WHITEPAPER

Best Practices - Banking Regulators New Catch-All

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by
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In response to the financial crisis in 2008, United States Congress enacted the Dodd Frank Wall Street Reform and Consumer Protection Act ("Dodd Frank"). Dodd Frank required banks to abide by a variety of new regulations and created the Consumer Financial Protection Bureau ("CFPB") as an oversight agency. Congress granted to CFPB rule-making authority as well as the ability to sanction any bank for non-compliance. As part of its rule-making mandate, CFPB pushed for the creation of certain best practice lending requirements.

Initially, these best practice rules were geared towards the largest financial institutions, but they quickly trickled down to the smaller banks, including community banks. In fact, there have been a number of instances where federal regulators cited Best Practices as a catch-all rule. On its face, Best Practices were created in order to ensure that a bank's consumer lending process complies with certain standards. However, Best Practices will likely be required for all lending in the near future. For community banks, Best Practices standards have heightened importance because the largest financial institutions may be reluctant to buy any loans from a smaller bank which cannot show that it had implemented appropriate Best Practices. In particular, non-compliance poses such a severe risk for the largest financial institutions that it would be careless for any of those institutions to enter into any relationship with a third party without first verifying that the third party followed certain Best Practices.

Due to that risk, the largest financial institutions also are auditing all of their third-party subcontractors. These audits tend to focus on the guidelines enumerated by American Land Title Association ("ALTA") in its seven pillars of Best Practices, as well as recommendations on how to comply with the CFPB regulations. When auditing any of their subcontractors, the large financial institutions will focus on whether the subcontractor developed specific policies and procedures, whether the subcontractor implemented appropriate processes to protect a borrower's privacy rights, and whether internal systems exist to manage any complaints. If community banks have not done the same, they should consider auditing certain third party vendors to ensure those vendors have adopted certain standards of Best Practices.

Concerning policy and procedures, CFPB has issued a number of advisory opinions reflecting that policies and procedures are at the top of its priority list. In fact, all banks should examine all of their internal policies and update those respective policies in order to ensure compliance with the seven pillars outlined by ALTA. For example, one of those pillars relates to protecting a borrower's privacy rights. Privacy rights appear to be one of the areas which the CFPB heavily regulates, including policies regarding who can touch a borrower's loan file, clean desk requirements, and background checks for all employees.

The other pillars outlined by ALTA are equally important, and it is important to comply with all of ALTA's pillars of Best Practices. Each community bank should take appropriate steps in order to ensure that it and its vendors have addressed Best Practices requirements. Unfortunately, this is another regulation that likely will not go away. In fact, it probably will continue expanding in its required scope. Moreover, this is a new regulation that appears to grant regulators a great deal of leeway when deciding to sanction a bank for non-compliance. Therefore, compliance with ALTA's Best Practices is good business for community banks.

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