2) how servicers should communicate with borrowers under the Early Intervention Rule, and (3) obligation to provide certain communications to borrowers who have filed bankruptcy and/or exercised their right under the Fair Debt Collection Practices Act (*"FDCPA"*) barring debt collectors from communicating with them. On October 23, 2012, the CFPB issued an interim final rule revising the servicing rule creating exemptions for certain communications when a consumer is in bankruptcy or sends a cease communication notice under the FDCPA.

Communications with Successor of a Deceased Borrower

The Rules require servicers to implement policies and procedures for identifying and communicating with the successor in interest of a deceased borrower regarding the property securing the deceased's mortgage loan. The Bulletin provides the following examples of practices that servicers can include in its policies and procedures include the following: (1) promptly providing a list of documents required for a successor to establish the borrower's death and the successor's identity and interest, (2) promptly identifying and evaluating any issues the servicer must consider upon notification of a borrower's death, (3) promptly providing information to successors about any issues and documents necessary to continue payments or evaluation of loss mitigation options, as applicable, and (4) training employees on compliance with laws, investor requirements, and other servicer obligations after a borrower's death.

The Bulletin also recommend servicers to consider other best practices such as the following: (1) promptly evaluating whether to postpone or withdraw a pending or planned foreclosure after notification the borrower's death to give the successor time establish rights, and (2) promptly giving a successor in interest information about potential consequences of assuming the loan, including costs and the fact that a loss mitigation option may not be available if the loan is assumed with a loss mitigation option in place or with a loss mitigation plan commencing simultaneously with the assumption.

Communications under the Early Intervention Rule

The Bulletin clarifies the types of communications that the CFPB would consider reasonable steps to establish live contact as required by the Early Intervention Rule (12 CFR 1024.39). Servicers can satisfy the live contact requirement through ongoing contact with the borrower about loss mitigation application if the borrower is also delinquent in consecutive billing cycles. Also, a servicer is permitted to rely on live contact initiated by the borrower and can combine contacts made with borrowers for other reasons to satisfy the live contact requirement. The CFPB has also indicated that only one telephone call or a written request for the borrower to contact the servicer in a statement or electronic communication satisfies "good faith efforts" in the case of multiple delinquencies with an unresponsive borrower. Generally, the CFPB affords great flexibility for servicers to meet this requirement and "good faith efforts" is a facts and circumstances analysis.

Communications under the Servicing Rule Requirements - Bankruptcy Filing and Cease Communication Notice Under the FDCPA

The Bulletin states that the "cease communication" option under the FDCPA generally will not make servicers that are considered debt collectors liable under the FDCPA for providing certain disclosures and communications required under Regulation X and Regulation Z.

The Interim Rule provides an exemption from the Periodic Statement (see 12 CFR 1026.41) and Early Intervention Rule (see 12 CFR 1024.39) notice requirements if the borrower has made a bankruptcy filing. In addition, servicer is exempt from notices and communications required under the Early Intervention Rule (see 12 CFR 1024.39) and the ARM Interest Rate Adjustment with Corresponding Payment Change Rule (see 12 CFR 1026.20(c)) when the servicer is considered a debt collector under the FDCPA and the borrower has sent a "cease communication" notice to the servicer.

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