

To the Point!

April 19, 2016

Legal, Operations and Strategy Briefs for Financial Institutions



Recent Action by the OCC of Special Concern for Directors, Senior Managers, and Compliance Officers

The OCC recently issued a revised Policies and Procedures Manual policy for assessing civil money penalties (the “*CMP Policy*”) for violations of laws, unsafe or unsound practices, and breaches of fiduciary duties. The *CMP Policy* includes a number of changes emphasizing the importance of a robust compliance program and the consequences of program failures. In its Bulletin announcing the revision to the *CMP Policy*, the OCC stated that imposition of a civil money penalty may serve as a deterrent to future violations by the institution or the institution-affiliated party (“*IAP*”) against whom such penalty is assessed (and by other institutions and IAPs) and will encourage correction of violations. The OCC noted specifically that the assessment of a civil money penalty against an IAP emphasizes the accountability of individuals.

The new *CMP Policy* includes enhancements to the Civil Money Penalty Matrix (“*CMP Matrix*”), which sets forth the factors for assessment of civil money penalties and provides an assigned weight to each factor. Significantly, there is now a *CMP Matrix* for the institution and a separate *CMP Matrix* for IAPs, emphasizing the OCC’s ability to penalize both the institution and individuals for violations. The OCC describes the *CMP Matrices* as guidance and notes that they do not “reduce the *CMP* process to a mathematical equation and are not a substitute for sound supervisory judgment.”

Among other changes, the *CMP Matrix* for institutions has been revised to add the “effectiveness of internal controls and compliance program” as a factor. The *CMP Policy* includes the following guidance regarding the application of this factor to institutions:

Evaluate whether and how a bank’s internal controls or compliance programs, or lack thereof, contributed to the violation or deficiency in question. Internal control systems or compliance programs that are so lacking as to permit the violation or deficiency to occur and remain undetected should be accorded the most severe score. Internal control systems or compliance programs that identified the violation or deficiency, which allowed the bank to initiate timely corrective measures, may receive a lower score.

Similarly, the *CMP Matrix* for IAPs includes “IAP responsibility for internal controls environment and its effectiveness” as a factor. The *CMP Policy* contains the following guidance regarding the application of this factor to IAPs:

This factor should be considered in cases when it has been determined that the institution’s internal control policies or procedures are inadequate in the area in which the misconduct occurred (for example, mortgage lending, BSA program, or consumer compliance), but only when assessing *CMPs* against an IAP responsible for ensuring adequate internal controls are in place for that area (for example, an IAP that has significant influence over, or participation in, major policymaking decisions).

If the OCC identifies a compliance failure, it will likely focus on the institution’s job descriptions and assignment of responsibility within its policies and procedures to enable the OCC to determine those bank employees with supervisory responsibility and thus potential liability under the *CMP Policy*.

Among other important changes is the OCC’s affirmative statement that the *CMP Policy* applies to service providers. Potential penalties are based on the entity’s total assets and the total *CMP Matrix* score. The lowest score suggested for a penalty has been lowered from 51 to 41, which raises the possibility that misconduct that previously would have only been subject to a supervisory letter may now result in the assessment of a civil money penalty.

We recommend that institutions become familiar with the new CMP Policy and review and consider revisions to their compliance program to avoid violations that may subject them to civil money penalties. Institutions should recognize that because the CMP Policy and CMP Matrix do not mandate the assessment of a penalty, it is important that an institution document its policies and procedures for the identification of potential violations, including prompt corrective action in order to mitigate against the assessment of a penalty and the size of a penalty that may be assessed.



FDIC Provides Additional Guidance on Corporate Governance

The FDIC recently issued a Special Corporate Governance Edition of its Supervisory Insights (the “Guide”). The Guide supplements the FDIC’s “Pocket Guide for Directors” published in 1988 and the Statement Concerning the Responsibilities of Bank Directors and Officers (FIL 87-92), providing up-to-date commentary on the core responsibilities of officers and directors identified in these earlier publications. The Guide emphasizes the responsibility of directors to ensure that there is a governance framework with sound objectives, policies, and risk limits and to monitor officers’ and employees’ compliance with the framework, applicable laws, and regulations.

Although the Guide is written for directors, it will also be helpful to bank senior managers and compliance officers because it details a number of standards related to compliance and corporate governance that are labeled as “minimums” by the FDIC. As such, failure to address these minimum requirements could result in unfavorable examination reports and CAMELS ratings, and even violations of law and regulation.

Directors are reminded of the need “for a strong risk management culture that incorporates strong ethical values” and instructed to ensure that the bank has adequate policies on ethics and corporate conduct. Such policies should include, at a minimum, safeguarding confidential information; ensuring the integrity of records; providing strong internal controls over assets; providing candor in dealing with auditors, examiners, and legal counsel; avoiding self-dealing and acceptance of gifts or favors; observing applicable laws; implementing appropriate background checks; involving internal auditor(s) in monitoring the corporate code of conduct or ethics policy; providing a mechanism to report questionable activity; outlining penalties for a breach of the corporate code of conduct or ethics policy; providing periodic training and acknowledgement of policy requirements; and periodically updating policies to reflect new business activities.

The Guide emphasizes a bank’s need for effective personnel administration including a clear organizational structure, detailed job descriptions, training and development opportunities, sound compensation policies, and a succession and talent development plan with a three- to five-year horizon.

The Guide discusses the obligation of directors to set business objectives, monitor the bank’s operations, and supervise senior management. To do so effectively, the Guide highlights the need to understand the bank’s risk profile, not only its financial condition. Banks are required to set objectives and parameters for overall credit risk; for asset concentrations both by business line and by borrower or issuer, as appropriate; for the bank’s funding mix; and for interest rate risk.

Strategic planning goals and objectives should be developed based on a bank’s established risk appetite and bank policies with a three- to five-year planning horizon. In addition, goals and performance measures should be included in the strategic plan and regular reports provided to the board to enable the board to determine how successful the bank is in meeting its goals and to make changes as deemed appropriate.

Directors are reminded of their obligation to ensure that there are readily understandable policies communicated to employees for all major operational areas and activities of the bank. The Guide designates as minimum policies those that are listed in the Pocket Guide;¹ those listed in the Interagency Guidelines Establishing Standards for Safety and Soundness;² and policies for BSA/AML compliance, information technology and cyber risk, compliance with the CRA, and compliance with

1 Policies covering: (i) loans, including internal loans review procedures; (ii) investments; (iii) asset-liability/funds management; (iv) profit planning and budget; (v) capital planning; (vi) internal controls; (vii) compliance activities; (viii) audit programs; (ix) conflicts of interest; and (x) codes of ethics.

2 Policies covering: (i) internal controls and information systems; (ii) internal audit systems; (iii) loan documentation; (iv) credit underwriting; (v) interest rate exposure; (vi) asset growth; (vii) asset quality; (viii) earnings; and (ix) compensation, fees, and benefits.

consumer protection laws and regulations. Additional policies may be required by the board based on the bank's business model, risk profile, location, and other factors.

Finally, the Guide discusses the need for independent review of certain bank areas mandated by FDIC and interagency policies and guidance, including BSA/AML compliance, interest rate risk, the allowance for loan and lease losses methodology, compliance with consumer protection laws, and compliance with the bank's internal policies. Independent review can vary by the business model and complexity of operations and can be conducted by bank staff or a board member, provided the individual is qualified and independent of the function under review; the bank's internal audit function; or the bank's external auditor or other qualified third party.

The Guide contains minimum standards that examiners will use to measure the institution's and its directors' and senior manager's performance, which should be used as a resource for directors and senior managers and compliance officers to identify weaknesses in corporate governance.

Chapman and Cutler LLP

Attorneys at Law • Focused on Finance®

To the Point! is a summary of items of interest and current issues for financial institutions with primary focus on regulatory, consumer, and corporate issues. Chapman maintains a dedicated practice group with the experience to counsel on these issues and other enterprise risk management matters facing financial institutions. If you would like to discuss any of the items contained in these briefings or other legal, regulatory, or compliance issues facing your institution, please contact one of the members of our Bank Regulatory Group:

[Marc Franson](#) • 312.845.2988

[Scott Fryzel](#) • 312.845.3784

[Heather Hansche](#) • 312.845.3714

[Dianne Rist](#) • 312.845.3404

[John Martin](#) • 312.845.3474

[Lindsay Henry](#) • 312.845.3869

This document has been prepared by Chapman and Cutler LLP attorneys for informational purposes only. It is general in nature and based on authorities that are subject to change. It is not intended as legal advice. Accordingly, readers should consult with, and seek the advice of, their own counsel with respect to any individual situation that involves the material contained in this document, the application of such material to their specific circumstances, or any questions relating to their own affairs that may be raised by such material.

To the extent that any part of this summary is interpreted to provide tax advice, (i) no taxpayer may rely upon this summary for the purposes of avoiding penalties, (ii) this summary may be interpreted for tax purposes as being prepared in connection with the promotion of the transactions described, and (iii) taxpayers should consult independent tax advisors.

© 2016 Chapman and Cutler LLP. All rights reserved.

Attorney Advertising Material.