

## **Reasonable Procedures and Other Compliance Issues that Continue to Shake Us Up**

The American Bankers Association recently held its 2010 Regulatory Compliance Conference in San Diego, California. Except for the 5.7 magnitude earthquake on the evening of June 14<sup>th</sup> it was an excellent conference focusing on several key issues that, if neglected, can (pardon the pun) put financial institutions on shaky ground.

### **Risk Assessment/Risk Management**

The phrase heard most often at the conference was "risk assessment." A related term, risk management, has become a standard phrase in banking vocabulary. More and more laws and regulations require a risk-based approach with the development of reasonable policies and procedures to ensure compliance. Bankers often struggle with the term "reasonable."

This is where the risk assessment becomes critical. In order for a bank to demonstrate to examiners that its policies, procedures, and internal controls are reasonable, the bank must develop a process to determine the level of risk connected to that product or activity. That process is the risk assessment. While there are many different ways to go about conducting a risk assessment, at its core a risk assessment requires a determination of the likelihood of damage and the level of damage. For example, the likelihood that an employee might occasionally throw a piece of paper with confidential information into the trash rather than shredding it is relatively high, but the potential level of damage from such an event is relatively low. On the other hand, the likelihood that a hacker will penetrate a bank's firewalls and access customer PINs is probably very low, but the damage that would occur if such a breach did occur could be catastrophic. Based upon those risk assessments, a bank would establish reasonable policies, procedures, and internal controls to minimize risk.

Some bankers have an intuitive approach to risk management based upon their experience over the years. The problem is that while the resulting policies, procedures, and internal controls may in fact be reasonable, there is no evidence of how that determination was made. During the conference a federal banking examiner from Tennessee stated that in her opinion if the bank can't prove how it determined the level of risk, how can it prove that it is adequately protecting itself against that risk? Documentation of the process is critical.

### **Fair Lending**

A second major theme of the conference was the resurgence of fair lending as a major "hot topic" in examinations. Nationwide, referrals to the Department of Justice from examiners are up. Fair lending is clearly a priority of the current administration with a new fair lending task force having been created in January 2010 and a significant increase in staff at the Department of Justice dedicated to fair lending reviews. Among the biggest issues today in fair lending are denial disparity rates. Subjective underwriting can often cause a problem, with criteria such as "character and reputation" receiving a high degree of scrutiny. Another potential problem is discretionary pricing. While risk based pricing is legal, allowing different lenders to price similarly qualified applicants in the same market in different ways can lead to a form of fair lending violation known as disparate impact, where a prohibited basis group receives credit on less favorable terms or is denied credit

more often, regardless of there being no intent to discriminate against the group.

## Social Media

A third issue that received a great deal of attention at the conference was the use of social media like Facebook, Twitter, and MySpace. More and more financial institutions are using social media for advertising. Those institutions must be careful to follow the applicable advertising compliance requirements, and providing the applicable disclosures when there is a trigger term can be challenging given the limited space available. Many employees also use social media. Financial institutions should strongly consider having policies in place regarding the use of both the bank's social media and the use of personal social media for matters that involve bank business. In addition to having a policy, banks should consider training and monitoring for compliance.

If Miller & Martin can assist your institution in any of these matters, please contact T. [Wayne Hood](mailto:whood@millermartin.com) at [whood@millermartin.com](mailto:whood@millermartin.com) or (615) 744-8421; [Beth Sims](mailto:bsims@millermartin.com) at [bsims@millermartin.com](mailto:bsims@millermartin.com) or (615) 744-8490; or [Adam Smith](mailto:agsmith@millermartin.com) at [agsmith@millermartin.com](mailto:agsmith@millermartin.com) or (615) 744-8573; or any member of Miller & Martin's [Financial Institutions Practice Group](#).

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