

# Banking

## IN THE NINTH

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### NINTH DISTRICT HIGHLIGHTS

## Tailoring Community Banking Supervision



Ron Feldman

The Federal Reserve System has increasingly moved to a potentially more effective method for tailoring supervision and regulation to community banks: exemption. In this article I briefly summarize the Minneapolis Fed's support for this approach. I then ask community bankers in the Ninth District for their thoughts on where the new approach could apply.

Standard tailoring of supervision and regulation often applied one general approach to all banks but either (a) made a few specific changes in the application to community banks or (b) called for supervisors to generally apply that methodology only after considering the size and complexity of the bank.

I see two problems with this standard approach. First, some rules just do not fit well for community banks. Second, over time it becomes hard to avoid a trickle down of standards applicable to large banks which flow to smaller ones. Exemption avoids these two concerns by not applying a rule or supervisory approach to community banks in the first place.

A recent speech by Federal Reserve Bank of Minneapolis President Narayana Kocherlakota—found at our website [minneapolisfed.org](http://minneapolisfed.org)<sup>1</sup>—focused on the need for a new kind of tailoring. In that talk he noted:

*Federal Reserve policymakers have recently discussed how better tailoring of supervision and regulation to community banks can be helpful*

*"I offer these ideas not as final prescriptions, but in the spirit of open inquiry. My main point is that we need to further investigate ways to tailor the supervision and regulation of community banks."*

Narayana Kocherlakota, President, Federal Reserve  
Bank of Minneapolis

*in reducing the extent of this problem. The Federal Reserve does some tailoring already, but I think we should do more.*

*Where can we engage in additional tailoring? Governor Daniel Tarullo has noted potential benefits in reviewing statutes that apply new regulations to all banks. Community banks may not create the risks that a specific regulation addresses.... I strongly agree with Governor Tarullo's point that Congress and supervisors should exempt all community banks from certain regulations. Exempting is the best way to guard against regulatory trickle-down.*

*A second fruitful approach to additional tailoring concerns supervision, not regulation. I worry that our current supervisory methods establish expectations that are too detailed across too many areas of bank*

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### CONSUMER COMPLIANCE UPDATE

## E-SIGN Act Requirements

The E-SIGN Act, or Electronic Signatures in Global and National Commerce Act, establishes that electronic signatures, contracts and records are valid or enforceable if they meet certain criteria. The act is applying to an increasing number of Ninth District banks as they expand the product lines and services

they offer electronically. As a result, examiners continue to identify violations involving electronic delivery of disclosures. We also receive questions from banks regarding compliance with the E-SIGN Act provisions. In this update, we summarize key aspects of compliance with the E-SIGN Act.

### **When must a bank follow the consent requirements of the E-SIGN Act?**

Banks' reliance on the electronic version of a disclosure related to a loan, deposit account or banking service triggers the requirements of the

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# Federal Reserve Bank Training Options for Bankers

The Federal Reserve Bank of Minneapolis wants to help banks meet our various regulatory, supervisory and operational requirements. One way we help banks is through training. Staff in Supervision, Regulation and Credit (SRC) can share expertise in the areas of safety and soundness supervision; consumer affairs; credit, payments systems risk (PSR) and reserves; and statistical and structural reporting. This article discusses our training and outreach philosophy and the approach the various sections of SRC take to provide such resources. Note that the listing below is not an exhaustive set of training opportunities, nor does it replace routine questions and answers that come up in the normal course of business.

## Outreach and Training Approach

Regulators and bankers have a common interest in making sure that institutions operate in a safe and sound manner and in compliance with governing laws and regulations. Our priority is to ensure that we communicate effectively with member banks and others, so that they understand regulations and policies and that we continue to build strong partnerships. These efforts take several forms, including formal training sessions, webinars, letters highlighting changes in supervisory expectations, Consumer Compliance Advisory visits and occasionally one-on-one meetings with bank management and staff outside the examination process.

Over the past few years, we have taken several steps to enhance our processes for informing regulated institutions of new or upcoming regulations and current procedures. For example, we began publishing this newsletter. As described in the first quarter 2014 edition of *Banking in the Ninth*,<sup>1</sup> we created the Relationship Manager (RM) and Consumer Affairs Contact (CAC) programs. These programs allow us to form a more personal relationship with member banks and large holding companies, making sure that questions and concerns can be addressed more directly. Finally, we hold outreach events, where we meet with member bank and holding company management and provide detail and clarification on regulations and compliance expectations.

## Section Specific Training

As detailed below, our Safety and Soundness, Consumer Affairs, Credit/PSR/Reserves and Statistical and Structural Reporting areas all have the ability to help you understand the expectations for your bank.

### *Safety and Soundness*

We use a variety of approaches to answer common questions we receive from organizations regarding Safety and Soundness supervision matters. We reach out via articles in *Banking in the Ninth*, outreach events and letters supplementing new regulations or supervisory guidance. We also monitor questions that we receive from examiners and institutions regarding the application of regulations and supervisory policies and follow up appropriately. For example, we received a number of questions from institutions about the application of the appraisal guidelines. We drafted a letter in response detailing expectations and outlining options for using evaluations. In addition, information technology (IT) specialists have met with institutions one-on-one outside of examinations to help them through IT challenges. Finally, RMs and Relationship Officers (ROs) visit banks

and work with management and staff to make sure they understand our expectations. The RMs and ROs also talk through issues and concerns of assigned banks, bank holding companies and savings and loan holding companies via telephone if that better fits the needs of institutions. They welcome input on concerns affecting member banks and holding companies.

Safety and Soundness staff can provide training and insight to bank management and boards of directors in other ways, including:

- We offer a half-day director training program, which concludes with an interactive case study. We conduct training for directors of multiple institutions at a central location or, with sufficient notice, we can work with institutions to provide training to a full board.
- RMs, risk specialists and other SRC staff are available to discuss supervisory guidance in more detail on the full range of safety and soundness issues, as well as to provide general information about supervisory expectations.

### *Consumer Affairs*

We know that Consumer Affairs regulations and expectations can be highly technical and challenging for many institutions, particularly smaller ones. As a result, we offer our Consumer Affairs Assistance Hotline,<sup>2</sup> and larger or more complex institutions have assigned CACs. In addition, banks can request an advisory visit, which is a non-examination visitation, frequently focused on assisting with implementation of specific regulations. Compliance examiners can address bankers' questions and review materials on specific compliance requirements or general risk management expectations through these tools.

Other ways our Consumer Affairs section has been willing to help banks, based on staff availability, include:

- Working individually with banks during their risk assessment or implementation of major changes in products or operations, including providing suggestions for risk management. In most cases, we'll work with a bank remotely.
- Providing training on compliance requirements to groups of banks or compliance officers. We provide training through conference calls, webinars or meetings in person.
- Meeting with management and/or directors to discuss their roles and responsibilities in compliance risk management. This training may involve a presentation or a less formal meeting conducted either via conference call or in person.

### *Credit/PSR/Reserves*

Our Credit/PSR/Reserves section provides assistance to all depository institutions that maintain accounts at the Reserve Bank, those that have collateral pledged to the Federal Reserve and other reporting respondents. We can provide broadcast and/or individual training on:

- Federal Reserve master account management
  - ✓ Account establishment, maintenance and monitoring, and monitoring tools
- Reserve requirement management

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## E-SIGN ACT REQUIREMENTS *continued from page 1*

E-SIGN Act. Put simply, banks must ensure that they meet requirements of the E-SIGN Act as they eliminate paper disclosures.

### **What does the E-SIGN Act require?**

The E-SIGN Act does not alter or limit any existing disclosure requirements or require any person to agree to use or accept electronic records or signatures. Consumers must consent to receiving disclosures electronically. The bank must do the following for customers prior to obtaining their consent:

- Indicate whether customers have a right or option to receive information on paper.
- Identify whether the consent relates to a particular transaction (e.g., account opening disclosures) or to ongoing disclosures over the course of the relationship (e.g., monthly statements and change-in-terms notices).
- Explain that the consumer has the right to withdraw consent and provide the procedures to withdraw consent as well as the consequences of withdrawing consent, such as fees, termination of the relationship, loss of preferred pricing or having to switch account types.

- Describe the procedures for updating the consumer's contact information.
- Outline the hardware and software requirements for accessing and retaining records.
- Explain how to obtain paper disclosures after consent has been given and describe any associated fees.

Consumers must also consent electronically, or electronically confirm consent, in a manner that reasonably demonstrates their ability to receive or access the information electronically. Having consumers retrieve a code contained within in a document sent to them is one way to demonstrate accessing of information.

### **What are the risks of the delivering information or disclosures electronically?**

A disclosure delivered in an electronic format will not meet the requirement to provide disclosures in writing under a given regulation (e.g., Regulation Z or DD) unless it meets E-SIGN requirements specifically provided by the relevant regulation.

### **What are examples of best practices to comply with the E-SIGN Act?**

E-SIGN violations most frequently result from

changes to banks' electronic products, services and delivery. To avoid such errors:

- Involve compliance personnel when relying on electronic delivery of products and services.
- Establish a regular audit or review that independently identifies bank products and services, activities and information consumers can access electronically.
- Focus on how changes in vendors or other third parties affect E-SIGN compliance. Vendors often assist banks in complying with the act.

### **What are some resources regarding the E-SIGN Act?**

- An article in the *2009 edition of Consumer Compliance Outlook*<sup>1</sup> has more information on the E-SIGN Act.
- A Consumer Affairs Electronic Banking Examination Checklist found in *CA 03-10*<sup>2</sup> is an optional tool for reviewing the websites and other electronic delivery channels of state member banks. Module IV of the checklist addresses the E-SIGN Act.

—Catherine Minor, Senior Examiner

<sup>1</sup> For the full article, go to: [philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/2009/fourth-quarter/q4\\_02.cfm](http://philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/2009/fourth-quarter/q4_02.cfm)

<sup>2</sup> For the full checklist, go to: [federalreserve.gov/boarddocs/caletters/2003/0310/caltr0310.htm](http://federalreserve.gov/boarddocs/caletters/2003/0310/caltr0310.htm)

## FEDERAL RESERVE BANK TRAINING OPTIONS FOR BANKERS *continued from page 2*

- ✓ Requirement calculation and compliance, position monitoring and monitoring tools
- Discount window and payments system risk collateral management
  - ✓ Discount window lending programs, daylight overdraft and overnight credit extensions, and collateral eligibility, pledging and valuation

Generally, we provide assistance based on telephone inquiries initiated by potential or existing depository institution customers; however, when significant changes in processes or policies occur, we send letters to affected institutions (either broad-based or institution-specific), conduct webinars or consider other methods for ensuring that institutions have a clear understanding of new requirements.

### *Statistical and Structural Reporting*

Our Statistical and Structural Reporting staff are eager to support reporting institutions. Most reporting institutions prefer telephone consultations,

but staff are flexible in providing help. The statistics staff routinely notifies Ninth District respondents when various webinars or modules clarifying or providing training on FR2900 and "Y" series reports are available.

### **Conclusion**

All sections within SRC are available to answer inquiries on specific issues or address concerns of District member banks and holding companies, account holders and report filers. The Federal Reserve Bank of Minneapolis wants to make sure you have the tools and resources you need to understand regulations and requirements prior to exams, reviews and ratings. Our goal is to help banks operate safely, soundly and in compliance with laws and regulations. If you have a concern, a topic or an issue you need more assistance with, contact your RM, CAC, Credit/PSR/Reserves or Statistical and Structural Reporting analyst, or email [mpls.src.outreach@mpls.frb.org](mailto:mpls.src.outreach@mpls.frb.org).

—Jacquelyn Brunmeier, Assistant Vice President & Chief Risk Officer

<sup>1</sup> To read the full article on the Relationship Manager and Consumer Affairs Contact programs, go to: [minneapolisfed.org/publications\\_papers/pub\\_display.cfm?id=5275&TC=1](http://minneapolisfed.org/publications_papers/pub_display.cfm?id=5275&TC=1)

<sup>2</sup> To read an article on the Consumer Affairs Assistance Hotline, go to: [minneapolisfed.org/publications\\_papers/pub\\_display.cfm?id=5277&](http://minneapolisfed.org/publications_papers/pub_display.cfm?id=5277&)

## Off-Site Examination Work

The Federal Reserve Bank of Minneapolis increasingly uses technology to conduct more of its examinations off-site (i.e., not on the premises of the bank). Secure access to electronic records means we can review policies, procedures, internal bank reports and, at times, imaged loan files from our offices. In this Safety and Soundness Update, we explain the off-site examination process, the benefits of this program and the challenges that could arise.

### Off-Site Examination Process

Planning for off-site examination work begins during the pre-examination management interview and examination scoping process. Examiners consider what work can be completed off-site and what needs to be completed on-site to conduct an effective supervisory review. We expect to maintain an on-site component of examinations to complete certain transaction testing, observe processes, test controls and hold key discussions with management. Much of the off-site work relates to operational areas and financial analysis (e.g., capital, earnings, liquidity, sensitivity to market risk and audit).

Banks typically need to provide more information before the examination than they had previously to enable us to complete expanded work off-site. We leverage information we gather through ongoing supervision by our Relationship staff to minimize our requests. Further, the amount of information the bank holds for the examination team to review on-site is often reduced by the provision of information earlier in the process.

In short, the change to off-site examination processes primarily alters where work is done rather than what work is done.

Many institutions send information to us through IntraLinks, a website provider that enables secure data exchanges. We remove files from the website after the close of the examination. While use of a secure website is the most common method of providing data, alternatives include use of encrypted files on removable media (USB flash drive or DVD) or paper records.

Good communication with bank management to determine how contacts are made, by whom and how frequently is critical for the off-site examination process to work efficiently. Examination teams typically conduct regular conference calls with bank management during the off-site examination. These calls allow both parties to remain informed, promote clear communication and facilitate timely completion of examination work.

### Benefits to Off-Site Exams

Increasing the amount of work we complete off-site has benefits for banks. In particular, it

- reduces the number of examiners at the bank and thereby reduces the burden of hosting a large examination team; and
- reduces working space requirements and may lessen the disruption to bankers' day-to-day business, as fewer examiners are vying for time with bank management and staff.

### Some Challenges of Off-Site Exams

Although the benefits to conducting examination

work off-site are significant and outweigh costs, the process does have some challenges, albeit ones that we are addressing. Early experiences with the examination process identified the need for more proactive management of examiner communications with bank management as described above. Loan review poses a unique set of challenges, centered on accessing and evaluating loan files. Some banks have uploaded loan files to the secure website along with other information, while others may grant examiners file access through either a SharePoint site or a virtual private network (VPN). The security and access for these latter options can present hurdles that generally require 60-90 days of lead time. We evaluate the indexing and file structure of imaged loan files prior to the examination to determine if an off-site review can be done efficiently.

To read more about the Federal Reserve System's off-site loan review efforts, see Community Banking Connections at [communitybankingconnections.org/articles/2014/Q2/loan-reviews-off-site.cfm](http://communitybankingconnections.org/articles/2014/Q2/loan-reviews-off-site.cfm).

### A Final Word

We would appreciate your feedback as we continue to refine the off-site examination process and conduct more off-site loan reviews. If you have ideas for how we might improve the off-site aspect of our examinations, please discuss them with the examiner in charge or contact your Relationship manager.

—Aaron Zabler, Supervisory Examiner, Team Leader

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*operations and too wide a swath of banks. Alternatively, supervisors could concentrate on a smaller number of activities that we believe are correlated with bad outcomes. To be specific, supervisors could choose to focus on rapid loan growth, high lending concentrations, specific high-risk types of lending and wholesale funding strategies and skip some of the more detailed reviews....*

President Kocherlakota went on to say, *"I offer these ideas not as final prescriptions, but in the spirit of open inquiry. My main point is that we need to further investigate ways to tailor the supervision and regulation of community banks."*

In this spirit of an open inquiry and an open dialogue, I want to ask you for your suggestions about this approach. I have some

ideas on where we can apply this new approach but I want to hear from bankers in the District on the topic. Where do you think this new approach of exemption and tailoring supervision for community banks could apply? My plan would be to receive ideas from bankers, consider if and how this new approach could be applied to the ideas submitted and report back to banks in the Ninth District in a future column.

Please send your suggestions to [mpls.src.outreach@mpls.frb.org](mailto:mpls.src.outreach@mpls.frb.org). I thank you in advance for your input.

—Ron Feldman, Executive Vice President, SRC

<sup>1</sup> For the full text of President Kocherlakota's speech, go to: [minneapolisfed.org/news\\_events/pres/speech\\_display.cfm?id=5374&](http://minneapolisfed.org/news_events/pres/speech_display.cfm?id=5374&)