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Regulatory Considerations for Banks Crossing the $10 Billion Threshold

The *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* (Dodd-Frank) brought sweeping regulatory changes to the United States financial system. As a result, the $10 billion consolidated asset threshold (the threshold) came into focus as banks had to consider the regulatory implications of crossing the threshold. More recently, the *Economic Growth, Regulatory Relief and Consumer Protection Act*, signed into law in 2018, marked the first significant reform to specific provisions implemented by Dodd-Frank and has changed the regulatory view on small and midsize banks as certain regulatory requirements of the past are no longer required for institutions crossing the threshold in assets, *e.g.*, DFAST requirements.[1] Although each prudential bank regulator views this asset threshold differently from a supervisory perspective, institutions are tasked with understanding the new regulatory scope, which includes heightened expectations from the regulators and regulatory compliance changes. Many processes are much the same, but there are several notable changes institutions can expect.

CFPB Becomes the Primary Compliance Regulator

An important change for institutions is the introduction of the Consumer Financial Protection Bureau (CFPB) as the primary regulator for consumer compliance supervision and enforcement. Title X of Dodd-Frank created the CFPB as an independent agency within the Federal Reserve Board of Governors to regulate consumer financial products and services under federal consumer financial laws.[2] The CFPB examination process is not drastically different from the process of other prudential regulators. However, with 19 consumer financial protection rules and regulations under its rule-making authority, institutions should prepare for the CFPB perspective on banking regulation, which is narrowly focused on an institution's ability to detect, prevent, and correct practices that present a significant risk of violating the law and causing consumer harm.

Regular examination schedules for large depository institutions and affiliates will depend on two considerations: (1) an assessment of risks to consumers and (2) ensuring consistency with statutory requirements that CFPB and prudential regulators coordinate.[3] The primary focus of the CFPB compliance examination entails evaluating compliance with relevant consumer financial laws, gathering information about company activities and compliance systems or procedures, and detecting and assessing risks to consumers.[3] Depending on the nature of the institution's operations, the CFPB will generally perform the following actions during an exam:

- Collect and review available information, from within CFPB, from other federal and state regulators, and public sources about the company and its activities, consistent with statutory requirements.
- Request and review supplementary documents and information from the entity to be examined.
- Conduct on-site interviews and review additional documents and information provided by the company.
- Consult if the examination indicates potential unfair, deceptive, or abusive acts or practices; discrimination; or other violations of the law.
- Draw preliminary conclusions about the institution's compliance management and overall statutory and regulatory compliance.

With this in mind, an institution should ensure that adequate time and resources are invested in a compliance management system appropriate for the institution's size and sophistication and is tailored to the products and services offered.

[1] https://www.congress.gov/115/plaws/publ174/PLAW-115publ174.pdf
[2] https://www.congress.gov/111/plaws/publ203/PLAW-111publ203.pdf
[3] CFPB Supervision and Examination Manual – CFPB Supervision and Examination Process Overview

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In addition to regular examinations within the supervisory cycle, the CFPB maintains the authority to conduct target and horizontal reviews. Typically, target reviews involve a single entity with the scope focusing on a particular situation, *e.g.*, a significant volume of customer complaints in an area, or a specific concern that has come to CFPB's attention. In contrast, horizontal reviews look across multiple entities to analyze issues arising from particular products or practices.[4]

While the process is much of the same, a proactive way to prepare for a CFPB examination is to perform a regulatory compliance readiness review. This exercise can assist in understanding the current state of the compliance management system (CMS) and identifying gaps or potential weaknesses that could draw the attention of the regulators. In addition, management will have an opportunity to identify areas where short-term actions may be taken, familiarize itself with the CFPB supervision process and expectations, and train staff on how to respond to requests for information, interviews, and other exam activities in a timely and professional manner, as well as develop action plans to address long-term needs.

Continuous Supervision

Banks can expect a more significant and frequent presence from regulators comprised of full-scope and targeted reviews and a variety of off-site monitoring activities. As previously noted, each prudential regulator views the threshold differently. Contingent upon the primary regulator, institutions crossing the threshold will be appointed a dedicated examiner that maintains a presence at the institution. With this in mind, the regulatory dynamic for the institution could be impacted; therefore, banks must ensure that sufficient resources are allocated across the organization to ensure that the enhanced demands of the regulators are met while balancing the daily needs of bank operations and the institution's risk identification and compliance program.

Increased Regulatory Scrutiny/Risk Management & Compliance Focus

The regulatory expectations of institutions in this asset group are generally aligned across each of the regulators, as the sophistication and complexity of operations is the driver of an institution's risk profile. Traditionally, banks of all sizes have been expected to maintain appropriate risk management processes and systems commensurate to their size and complexity and operate in a safe and sound manner, so this is nothing new. This could encompass a separate board risk committee or, at a minimum, a subcommittee of directors, which is responsible for enterprise risk management (ERM) issues and activities. Board and senior management oversight is a key focus area, as well as risk monitoring and management information system (MIS) reporting. The support of the board is critical to understanding risk areas, developing training programs, and establishing roles and responsibilities among leadership and risk management team members. A formal discussion on risk management is available in SR Letter 16-11, Supervisory Guidance for Assessing Risk Management at Supervised Institutions with Total Consolidated Assets Less than $100 Billion.[5] Below are fundamental guiding principles and leading practices a bank may consider as it crosses the threshold:

- A board-approved risk appetite statement should be based on guiding principles, including soundness, profitability, and sustainable growth.
- The board should be actively engaged and oversee the institution’s risk level by approving overall business strategies and significant policies.
- The institution's management information systems should provide the board with sufficient information to identify the size and significance of the risks.
- Transparent and well-understood policies, procedures, and standards, including limits designed to prevent excessive risk-taking, should be developed, reviewed, and approved periodically.

[4] CFPB Supervision and Examination Manual – CFPB Supervision and Examination Process Overview

[5] https://www.federalreserve.gov/supervisionreg/srletters/SR1611a1.pdf

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- The executive leadership team should be responsible for establishing and maintaining an effective system of controls, including the enforcement of official lines of authority and the appropriate segregation of duties.
- Senior management should identify, and review risks associated with engaging in new activities or introducing new products to ensure that the necessary infrastructure and internal controls are in place to manage related risks.
- Develop a tailored operational risk management framework that houses internal and external loss data, risk assessments, scenario analysis results, key risk indicators (KRIs), and emerging risks, among other items.
- Training in risk management and emerging risks should be a continuous process and ongoing for all bank positions.

Many institutions face increased regulatory scrutiny and experience more frequent examinations from regulators once they cross the threshold. Significant changes to an institution's operations may come about due to new regulatory requirements. As a result, banks must analyze the long-term repercussions of crossing the threshold and the possible impacts on bottom-line profitability. Proactive preparation, well in advance of this milestone, will help ensure that an institution is well equipped to manage impending changes or regulatory risks.

The Impacts of the Durbin Amendment

Another notable change for banks is the loss of interchange fees, which are capped by the Federal Reserve under Section 1075 of Dodd-Frank, also known as the Durbin Amendment. In response, some banks have adjusted business practices to offset the anticipated loss in income through various means, the introduction of new checking account fees being one example. While there is no one-size-fits-all approach of adhering to these provisions, banks must carefully consider the compliance implications of new product offerings and price and fee changes to existing products to ensure they are not regarded as unfair, deceptive, or abusive.

Additional Considerations & Regulatory Impacts

In addition to the items mentioned above, banks crossing the threshold will need to be aware of additional regulatory considerations contingent upon several variables and the activities undertaken by the institution. While not an encompassing list, we highlight a few items below:

- **Deposit Insurance**: Banks crossing the threshold are assessed under the large bank scorecard
- **Volcker Rule**: Several changes, including but not limited to, community bank leverage ratio and proprietary trading prohibition
- **Bank Holding Company**: Increased supervision of holding company, which is now designated as large per FFIEC definition
- **Management Interlocks**: Limits the ability of a bank manager or director to work for more than one unaffiliated bank at a time

Conclusion

Passing the threshold brings about significant implications for institutions in several ways. Despite the passage of legislation that has lessened the regulatory burden, heightened expectations remain. The introduction of a new primary compliance regulator increases costs and pressures on revenue and adds regulatory presence, among other influences, potentially impacting the entire organization. Preparing for these changes is a complex undertaking requiring time and a concerted effort. The following are some proactive steps an institution can take to prepare for the journey of crossing the threshold:

Plan your timeline to reach the threshold. Banks approaching or planning for the threshold should analyze various growth scenarios. Management will play a key role during this process and in deciding the bank's overall growth strategy. No matter the decision, the stakeholders must carefully consider the costs of crossing the threshold, especially in the following areas: higher FDIC assessment costs, interchange fee income reductions due to the Durbin Amendment, data management, and the cost of complying with enhanced supervisory standards.

Conduct a current- and future-state assessment. Management should conduct an

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assessment to gain an understanding of the bank's current state and where risk management or compliance gaps may exist. When performing the assessment, particular consideration should be given to enhanced data production, storage requirements, and reporting requirements in light of crossing the threshold. The gap between current capabilities and regulatory expectations must be identified. Along those lines, management should develop plans for remedial action where gaps are noted. These assessments will also help ensure an institution has the right mix of talent, processes, and technology to succeed.

Enhance your complaint management system and review process. Banks should ensure that their complaint management system and internal processes are well developed, as this is a critical component of an effective compliance management system. Moving to a formalized complaint tracking system is a proactive step a bank can take in anticipation of CFPB oversight.

Obtain assistance. If the regulatory requirements and expectations appear too complex or time-consuming for an institution, utilizing a professional at **FORVIS** can help ensure an institution has the appropriate guidance and skilled resources needed to help achieve its goals. FORVIS can also provide an independent perspective on an institution's processes and preparedness for crossing the threshold, which can be critical for senior management during the decision-making process.

The risk advisory professionals at FORVIS have performed regulatory and compliance assessments across many global financial institutions of various asset sizes. Our approach is developed and executed by our diversified team comprised of former regulators as well as industry professionals that stand ready to help clients navigate complex requirements, organizational structures, and technological obstacles to deliver industry-leading and efficient regulatory strategies.

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