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"WHAT WAS THAT YOU SAID...A COMPLIANCE EXAMINATION?"

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Webster's New World College Dictionary defines "compliance" as, "a complying with or giving in to a request, wish, or demand; acquiescence" or "a tendency to give in readily to others." The term "compliance" however carries a very specific meaning for financial institutions, and generally refers to the fact that financial institutions must comply with state and federal law. Compliance examinations are the primary means for the state and federal regulators to determine violations of laws and regulations, and the strength of the institution's compliance program.

One of the basic economic pillars of financial institutions like any for-profit business enterprise, is that they are not sustainable if they are required to expend more money than they are able to take in. Unfortunately that is exactly what compliance departments do for banks – money is expended on compliance programs, but there is no immediate increase of the "bottom line." With that said, the hoped-for "return" of a well-run compliance program is a more favorable report of examination and hopefully a higher rating (these ratings are themselves confidential). An argument can and should be made, however, that in having a rigorous compliance program, the benefits also include greater consumer confidence and reduced reputational risks.

Section 655.045(1), Florida Statutes, prescribes that state chartered financial institutions be examined by the State of Florida Office of Financial Regulation ("OFR") at least every 18 months. While the Federal Deposit Insurance Corporation ("FDIC") conducts the compliance examination, the OFR may concurrently conduct its own safety and soundness examination in conjunction with the FDIC. The frequency of these examinations can be increased or decreased depending on a variety of factors ranging from prior examination results, to whether the institution made any significant changes in its operations, to the financial institution's rating.[1] The examination can be a lengthy and intrusive process in which the examiners comb through the books and records of the institutions.

The compliance examination is driven in part to prevent consumer harm. Thus, the examination focuses typically on the areas where compliance errors pose the greatest potential for consumer harm. The examination will naturally then focus on the financial institution's internal control mechanisms and methods of ensuring compliance with federal and state consumer protection laws and regulations. This is also being undertaken to determine not only whether the compliance program has complied since the prior examination, but also whether the compliance program is robust enough to address future compliance issues that may arise. Some of the issues that an examiner may be interested in reviewing include: board and management oversight to determine the level of commitment and oversight of the institution's Compliance Management System and the level of resources dedicated to compliance functions (essentially, is the board and management sufficiently involved in the institution's compliance efforts?); and, the actual compliance program – is it robust enough to address state and federal requirements and does is it go far enough to address potential consumer harm?

In my capacity as the former General Counsel of the OFR, financial institutions were encouraged to be careful and proactive in their compliance efforts, and not wait until they had to revise and address compliance deficiencies after having received a less than favorable report of examination from the federal examiner. [2] It is important to note that the reports of examination are confidential in nature, the contents of which should not be revealed, except as it may relate to the Community Reinvestment Act which is open for public comment.

While the trepidation of being involved in a compliance examination is understandable, it is also healthy for the financial institution to get a full view of what is occurring with its business practices. Quite often many directors are appreciative of the examination's findings because they are afforded the opportunity to fix issues with which they may not have been fully aware, and that may prove problematic to the regulators or which could negatively impact consumer confidence or the institution's reputation.

So in the end financial institutions need to ensure that they have an adequate compliance management system in place and either a sound internal compliance department or outside counsel who can assist in compliance examinations and a variety of compliance related matters.

For more information on this topic, please contact the author, Colin Roopnarine, on the firm's Government and Regulatory Team.

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[1] The financial institution's rating is referred to the confidential CAMELS rating system which is described as follows (on a scale of 1 to 5 for each category, and an overall score of 1 and 2 indicates an institution with the fewest concerns for regulators; 3 is of concern; 4 is an institution with higher problems; and, 5 which could indicate that an institution will fail within 12 months) :

- Capital adequacy, as in the quality and amount of capital a bank can access.
- Asset quality, which looks at a bank's credit and how it identifies risk.
- Management quality is concerned with the quality of a bank's support and oversight.
- Earnings, which explores how stable a bank's earnings are.
- Liquidity refers to how quickly a bank can turn assets into cash.
- Sensitivity to market risk, which explores how sensitive the bank's earnings are to adverse developments in the market, such as a sudden change in interest rates.

[2] The OFR as state regulator relies on the FDIC report while it prepares its own which focuses on the safety and soundness of the institution.

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