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Risk Management through Analytics and Third-Party Oversight

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Agenda

- Third Party Service Providers (TPSPs) and Regulatory Expectations
- Industry-Specific TPSP Issues
- TPSP Oversight and Your Compliance Management System (CMS)
- TPSP Scrutiny from Partners

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TPSPs and Regulatory Expectations - Overview

- Definition and scope of TPSPs in financial services
- Importance of robust TPSP oversight in maintaining compliance and protecting customers
- Reference: CFPB Guidance on Service Providers

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TPSPs and Regulatory Expectations – CFPB

- **CFPB Bulletins 2012-03 and 2016-02**
  - 2012-03: Outlines the expectation that supervised banks and nonbanks manage the risks of service providers by establishing consistent oversight and accountability (CFPB Bulletin 2012-03)
  - 2016-02: Reinforces the requirement for comprehensive oversight, including monitoring and training TPSPs to ensure compliance with federal consumer financial laws (CFPB Bulletin 2016-02)
- **Examination**
  - How CFPB examines supervised entities for TPSP compliance, focusing on adherence to applicable laws and policies
  - Common examination findings and areas of focus
  - Reference: CFPB Supervision and Examination Manual
- **Enforcement**
  - Case studies and penalties resulting from non-compliance, illustrating the consequences of failing to manage TPSP risks effectively
  - Strategies for mitigating enforcement risks, including enhanced due diligence and ongoing monitoring

TPSPs and Regulatory Expectations – Prudential Regulators

- **What is the latest banking regulator guidance on the topic of third-party risk management?**
  - On June 6, 2023, the FRB, FDIC, and the OCC issued the Final Third-Party Guidance.
  - Framework based on sound risk management principles for banking organizations, taking into account the level of risk, complexity, and size of the banking organization along with the nature of the third-party relationship.
  - The agencies have each previously issued general guidance for their respective supervised banking organizations to address appropriate risk management practices for third-party relationships, each of which is rescinded and replaced by the Final Third-Party Guidance: the Board's 2013 guidance.

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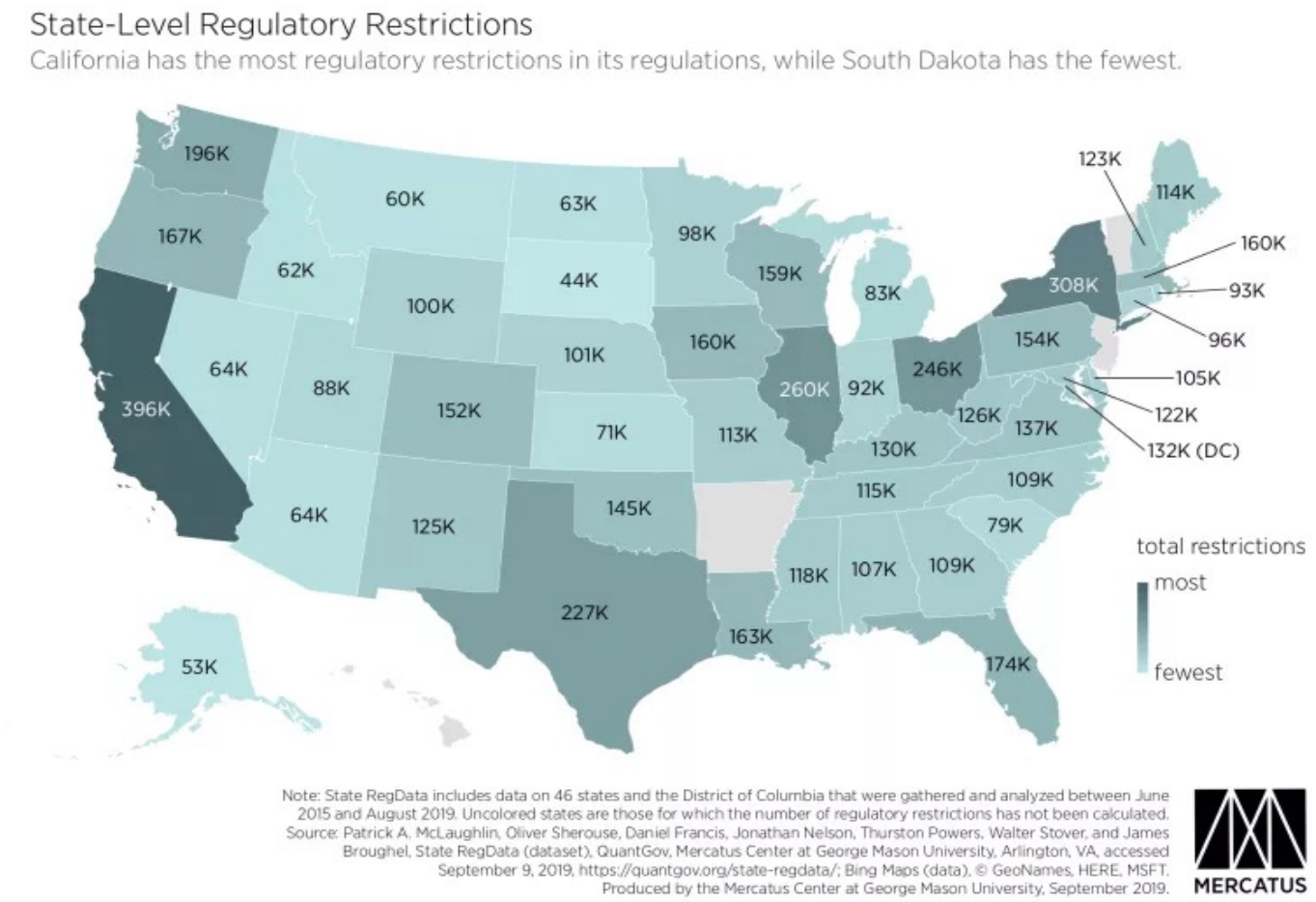
TPSPs and Regulatory Expectations – FDIC Oversight and Enforcement

- **Key lessons from recent FDIC consent orders** involving TPSPs, including the importance of compliance and risk management.
  - **Cross River Bank, Teaneck, NJ**: Enforcement action focused on deficiencies in managing risks related to TPSPs (FDIC Consent Order, July 2021).
  - **MetaBank, Sioux Falls, SD**: Issues related to the oversight of service providers and corrective actions mandated by the FDIC (FDIC Consent Order, March 2022).
  - **Umpqua Bank, Roseburg, OR**: Consent order highlighting the need for better vendor management practices and compliance measures (FDIC Consent Order, May 2023).
  - **Bancorp Bank, Wilmington, DE**: Focus on compliance gaps in managing third-party relationships and required remediation steps (FDIC Consent Order, January 2023).

TPSPs and Regulatory Expectations – State Regulatory Considerations



Note: State RegData includes data on 46 states and the District of Columbia that were gathered and analyzed between June 2015 and August 2019. Uncolored states are those for which the number of regulatory restrictions has not been calculated. Source: Patrick A. McLaughlin, Oliver Sherouse, Daniel Francis, Jonathan Nelson, Thurston Powers, Walter Stover, and James Broughel, State RegData (dataset), QuantGov, Mercatus Center at George Mason University, Arlington, VA, accessed September 9, 2019, https://quantgov.org/state-regdata/; Bing Maps (data), © GeoNames, HERE, MSFT. Produced by the Mercatus Center at George Mason University, September 2019.

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TPSPs and Regulatory Expectations – State Regulatory Considerations

- **Licensing Laws**
  - Is the TPSP required to be licensed and actually licensed?
- **Consumer Lending Laws**
  - If outsourcing certain lending functions, does the TPSP comply with relevant state consumer lending laws?
  - Examples:
    - KYC/CDD obligations
    - Fair lending laws
    - Loan agreement and disclosure requirements
    - Marketing and advertising laws
    - Telephone consumer protection laws
- **Consumer Data Privacy Laws**
  - Does the TPSP comply with state data privacy and cybersecurity laws?
  - Examples:
    - California Consumer Privacy Act
    - New York Department of Financial Services Cybersecurity Regulation Part 500

TPSPs and Regulatory Expectations – State Regulatory Considerations

California Privacy Enforcement Actions

- **Equifax, 2019 ($600 million) –** data breach occurred after failure "to apply a critical software fix and implement security measures, including encrypting consumer Social Security numbers."
- **Wells Fargo Bank, 2016 ($8.5 million) –** recording consumer calls without timely disclosure
- **Citibank, N.A., 2013 ($475,000) –** breach of online website
- **Google, 2023 ($93 million) –** location data used to for profiling and advertising purposes without consent
- **Glow, Inc., 2020 ($250,000)** – medical app found to have "clear basic security flaws that put its users' data at risk."
- **Aaron's, Inc., 2014 – ($28.5 million)** – Allegations that the company "permitted its franchised stores to install spyware on laptop computers rented to customers without their knowledge or consent, as well as charging improper late fees, overcharging customers who paid off contracts early and omitting important contract disclosures."

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TPSPs and Regulatory Expectations – State Regulatory Considerations

New York Part 500 Enforcement Action Findings

- **Business continuity and disaster recovery planning and resources**
  - Business impact analysis
- **Limitation of user access privileges to information systems**
  - Manual review of access privileges
  - Shared Accounts
  - Default Passwords
  - Storage of Passwords
- **Security of Information Systems and NPI that are accessible to, or held by, TPSPs**
  - Beginning work prior to completion of onboarding process
  - Adjusting risk scores
  - Enhancing TPSP policies and procedures and TPSP due diligence processes

Industry-Specific TPSP Issues - Overview

- AI and “Big Data”
- Data Providers and Data Aggregators
- Servicing and Collections
- Lead Generation

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Industry-Specific TPSP Issues – AI and "Big Data"

Overview

Big Data and AI are used to systematically analyze vast and diverse datasets in order to extract insights, patterns, trends, and correlations to gain a competitive edge.

- **Big Data:** collects, stores, and manages data efficiently with a focus on infrastructure and tools necessary to handle large datasets
- **Artificial Intelligence:** revolves around creating algorithms and models that can learn from the data and perform intelligent tasks.

Uses for Big Data and AI

- Developing a strategic marketing plan
- Customer and application data verification
- Credit underwriting
- Chatbots

Industry-Specific TPSP Issues – AI and "Big Data"

AI and Big Data Concerns

- Bias in data processing and decision-making algorithms
- Ethical use of big data

Considerations when contracting with TPSPs

- How does the TPSP protect data?
- What systems are in place to mitigate biases in data collection?

Regulatory Guidance

- CFPB Guidance on Chatbots, June 2023
- CFPB Guidance on Credit Denials, September 2023
- CFPB Guidance on Home Appraisals, June 2024
- CFPB Circular 2022-03: Adverse Action Notifications for credit decisions based on complex algorithms

Industry-Specific TPSP Issues – Data Providers and Data Aggregators

- **Data Accuracy and Quality:** Ensuring accuracy and quality of the data provided by third-party providers. Inaccurate or outdated data can lead to incorrect business decisions and regulatory non-compliance.
- **Privacy and Security Concerns:** Robust cybersecurity measures to protect against data breaches and unauthorized access.
- **Regulatory Compliance:** Audits and assessments to ensure that data handling practices meet regulatory standards
- **Data Integration and Compatibility:** Employing standardized data formats and APIs can help mitigate integration issues.
- **Transparency and Ethical Use of Data:** Clear communication about how data is collected, processed, and used is necessary.

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Industry-Specific TPSP Issues – Servicing and Collections

When contracting with a TPSP to conduct loan servicing and debt collection, the lender must ensure the TPSP follows fair and lawful practices.

Examples of Applicable Laws

- Fair Debt Collection Practices Act (FDCPA)
- Unfair, Deceptive, and Abusive Acts and Practices (UDAAP)
- State Debt Collection and UDAAP Laws

Industry-Specific TPSP Issues – Lead Generation

- Risks and compliance issues with TPSPs providing lead generation services, focusing on transparency, consent, and data handling practices.
- Best practices for ensuring responsible and compliant lead generation, including monitoring of marketing activities and third-party disclosures.

Be mindful of:

- Compliance with financial regulations
- Data privacy and security
- Quality and accuracy of leads
- Transparency and ethical practices
- Integration with CRM systems

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TPSP Oversight and Your Compliance Management System (CMS) – Overview

- Overview and Implementation
- Creating a Risk-Based Approach
- "Managing the Business" – Practical Realities of In-House Life
- For Your Consideration: “A Three-Tiered Approach”
- Issues in Contracting with TPSPs and Regulatory Expectations

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TPSP Oversight and Your CMS – Overview and Implementation

A lender must integrate TPSP management into its overall CMS framework to ensure continuous compliance and risk mitigation when using TPSPs.

- Steps to establish an effective TPSP oversight program include:
  - Development of policies, procedures, and internal controls for TPSP management
  - Allocate resources to TPSP management
  - Conduct risk assessment when onboarding a new TPSP or a new TPSP service
  - Conduct ongoing training
  - Conduct ongoing monitoring and audits of the lender's TPSP Oversight Program

TPSP Oversight and Your CMS – Creating a Risk-Based Approach

Risk Assessment Process

- **Identify risks of different TPSPs based on their functions**
  - Will the TPSP be involved in critical operations?
    - Does the TPSP have access to sensitive data?
    - Does the TPSP process transactions?
    - Does the TPSP provide essential technology or business services?
  - What legal requirements are applicable to the services provided by the TPSP?
  - Will the TPSP have direct contact with consumers?
- **Analyze and prioritize risks**
  - Can the risks can be prevented?
  - If risks cannot be prevented, how can risks be effectively monitored and mitigated?
  - What is the impact of the risk on customers and the lender's financial condition or operations?

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TPSP Oversight and Your CMS – Creating a Risk-Based Approach

- **Implement risk mitigation and controls**
  - Tailor oversight activities based on the TPSP's risk profile (*i.e.*, high-risk vendors receive more intensive monitoring)
- **Track risk and effectiveness of controls**
  - Analyze TPSP performance based on risk assessment results and controls implemented to mitigate risks
  - Conduct risk assessments periodically to determine if the risk rating of a current TPSP or TPSP service has changed
  - Conduct Quality Assurance review of oversight activities
- **Make adjustments as needed**
  - Periodically review policies, procedures, internal controls, and training to account for changes in risk and changes in legal requirements
  - Update risk assessment process based on results of TPSP performance

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TPSP Oversight and Your CMS
"Managing the Business" - Practical Realities of In-House Life

Early Engagement

- Involve compliance early in the vendor selection process to align with strategic goals and regulatory requirements
- Best practices for early-stage TPSP vetting

Factual Accuracy of Diligence

- Ensure accuracy and completeness in due diligence processes to avoid costly mistakes and regulatory scrutiny
- Common pitfalls in due diligence and strategies to mitigate them

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TPSP Oversight and Your CMS
For Your Consideration: "A Three-Tiered Approach"

First: Contracting

- Crafting contracts that enforce compliance and performance expectations, including detailed roles, responsibilities, and penalties for non-compliance
- Key contractual clauses and provisions for TPSP management, such as audit rights, data security requirements, and exit strategies.

Second: Due Diligence

- Comprehensive due diligence practices for TPSP onboarding, including financial stability assessments, compliance history reviews, and capability evaluations
- Tools and techniques for effective TPSP evaluation, such as questionnaires, site visits, and reference checks

Third: Information Security

- Ensuring TPSPs adhere to robust information security standards to protect sensitive data and maintain operational integrity
- Incorporating cybersecurity assessments into the TPSP lifecycle, including penetration testing and compliance with frameworks like NIST and ISO 27001

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TPSP Scrutiny from Partners - Overview

- Diligence and Onboarding
- Monitoring and Audit
- Current Regulatory Environment

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TPSP Scrutiny from Partners– Diligence and Onboarding

- **Regulatory and Compliance Checks**: Ensure that third-party providers comply with relevant regulatory requirements such as GLBA and the BSA. Detailed compliance checks are critical during the onboarding process to avoid future legal and compliance issues.
- **Risk Assessment and Management:** Comprehensive risk assessments are necessary to identify potential risks associated with third-party providers. This includes evaluating financial stability, cybersecurity measures, and operational risks. Effective risk management frameworks must be established before onboarding.
- **Contractual Agreements and SLAs:** Clear contractual agreements and Service Level Agreements (SLAs) must be established to outline expectations, performance metrics, and penalties for non-compliance. This ensures accountability and sets the standard for the level of service expected from the third-party provider.

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TPSP Scrutiny from Partners – Monitoring and Audit

TPSP Scrutiny from Partners – Current Regulatory Environment

- **Constantly Evolving Regulations:** Regulatory requirements for banking and third-party relationships are continually changing, necessitating ongoing awareness and adaptation. Staying updated on new laws, guidelines, and enforcement actions is crucial to maintaining compliance
- **Complex Compliance Obligations:** Banks and their third-party providers must navigate a complex web of federal and state regulations.
- **Heightened Focus on Cybersecurity and BSA/AML:** Third-party providers must stay updated with evolving data privacy regulations and BSA/AML protocols.
- **Enhanced Due Diligence Requirements:** Regulators are emphasizing the importance of thorough due diligence and continuous monitoring of third-party providers.

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Thank You

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