

Compliance Oversight Examination Program

The purpose and goal of the OTS compliance oversight examination program is two-fold:

- To determine the extent and effectiveness of management's efforts toward ensuring compliance with laws and regulations.
- To determine the extent and effectiveness of management's efforts to maintain a comprehensive and reliable internal compliance program.

LINKS

 [Program](#)

 [Appendix A](#)

Since 1988, OTS has encouraged associations to adopt a comprehensive compliance program by providing a framework that the association can adapt to its specific needs. The key to efficiently examining associations and focusing examination scope is to assess the quality of the association's compliance program by first establishing a comfort level with the association's self-assessment efforts.

OTS encourages associations to apply OTS's guidance by adapting the framework to reflect differences in association size, business strategy, operational complexity, and risk profile.

WORKING SMAART

Sound compliance management, like other areas of operational management, depends on establishing a comprehensive program of risk controls and reviews. While each association must develop a compliance program tailored to its organizational needs, business strategy, operational complexity, product diversity, market circumstances, and risk profile, there are fundamental components that characterize a successful compliance program across association size and type. The Working SMAART framework categorizes those basic components:

Systems: Procedures and controls that ensure the association conducts and records transactions in compliance with legal obligations and customer service goals.

Monitoring: Supervising the functioning of systems to deliver consistent real-time execution of program standards.

Assessment: Periodic review of transaction records and operations to identify program deficiencies.

Accountability: Working lines of authority and reporting that reinforce responsibility of managers and board to achieve good compliance performance.

Response: Process of addressing complaints, remedying violations, and correcting internal control deficiencies.

Training: Communicating policies, regulatory requirements, and compliance objectives to maintain staff and board expertise.

When evaluating association efforts to manage compliance by Working SMAART, you must keep in mind that the sophistication of individual compliance programs will vary by association according to internal and external risk factors. Each of the SMAART components corresponds to a basic question addressed to association management:

Systems: How do you conduct transactions correctly?

Monitoring: How do you supervise people and processes to deliver consistent program standards?

Assessment: How do you check results and confirm functionality?

Accountability: How do you apportion and assure responsibility to achieve compliance performance?

Response: How do you correct problems?

Training: How do you communicate information and maintain staff and board expertise?

OTS believes that associations with successful compliance programs can answer these questions appropriately for the association's operations and in keeping with peer best practices. This section guides you through a process to evaluate whether the association demonstrates an appropriate level of performance for its particular risk profile.

Program Overview

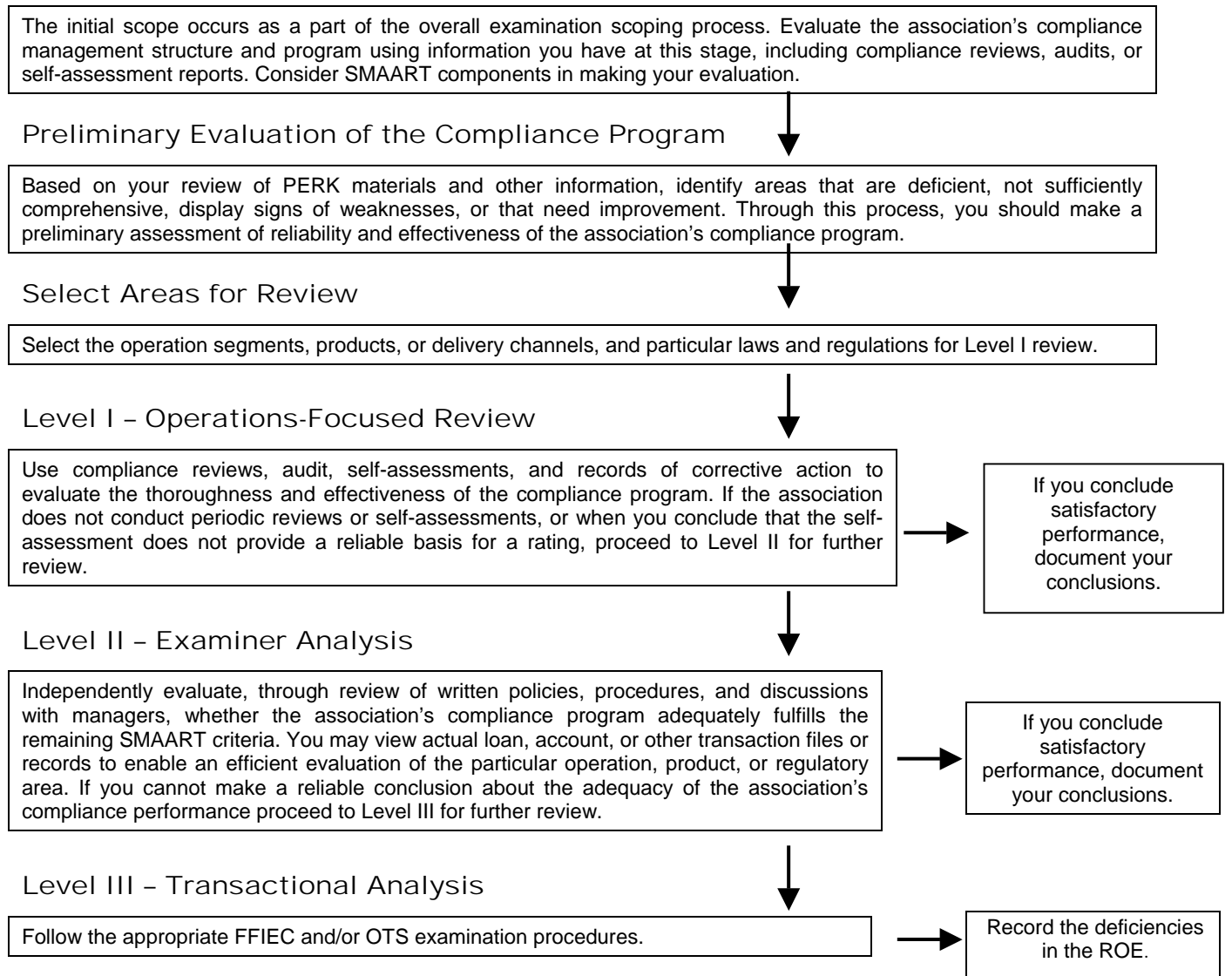
You should use a top-down/risk-focused approach. This approach places emphasis on a savings association's demonstrated ability to manage its compliance responsibilities. In following this approach, consider the savings association as a whole, taking into account all operations conducted, however structured. This means focusing on the association's compliance program for performing regular oversight and monitoring of its own activities, as well as those activities conducted through affiliated organizations or third-party vendors.

Using the top-down/risk-focused approach generally involves a comprehensive review and analysis of internal procedures, monitoring, and self-assessment programs. This serves as a basis for determining the association’s compliance with consumer protection and public interest laws and regulations.

Compliance is an integral part of the comprehensive examination process. You should be careful to manage the examination to realize the efficiencies of conducting scoping, systems evaluation, and transaction analysis in a coordinated or joint basis. This will reduce regulatory burden on associations and effectively eliminate needless repetitive reviews by examiners.

COMPLIANCE OVERSIGHT EXAMINATION PROGRAM FLOWCHART

Refine the Scope



REFINE THE SCOPE

Scoping occurs initially as part of the overall exam scoping process. You must be familiar with the overall scope to exercise judgment relevant to the compliance review. Consider the compliance ramifications of the association's business operations, external circumstances, and management's track record for controlling risk. Place particular emphasis on identifying the potential effect of changes in operations or environment on compliance performance.

As necessary to refine the scope, you may need to delve deeper into PERK materials or other information sources. Consistent with the instructions of the EIC, you should conduct such additional interviews with appropriate management personnel to accomplish the following:

- Confirm, modify or supplement the initial scoping judgment.
- Understand the risk profile.
- Determine the extent to which you should examine certain operations, laws, or regulations.

Understanding the association's operational risk, external risk, and management's control structure are essential in planning the examination.

Consider the following factors to identify the association's risk profile:

- Significance of changes to business strategies related to operations.
- Expansion of business operations using new products and distribution channels.
- Substantive changes to compliance policies, procedures, systems, or controls.
- Significance of changes to management and compliance personnel or the level of staff or support for these areas.
- Decreased emphasis on training.
- Effect of new compliance obligations on business lines pursued.
- Volume and subject matter trends of consumer complaints.
- Absence of periodic internal reviews or incomplete coverage of business operations by such reviews.
- Changes to the risk schedules adopted by management to conduct internal compliance reviews.
- Extent of regulatory violations or deficiencies and corrective action noted in reports to management and the board of directors.

- Changes to third-party service providers or the standards for monitoring their compliance performance.
- Length of time since a particular law, regulation, product, service, operation or delivery channel received regulatory scrutiny.
- Areas where the association had problems in the past.
- Areas where other similarly situated associations experienced problems.
- Areas where there is a current public interest or agency priority.

Preliminary Evaluation of the Compliance Program

Use the information available at this stage to evaluate the association's compliance program. In your evaluation, consider the association's size, staff resources, business strategy, operational complexity, market demands, and risk profile. You must familiarize yourself with the elements that constitute the association's record of compliance performance. Consider the information you have at this stage,

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including audit or self-assessment reports, prior familiarity with association operations and personnel, and any new information from current interviews with management. Then, consider how the association's compliance program or control processes answer, at a

macro level, each of the basic SMAART questions previously mentioned. Refer to Appendix A for a discussion of the SMAART components, which may assist you in your evaluation.

As you conduct your analysis of compliance program quality, determine whether the association has an established compliance record for addressing these factors. Most associations will have a compliance record that serves as a valid foundation to build upon and assists you in updating your evaluation of the compliance program.

Based on your evaluation of overall compliance program quality at the macro level, identify areas that are deficient, not sufficiently comprehensive, display signs of weakness, or need improvement.

Select Exam Elements

Determine the compliance risks that warrant examination. Consider the following core operational and regulatory areas:

- Lending operations by product type and delivery channel.
- Retail operations by product type and delivery channel.

- Bank Secrecy Act, anti-money laundering requirements, Office of Foreign Assets Control (OFAC) Economic Sanctions, and USA PATRIOT Act standards.
- Fair lending and nondiscrimination responsibilities.

We discuss these areas in more detail under Compliance Examination Core.

Based on the analysis, evaluations, findings and judgments made in reviewing PERK materials or other information available, select the operation segments, products, or delivery channels, and particular laws and regulations for Level I review.

You have the flexibility to focus on priority areas. You should minimize the time spent on areas where the compliance systems of the association appear strong and where the likelihood of problems or noncompliance is extremely small or nonexistent.

You should record in the work papers the judgments you make, and the basis for selecting those operations, products, or regulatory areas subject to further review at Level I. You should also record the methods used to conduct necessary reviews in an efficient, integrated manner as appropriate to the overall examination plan.

Compliance Examination Core

The compliance core reflects the two fundamental operational components of most associations, lending and retail banking, as well as significant regulatory areas.

<p><u>Compliance Core:</u> Lending Operations Retail Operations BSA/AML/OFAC/USA PATRIOT Act Fair Lending/Nondiscrimination</p>

Lending Operations

This core area covers the management of compliance for the association's mortgage and other consumer credit products. You should distinguish among the products, delivery channels, and functional divisions – such as marketing, application processing, origination, and servicing – when analyzing the association's lending operations' compliance performance. Depending on an association's operation complexity each of these major areas can display significant organizational and management variation.

In making judgments about focusing the examinations, you should probe each different operational element to identify distinctions in their compliance management structure and risk profile. A potential problem in one facet of lending operations may not implicate another facet. On the other hand, concerns in one area may have causes that suggest parallel concerns in other areas.

This section covers the compliance requirements contained in the following FFIEC and OTS procedures (Handbook Sections):

- [Fair Credit Reporting Act \(1300\)](#)
- [Truth in Lending \(1305\)](#)

- [Restitution \(1310\)](#)
- [RESPA \(1320\)](#)
- [Homeowners Protection Act \(1323\)](#)
- [Consumer Leasing \(1325\)](#)
- [Flood Disaster Protection \(1340\)](#)
- [Fair Debt Collection Practices \(1350\)](#)
- [Unfair and Deceptive Acts \(1355\)](#)
- [Homeownership Counseling \(1360\)](#)
- [Advertising \(1425\)](#)

Although this is a long list of regulatory requirements with extensive exam elements, the aspects of these requirements and procedures that apply in any given lending operation review will depend on the risk-focused analysis. Tailor the requirements and procedures to the products, delivery channels, and operational functions identified through that process.

You should organize reviews to take advantage of efficiencies presented by the scoping plan to conduct comprehensive reviews across exam programs, especially those in connection with the Asset Quality and Management components of CAMELS. Integrated association policies, lending transaction records, and other association lending program features afford opportunities to conduct consolidated, coordinated analysis of compliance exam components simultaneously with operationally related safety and soundness standards.

Retail Operations

This core area covers compliance management for payment, deposit, and investment products. You should recognize distinctions among products. Evaluate how the association manages the possible consumer confusion that can arise from such distinctions. This will depend on the sales practices followed by bank personnel and the different needs and risk tolerances of its customers.

The association may distribute retail products through different delivery channels. You can also analyze them along functional divisions such as marketing, account opening, and account management. As with lending operations, you should probe each operational element in the association's retail business.

This section covers the compliance requirements contained in the following FFIEC and OTS procedures (Handbook Sections):

- [Electronic Fund Transfer Act \(1330\)](#)
- [Expedited Funds Availability Act \(1335\)](#)
- [Truth in Savings \(1365\)](#)
- [Electronic Banking \(1370\)](#)
- [Insurance Consumer Protection \(1380\)](#)
- [Bank Protection Act \(1405\)](#)
- [Interest on Deposits \(1420\)](#)
- [Advertising \(1425\)](#)
- [Branch Closing \(1430\)](#)

You should conduct the reviews selected here in coordination with procedures in other programs that afford opportunities for joint review and elimination of redundant analysis. Programs evaluating products such as securities or insurance afford one such opportunity to conduct a joint review when there is an overlap of risk assessments in the compliance and safety and soundness areas.

Bank Secrecy Act (BSA), Anti-Money Laundering (AML), Office of Foreign Assets Control (OFAC) Economic Sanctions

This core area covers the association's controls for identifying and reporting financial transactions that display different indicators of suspicious activity, including money-laundering and terrorist financing. Many associations manage BSA/AML related risks as an element of association security. Whether assigned to compliance or security, your expectations about management performance should be the same.

We list this area separately in the core because of its visibility. Operationally, these risks are in retail operations. Accordingly, when evaluating the thoroughness of compliance performance in retail operations, you should pay particular attention to BSA/AML/OFAC systems, monitoring controls, self-assessments, reporting, response, and training.

The [FFIEC's BSA/AML Examination Handbook](#) covers the examination procedures for the following areas:

- Bank Secrecy Act
- Anti-Money Laundering
- Office of Foreign Assets Control

Although BSA is a separate core element, you can emphasize its policy significance while achieving examination efficiencies. You can do this by conducting analysis of BSA in conjunction with other operational reviews, for example, branch operations or certain parts of the lending or retail operations.

Fair Lending and Nondiscrimination

This core area evaluates the exercise of business judgment for prohibited discriminatory effects. Fair lending embraces primarily the standards established by the FHA and the ECOA for credit decisions. However, the OTS Nondiscrimination regulations, as well as the obligations imposed by the Americans with Disability Act, have implications for retail operations in addition to lending operations.

This section covers the compliance requirements contained in the following FFIEC and OTS procedures (Handbook Sections):

- [Fair Lending: General \(1200\)](#)
- [Fair Lending Examination Procedures \(1201\)](#)
- [Equal Credit Opportunity Act \(1205\)](#)
- [Fair Housing Act \(1210\)](#)
- [Home Mortgage Disclosure Act \(1215\)](#)
- [Equal Employment Opportunity \(1410\)](#)

When evaluating this core area, you must be particularly mindful of the racial, ethnic, and gender diversity in the geographic markets served and the association's record of penetrating these markets.

When you identify substantive fair lending problems, you may use such findings as reasonable cause for conducting a CRA evaluation of the association in spite of the normal cycle requirements established by the Gramm-Leach-Bliley Act.

In some cases, you can combine reviews of the fair lending laws with examination tasks under the lending core and the Asset Quality programs. Substantive discrimination analysis under some circumstances may also entail system, self-assessment, or file reviews that you can combine with program reviews of related lending operations.

When you identify substantive fair lending problems, you may use such findings as reasonable cause for conducting a CRA evaluation of the association in spite of the normal cycle requirements established by the Gramm-Leach-Bliley Act.

LEVELS OF REVIEW

There are three levels of review in the examination procedures. These levels of review begin at a high, broad level and become more detailed and specific as the level increases, as required by the top down, risk-focused examination approach. The three levels are as follows:

Exam Level I – Operation-focused review.

Exam Level II – Examiner analysis and limited transaction testing.

Exam Level III – Transactional analysis examination procedures.

The first level consists of evaluating the adequacy and effectiveness of compliance reviews, audits, self-assessments, and records of corrective action for operation segments, products, or regulatory areas identified in scoping and the risk profile.

When the institution does not conduct a self-assessment or periodic internal review of an examiner risk-selected operation, program or regulatory area, or the self-assessment conducted does not provide a reliable basis for favorably rating compliance management performance, proceed to Level II and independently evaluate how well the thrift's compliance management fulfills the other SMAART components. Where study of actual loan, account, or other transaction files or records enable an efficient evaluation of the particular operation, product, or regulatory area, then you may conduct such a study.

When you are unable to make a confident judgment about compliance performance proceed to Level III to complete transactional analysis examination procedures.

Exam Level I – Operation-Focused Review

Conduct an operation-focused review of the areas selected in scoping by following the guidance contained below.

Review of Self-Assessments

Obtain management's compliance reviews, self-assessments, compliance audits, and records of correcting compliance deficiencies in connection with the operations, products, or regulatory areas selected for focused review. Evaluate the adequacy and effectiveness of the compliance program covering the selected operations, products, or regulatory areas using these materials. Begin by examining the thoroughness and reliability of the association's periodic compliance reviews, audits, or self-assessments by determining whether:

- The frequency of self-assessments is appropriate given the level of risk and complexity presented by the selected operations, products, or regulatory areas.
- The association conducts periodic reviews for the selected operations, products, and regulatory areas that comprehensively cover all pertinent regulatory requirements.

- The association conducts periodic reviews to evaluate the adequacy of the procedures, systems, controls, monitoring, self-correcting processes, and training curriculum applicable to the operations, products, or regulatory areas selected for examination.
- Transactional analysis of representative files or accounts occurs as part of the association's periodic self-assessment.
- The association prepares and retains detailed work papers of transaction analyses that support the conclusions of the periodic review.
- The association documents violations, deficiencies, or potential weaknesses identified in compliance performance or controls.
- The board of directors and senior management ensure receipt of and act upon written reports detailing findings, conclusions, and recommendations for corrective action.
- The association tracks recommended corrective actions and management verifies and confirms to the board the assimilation of recommended corrective actions into systems, controls, and training.

Record the basis for your conclusion in the work papers when you arrive at the following conclusions:

- The self-assessments or periodic internal reviews demonstrate that the association conducts a comprehensive, reliable, self-correcting compliance program for the operation, product, or regulatory area(s) selected covering the SMAART components of a customized program.
- The compliance program is appropriate to the association's size, resources, business strategy, operational complexity, market demands, and risk profile.

You may reach conclusions about compliance deficiencies without conducting transaction analysis or identifying transaction violations.

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Where the self-assessment or periodic internal review proves sufficiently reliable, but displays weakness in scope or lacks adequate response to identified deficiencies, evaluate the significance of the shortcomings and the ability of management to readily implement necessary improvements to attain the degree of thoroughness expected. When management commits to implement the requisite improvements and report to OTS supervision on the results of any re-assessment in a manner and time frame satisfactory to OTS, then you may consider this commitment in evaluating compliance management performance. Where you consider the undertaking commensurate with the risk addressed, document your conclusions.

Where your work from this analysis does not enable you to reach such a conclusion, record any deficiencies that management should correct. Proceed to Level II, if necessary, and evaluate other SMAART components to address any area of identified risk that the association is not managing adequately or that you are unable to determine if the association is managing it adequately.

Exam Level II – Examiner Analysis and Limited Transaction Testing

Examiner Analysis

You must independently evaluate whether the association's compliance management adequately fulfills the other fundamental components (SMAART) of a comprehensive program when the association:

- Does not conduct a self-assessment or periodic internal review of a selected operation, program, or regulatory area, or
- Conducts a self-assessment that does not provide a reliable basis for favorably rating compliance management performance.

For each operation, product, or regulatory area you evaluate, review association compliance systems, monitoring, accountability, response, and training as outlined in the examination program.

Combining these components of SMAART with your judgments about the association's self-assessment performance, you should be able to form a comprehensive judgment about the quality of the association's compliance management capabilities and performance in the context of the association's particular size, operational complexity, business strategy, and risk profile.

Conducting the analysis required by these procedures involves developing a thorough understanding of the root causes of an association's compliance performance that explain its success – or lack thereof – for the area you are examining. You should probe performance through discussions with managers and other knowledgeable staff to demonstrate that the association:

- Executes transactions correctly.
- Supervises for consistency.
- Checks results.
- Holds managers accountable.
- Corrects problems that arise.
- Maintains expertise.

The key to interviewing management is to inquire sufficiently of responsible officials and staff to produce reliable indicia of a functioning compliance management capability. Further, that compliance

management delivers consistent performance appropriate to the association's operations and in keeping with peer best practices. Use SMAART and the risk concerns you identify to guide your choice of questions during this analysis.

Of course, you should also use system design documentation and change orders, handbooks, loan and account forms, board materials, management reports, audits, service provider contracts, and consumer complaints, among other sources, for conducting your evaluation of compliance management.

Limited Transaction Testing

Where study of actual loan, account, or other transaction files or records enable an efficient evaluation of the particular operation, product, or regulatory area, then you may conduct such a study. While it can be helpful to use the relevant compliance examination program to guide your review, you should select those program sections relevant to the specific area of concern. However, extensive transaction or file analysis should not be a routine tool at this Level. When you are unable to make a confident judgment about compliance performance for a selected operation, product, or regulatory area at this stage of the examination process without full-fledged transactions review, you might conclude that compliance performance is not demonstrably adequate and the association warrants further analysis at Level III.

Examiner Judgments

When applicable, record in the work papers the basis for your conclusion from the Level II analysis that the association's SMAART procedures ensure compliance with the association's own standards and regulatory requirements. Further, that the association consistently complies with these standards and regulatory requirements for the selected operation, product, or regulatory area. Then proceed to document your conclusions. You may reach conclusions about compliance deficiencies without conducting transaction analysis or identifying transaction violations.

Where your work from this analysis does not enable you to reach such a conclusion, record any deficiencies that management should correct. Proceed to Level III, if necessary, to address any area of identified risk that the association is not managing adequately or that you are unable to determine if the association is managing it adequately.

Exam Level III – Transactional Analysis Examination Procedures

Follow the standards established by the FFIEC and/or OTS examination procedures contained in the subsequent sections of the Compliance chapter and conduct a transaction file or account analysis in the situations below:

- When, taken together, the association has deficient policies, procedures, systems, controls, self-assessment periodic reviews, or other compliance management components for a particular area, or

- When you cannot make a reliable conclusion about the adequacy of the association's compliance performance for a selected operation, product, or regulatory area, including when you cannot make such a conclusion from limited transaction testing.

Do not conduct a transaction analysis just because the compliance program is not in writing. Transaction reviews are appropriate only when the Level II review of the SMAART components taken together do not allow you to reach a supervisory judgment about the risk-focused operational area without doing a detailed analysis. As noted in the Level I and II reviews, you may reach conclusions about compliance deficiencies without conducting transaction analysis or identifying transaction violations.

When the region is confident that the association can do so reliably, you may instruct the association to conduct and report on a transaction analysis that meets your specifications and requirements.

Based on the analysis conducted, evaluate the compliance performance of the association for the selected operation, product, or regulatory area. Record in the work papers your conclusions about that performance, any deficiencies or violations and their causes, and corrective actions or compliance program improvements required.

Program Conclusions

Document in the ROE, in your overall assessment of management, your conclusions about the effectiveness of the association's compliance management program and management's self-assessment efforts.

Refer to [Handbook Section 070, Ratings: Developing, Assigning, and Presenting](#), to finalize your exam conclusions and comments, to determine and assign ratings, and to present examination findings.

REFERENCES

United States Code (USC)

12 USC § 1701x(c)(5)	Homeownership Counseling Procedures
15 USC § 1681-1681(u)	Fair Credit Reporting Act
15 USC Part 1692	Fair Debt Collection Practices Act
42 USC Part 3601	Fair Housing Act

Code of Federal Regulations (12 CFR)

OTS Regulations

Part 528	Fair Lending
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Part 535	Unfair and Deceptive Acts
Part 536	Insurance Consumer Protection
§ 563.27	Advertising
§ 563.177	Bank Secrecy Act
§ 563.180	Suspicious Activity Reports
Part 568	Bank Protection Act
Part 572	Flood Disaster Protection Act

Federal Deposit Insurance Corporation (FDIC) Regulations

Part 328	Advertising
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Federal Reserve Board (FRB) Regulations

Part 202	Equal Credit Opportunity Act
Part 203	Home Mortgage Disclosure Act
Part 205	Electronic Funds Transfer Act (Regulation E)
Part 213	Consumer Leasing Act (Regulation M)
Part 226	Truth In Lending Act (Regulation Z)
Part 229	Expedited Funds Availability Act (Regulation CC)
Part 230	Truth in Savings Act (Regulation DD)

Housing and Urban Development

Part 3500	Real Estate Settlement Procedures Act
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Code of Federal Regulations (31 CFR)

Part 103	Bank Secrecy Act
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Other Statutes and Regulations

Office of Foreign Economic Sanctions (OFAC) Economic Sanctions
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Homeowners Protection Act

Federal Financial Institution Examination Council (FFIEC)

Interagency Guidance on Electronic Financial Services and Consumer Compliance

Examination Handbook Administration Sections

[Section 060](#) [Examination Scheduling, Scoping, and Management](#)

[Section 070](#) [Ratings: Developing, Assigning, and Presenting](#)