

# Vendor Risk Management – Compliance Considerations

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# Vendor Relationships

## Why banks use third party vendors?

- Reduce costs
- Enhance performance
- Obtain access to specific expertise
- Increase product offerings

## Who requires oversight?

All third parties. Board and senior management ultimately responsible for all aspects of its operations, whether performed by bank employees or third parties. **Good rule of thumb – Oversee vendors as you would any other division of the bank!!!**

# Vendor Relationships *(Continued)*

## What are common types of vendor relationships?

- **Outsourced bank/compliance functions** – Third parties to conduct compliance audits, fair lending reviews and compliance monitoring activity
- **Third parties to offer products** – Mortgage brokers, auto dealers, affinity card and credit card providers
- **Loan servicing providers** – Flood insurance monitoring, debt collection, loss mitigation/foreclosure activities
- **Disclosure preparation** – Disclosure preparation software, third party documentation preparers
- **Technology providers** – Software vendors, website developers

# What are the Risks?

- **Reputation Risk**
  - Dissatisfied customers
  - Violations of laws or regulations – public enforcement actions
- **Operational Risk**
  - Loss from failed processes or systems
- **Transaction Risk**
  - Problems with service/product delivery
- **Credit Risk**
  - Third party is unable to meet contract terms
- **Compliance Risk**
  - Violations of laws, rules or regulations
  - Non-compliance with policies or procedures
  - Examples:
    - Deceptive marketing
    - Discriminatory lending
    - Privacy

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# Third Parties and UDAP Risk

- **Compliance Risk and UDAP Risk Heightened with Use of Third Parties, as they:**
  - May be positioned directly or indirectly between the bank and customer
  - May be deeply involved in delivery of products and services to consumer
  - May have unfettered access to bank's customers
  - May not be adequately monitored by the bank
- **UDAP is not always apparent and may involve commonly accepted bank practices**

# Flood Insurance Monitoring

**Relationship:** Vendor used to monitor flood insurance

## Identified Issues:

- 1) Vendor does not have information necessary for them to do their job – multiple instances of insufficient coverage
- 2) Complete reliance on vendor – vendor activity is not monitored and no reviews of vendor activity are performed. Issues not self-identified

**Results:** Significant flood violations - civil money penalties

# Loan Modifications

**Relationship:** Third party used to process loan modification requests (e.g., Home Affordable Modification Program). Reliance on “experts to process requests”

## Identified Issues:

- 1) Vendor not processing requests as expected (i.e., delays, processing errors, etc.)
- 2) Vendor perceived to be expert, so no monitoring of vendor activity was performed

**Results:** Significant examination findings; potential UDAP raised; extensive corrective action, including file search, re-solicitation of borrowers, and compliance program changes

# Credit Card Relationships

**Relationship:** Third parties used to help administer and market credit cards

## Identified Issues:

Deceptive marketing – Third party used to market the product failed to properly disclose all fees (i.e., consumers not given enough info to make informed decisions when opening account)

**Results:** Enforcement actions can be issued, violations of UDAP, and CMPs issued.



# Disclosure Generation Software

**Relationship:** Third party software providers used to generate disclosures

## Identified Issues:

- 1) Management relies on software provider to implement required disclosures changes
- 2) Limited to no tracking to verify changes are implemented and disclosures are in compliance

**Results:** Violations limited; however, compliance management programs criticized

# Third Party Payment Processors

**Relationship:** Bank customers who use accounts to process payments for merchant clients

## Identified Issues:

- 1) TPPP initiated payments for merchants engaged in high-risk or illegal activity

**Results:** Institutions cited for failure to comply with Bank Secrecy Act (i.e., lax treatment of accounts belonging to third-party payment processors) - Consent orders issued requiring additional training, formalized processes to review TPPP transactions. Could also result in UDAP risk if merchants are engaged in deceptive practices.

# Revenue Enhancement

**Relationship:** Vendors are now offering “revenue enhancement” services

- Can apply to a variety of products and services
- Recommend bankers conduct due diligence, understand vendor activities, ensure technical compliance with all applicable laws and regulations, and know the impact to consumer – UDAP

# Common Themes

**Over Reliance on Third Party** - Sometimes complete reliance. Using third parties does not eliminate compliance responsibilities. **How do you know you are in compliance?**

**Failure to Understand/Retain Knowledgeable Staff** – Reliance on third party may result in institutions not retaining sufficient knowledge to understand and monitor risks. **Is someone at institution sufficiently knowledgeable to understand and oversee vendor's activities?**

**Failure to Monitor Vendor** – Need to monitor your vendor to ensure compliance. **How is your vendor performing? Do you know what they are doing? Are you getting complaints?**

# Common Themes *(Continued)*

**Garbage In – Garbage Out** – Vendor’s performance only as good as information provided and/or the expectations set. **Are you giving your vendor the information necessary to do their job? Is the contract with the vendor clear on your expectations?**

**Vendor’s Activities Result in Violations** - How are you verifying that your vendors’ activities comply with the law?

# Best Practices

- **Conduct thorough due diligence before selecting a vendor**
  - References
  - Financial information
  - Background of third party principals
- **Prepare a detailed risk assessment**
- **Ensure the contract with the third party includes expectations concerning compliance with consumer protection laws and regulations**
  - Expectations should include specific terms based on risk assessment
  - Include the ability to request proof of compliance, e.g., vendor's audits, monitoring, etc.

# Best Practices *(Continued)*

- **Implement a comprehensive monitoring program**
  - Monitoring frequency and depth should be based on risk assessment
- **Implement training for those conducting monitoring to ensure they understand the risks and receive regulatory updates**
- **Track consumer complaints**
- **Ensure board of directors receive third party due diligence, monitoring reports, and training to enable them to provide proper oversight of risks inherent in third party relationships**

# Conclusion

- **When outsourcing a function, ultimately responsibility for compliance cannot be delegated – remains with institution**
- **While vendor arrangements can provide valuable benefits, active role in risk management is required**
- **Ensure appropriate program is in place that includes**
  - Due Diligence
  - Risk Assessment
  - Contract Structuring and Review
  - Oversight



# Federal Reserve Resources

- *Vendor Risk Management*, Outlook Newsletter Article, 2011  
<http://www.philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/2011/first-quarter/vendor-risk-management.cfm>
- *Third –party service provider risk and the Unfair and Deceptive Acts and Practices rule*, Retail Payments Risk Forum (Federal Reserve Bank of Atlanta), February 2011  
<http://portalsandrails.frbatlanta.org/third-party-service-provider/>
- *Outsourcing Financial Services Activities: Industry Practices to Mitigate Risks*, Federal Reserve Bank of New York, October 1999  
<http://www.ny.frb.org/banking/circulars/outsource.pdf>
- *Interagency Review of Foreclosure Policies and Procedures*, The Federal Reserve Board, April 2011  
<http://www.federalreserve.gov/boarddocs/rptcongress/interagency/interagency.htm>

# Other Agency Resources

- CFPB Bulletin 2012-2 on Service Providers  
[http://files.consumerfinance.gov/f/201204\\_cfpb\\_bulletin\\_service-providers.pdf](http://files.consumerfinance.gov/f/201204_cfpb_bulletin_service-providers.pdf)
- FIL 44-2008 – Third-Party Risks: Guidance for Managing Third-Party Risk  
<http://www.fdic.gov/news/news/financial/2008/fil08044.html>
- OCC Bulletin 2001-47 – Third Party Relationships: Risk Management Principals  
<http://www.occ.gov/news-issuances/bulletins/2001/bulletin-2001-47.html>
- FTC Website  
<http://www.ftc.gov>

# Questions

