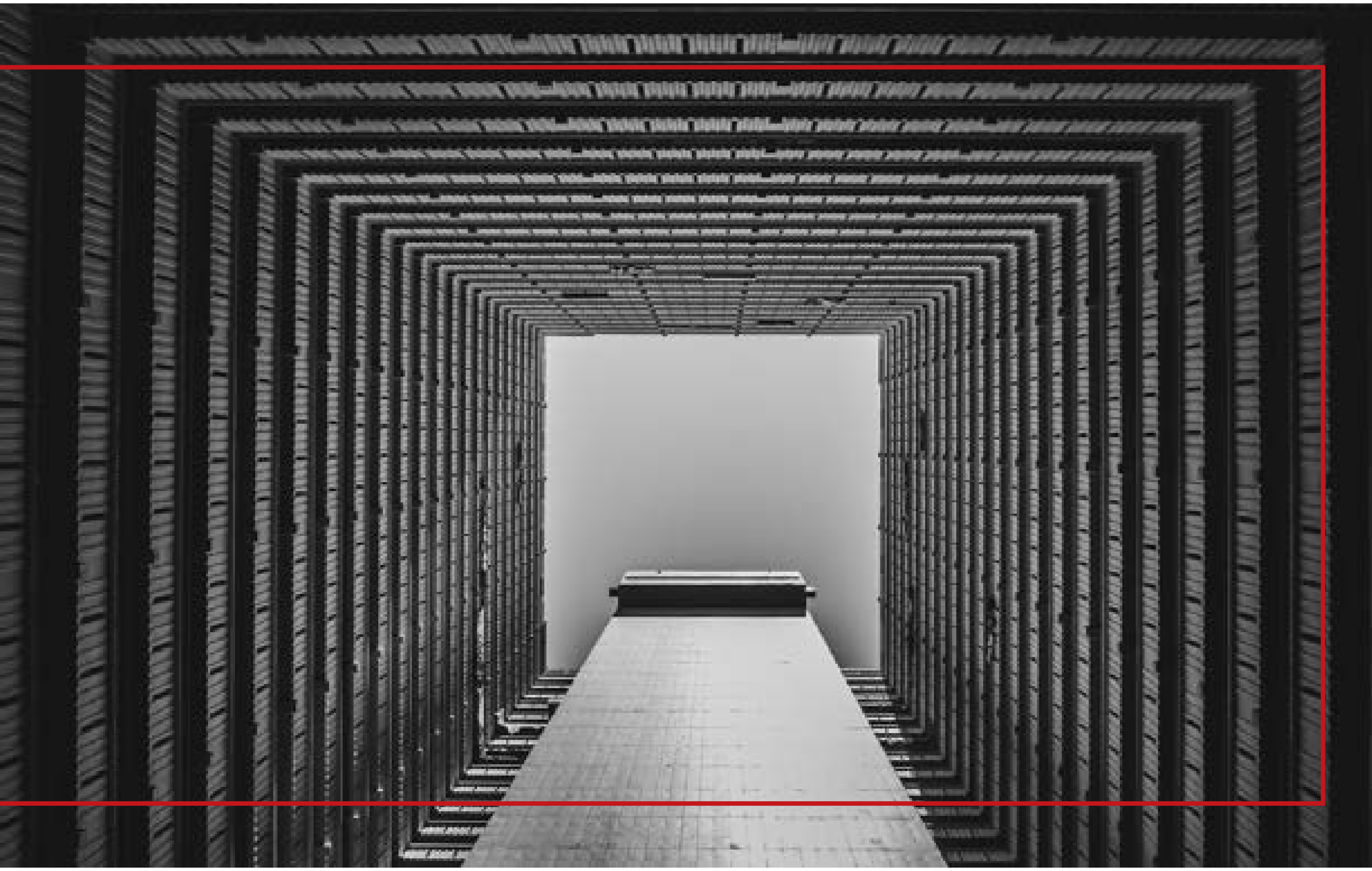
FINDING THE SILVER LINING IN CUSTOMER COMPLAINTS



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IN THIS ISSUE

EDITORIAL NOTE FROM THE MANAGING PRINCIPAL, CENTER OF REGULATORY INTELLIGENCE

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Peter has more than 16 years of government and consulting experience in advising clients on supervisory matters before the U.S. government and in the implementation of enterprise risk management programs. He is a thought leader in government affairs and regulatory strategies in support of banks' and financial institutions' compliance with the Dodd-Frank Act and Basel Accords. Prior to joining Capco, he served as a director of government relations at Clark Hill and in senior government positions, including serving as a deputy assistant secretary at the United States Department of the Treasury.

There are few people who enjoy receiving criticism. Those who do view it differently — criticism to them is constructive feedback, an opportunity to strengthen and grow. For those of us in the financial services industry, consumer complaints and inquiries can be even more dreaded than personal criticisms, because a single complaint can, in some cases, lead to legal repercussions, regulatory action or reputational damage. However, just like individuals who can turn criticism into growth opportunities, financial institutions can learn and evolve through proper complaint processing and analysis, and not only use the feedback to inform compliance systems and avoid regulatory violations, but also creating compelling competitive edges.

In this month's Regulatory Intelligence Briefing (RIB), Center of Regulatory Intelligence (CRI) delves into customer complaint processing systems. We review the impact complaints can have on an institution, and the ways in which utilizing these complaints can strengthen systems and processes. First, we look at customer complaints from a regulatory perspective before providing hands-on tips for uncovering the constructive feedback within your customers' complaints.

Our secondary article this month delves into the processes behind creating robust quality assurance (QA) and quality control (QC) programs. In today's competition-driven financial services landscape, it is essential for institutions to remain competitive, and this means ensuring quality offerings through procedures that provide for and maintain quality in products, services and operations. This article offers tips for best-in-class QA and QC to help your institution evaluate and sharpen your efforts, creating fully integrated, productive systems that support secure business development.

As always, Capco continues to monitor all relevant developments in risk and compliance. Pease let us know how these areas are affecting your institution by reaching out to us at Capco.CRI@Capco.com. ❖

REGULATORY ROUNDUP

Regulatory and Compliance Alerts

FDIC Proposes Retirement of Certain Financial Institution Letters

On September 10, 2018, the Federal Deposit Insurance Corporation (FDIC) proposed to retire certain Financial Institution Letters (FILs) to an inactive status. The proposal is part of a continuing effort to reduce regulatory burden, and would target 374 of the 664 risk management supervision-related FILs issued between 1995 through 2017. **Comments are due by October 10, 2018.**

Agencies Issue Statement Reaffirming the Role of Supervisory Guidance

On September 11, 2018, the Federal Reserve Board (FRB), Bureau of Consumer Financial Protection (BCFP or CFPB), FDIC, National Credit Union Administration (NCUA) and Office of the Comptroller of the Currency (OCC) issued a statement explaining that supervisory guidance does not have the force and effect of law, and the agencies do not take enforcement actions based on supervisory guidance.

OCC Releases Bank Supervision Operating Plan for Fiscal Year 2019

On September 25, 2018, the Office of the Comptroller of the Currency (OCC) released its bank supervision operating plan for fiscal year 2019. The plan provides the foundation for policy initiatives and for supervisory strategies as applied to individual national banks, federal savings associations, federal branches, federal agencies and technology service providers. OCC staff members use this plan to guide their supervisory priorities, planning and resource allocations.

FCA Issues LIBOR Phase-out Memo

On September 11, 2018, the Farm Credit Administration (FCA) issued an informational memorandum to provide guidance to Farm Credit System institutions on planning and preparing for the expected phase-out of the London Interbank Offered Rate (LIBOR).

FRB Amends Regulation CC Liability Provisions

On September 12, 2018, the FRB approved final amendments to the liability provisions of Regulation CC (Availability of Funds and Collection of Checks), related to situations where there is a dispute as to whether a check has been altered or was issued with an unauthorized signature, and the original paper check is not available for inspection. **The rule is effective January 1, 2019.**

CSBS Announces Intention to Pursue Litigation against OCC

On September 12, 2018, the Conference of State Bank Supervisors (CSBS) published that state financial regulators will renew their litigation efforts against the OCC regarding the agency's recent decision to create a special purpose charter for fintech firms.

CFPB and FTC Announce Free Credit Freezes and Fraud Alerts on Credit Files

On September 21, 2018, the CFPB announced that new federal law allows consumers to place free credit freezes and year-long fraud alerts on their credit files, starting September 21, 2018. The Federal Trade Commission (FTC) also issued a similar announcement. ❖

FINDING THE SILVER LINING IN CUSTOMER COMPLAINTS

Receiving customer complaints is not typically fun. For front-line staff, it can mean interacting with customers who are angry or upset. For management, the complaints can highlight mistakes or shortcomings. These complaints, however, can be uniquely beneficial if an institution utilizes the feedback correctly.

A proper complaint management system can be one of the best tools an institution has to refine its operations. Not only can complaints point out areas where an institution can improve customer satisfaction, but they are also an indicator of risk exposure. Analyzing complaints allows institutions to find gaps or omissions in policies, procedures or practices; draw attention to operational weaknesses; and, in some cases, highlight possible discrimination or inadvertent illegal practices, both in the institution's business operations and in the practices of affiliated third parties.

A RECENT REGULATORY SPOTLIGHT

CFPB

Since Dodd-Frank's passage in 2010, the Bureau of Consumer Financial Protection (BCFP or CFPB) and the Federal Reserve Board (FRB), which have joint supervisory jurisdiction over consumer complaint processing, have placed a heavy emphasis on consumer complaints. This not only means that from the consumer standpoint it is now easier than ever to file a complaint, but also that complaints are taken into consideration in rulemaking and supervision.

The CFPB has an online submission form that is user-friendly and easily navigable, and former Director Richard Cordray often used complaints as driving factors for investigations and guidance, and made clear his support of strong complaint management systems within institutions as well as the importance of a publicly available complaints database.

Acting Director Mick Mulvaney has said the CFPB will prioritize its focus on areas that drive consumer complaints, such as debt collection, credit reporting and student loan servicing. The CFPB is also reconsidering the structure and content of the publicly available complaints database. In April 2018, the CFPB issued a request for information (RFI) on the agency's consumer complaint and inquiry handling process, as part of a series of RFIs comprising a call for evidence to ensure the CFPB is "fulfilling its proper and appropriate functions."

FRB

On August 29, 2018, the Federal Reserve Board (FRB) hosted a webinar titled "Complaints as a Supervisory and Risk Management Tool." Senior Compliance Manager for the Federal Reserve Bank of San Francisco Laurie Lavaroni stated that complaints are "an important supervisory tool. They're a window into an institution… [They] help us better understand an institution's policies, practices, even strategic directions that may be undocumented or that we may otherwise miss. Sometimes, too, complaints can reveal practices that even management may not be aware of, for example, practices that may have the effect of discouraging some customers from applying for loans or when customer service staff speak to customers and use language that's 'off-script.' Put another way, a consumer complaint may raise an issue that isn't necessarily obvious or identifiable through our normal examination process."

FRB reviews complaints that concerned parties send to the agency and to other agencies, looking for trends that may require supervisory guidance. The FRB views complaints not only as a way to gauge the adequacy of an institution's compliance risk management program, but also as possible indications of consumer protection concerns that may require industry regulatory guidance.

The FRB established its complaint program in 1976. In 2017, the FRB's complaint intake center received over 10,000 written complaints and just over 20,000 inquiries. The agency is also expecting to publish a *Consumer Compliance Outlook* magazine article in the near future.

FTC Complaints Compilation: Using Multiple Data Sources and Platforms

The Federal Trade Commission (FTC) also accepts consumer complaints and keeps a complaint database, which is available only to law enforcement, and comprises complaints directly from people who call the FTC's call center or file online, as well as complaints filed with other federal, state, local and international law enforcement agencies and other organizations like business councils. In 2017, debt collection remained the top consumer complaint category, making up about 23 percent of all complaints. Identity theft was second at 14 percent, with credit card fraud and tax fraud the most common types of identity theft consumers reported.

Interestingly, the high number of debt collection complaints was due in part to reports submitted by a data contributor who collects complaints via a mobile application. One of the top-heard comments from regulators is that a low number of complaints isn't necessarily a good thing, as it could simply mean complaints are not being captured properly. The FTC's ability to pinpoint a main complaints stream in this case implies that it might be prudent to investigate alternative methods for submitting complaints, such as mobile apps, to ensure consumers have ready access to complaint programs and remediation services.

THE GOALS OF COMPLAINT SYSTEMS

Both individual institutions and regulating agencies maintain complaint management systems. While there is overlap in the intention and outcome of these programs, there are differences in overall goals.

Historically, institutions have used complaints to serve a few purposes:

1. Address customer dissatisfaction with products and/or services
2. Show the institution's examiners that the institution is responsive to its customers
3. Provide the financial institution an opportunity to correct a perceived or actual regulatory violation
4. Identify the need for enhanced or specialized employee training
5. Build customer loyalty

In its regulatory efforts, the CFPB uses complaints to:

1. Identify exposures in functional areas and target exam activities accordingly
2. Evaluate the adequacy of the financial institution's compliance management program
3. Assess the risk reporting to the board of directors and senior management

Additionally, the FRB outlined three complaint investigation process goals:

1. Safeguard the rights of consumers
2. Ensure prompt and consistent responses to consumer complaint against entities the FRB regulates
3. Provide a means to identify banks' acts or practices that may require further investigation and possible regulatory action

HOW REGULATORS HANDLE COMPLAINTS

For regulatory agencies, a single complaint can spur testing for consumer harm — especially if it turns out the root cause for the complaint affects multiple customers. Multiple complaints can also spark investigation, and either type of investigation can (1) provide data for an examination or (2) serve as a "health check" between exams, verifying the ongoing adequacy of a bank's risk management program. The FRB specifically stressed that looking into complaints can help the agency determine an institution's awareness of or sensitivity to consumer harm by:

- Evaluating product management and materiality
- Applying a risk-focused approach to supervision, as examiners will focus on complaints about products, services and areas that are considered material to the institution
- Finding issues that may pose the highest risk to the institution, such as those in fair lending, the CFPB's Unfair, Deceptive, or Abusive Acts or Practices (UDAAP) or the Federal Deposit Insurance Corporation's Unfair or Deceptive Acts or Practices (UDAP)

After investigating a submitted complaint, the FRB drafts a letter to the consumer addressing each issue raised and explaining if there was any violation of any consumer protection law or regulations, or any bank error, and what recourse was taken, if any. The agency strives to make the complaint process a learning opportunity for parties who submit complaints, and to provide a fair, independent review of the situation.

CA 13-19, "Community Bank Risk-Focused Consumer Compliance Supervision Program," dated November 18, 2013, states the FRB must consider complaints and their pertinence during any supervisory event when reviewing product management, and also for fair lending and UDAP/UDAAP purposes. Complaints can be a view into consumer perceptions of, and potential problems related to a bank's products, services and operations.

Specifically, complaints can:

- Show changes that may have occurred in a bank's purpose
- Reveal cracks in a bank's risk management armor
- Make the FRB aware that a bank is going in a new direction, or is offering new products or services
- Highlight a bank's emerging risks
- Show sore spots in consumer interactions
- Depict management's awareness, sensitivity and proactiveness in managing potential risk areas
- Expose risk in any of the four pillars of risk management: senior management and board oversight; policies, procedures and training; monitoring and management information systems; and internal controls

An FRB examiner's report must also scope the "pertinence" of complaints, including a discussion of quantity, type and resolution. Pertinence depends on a bank's environment; business focus; and volume, nature and outcome of complaints. FRB will look for the root cause of a problem to assess whether there is a systemic issue or pattern of consumer harm. This means that while a large volume of complaints related to a specific issue will matter, the FRB will consider substance over volume, and a single complaint will also be taken seriously as it may reveal a particular risk. Additionally, FRB will consider how the bank addressed the issue. Some issues make a complaint pertinent, in other words, inherent risk may be higher in these categories, regardless of complaint volume:

- UDAP/UDAAP
- Discrimination (lending and deposit) allegations
- Federal consumer protection law violations
- Bank errors (e.g., consistent software and/or vendor management issues, front-line staff misinformation)
- Community Reinvestment Act (CRA)-specific, which a bank generally must also retain in its CRA public file and could have other implications

CC Rating System

FFIEC Consumer Compliance Rating System (CC Rating System) requires supervisory agencies to assess how well an institution's complaint system operates. This is one of FFIEC's 12 rating determination factors. There are two consideration levels:

"Responsiveness"

- A more consumer-focused review
- How thorough and prompt an institution is in responding to and/or resolving complaints

"Effectiveness"

- A more bank-focused review
- How well an institution integrates complaints into its compliance risk management structure, including making changes as complaints highlight risks

In other words, to be successful in this rating framework, an institution must have an active complaint management system in place, in which the institution:

1. has policies and procedures for defining and addressing consumer complaints,
2. performs complaint investigations thoroughly and promptly, and
3. incorporates findings into the overall risk management program.

HOW INSTITUTIONS CAN CREATE STRONG COMPLAINT MANAGEMENT SYSTEMS

Now that we've reviewed how regulators process complaints, and the impact complaints can have on an institution in terms of supervisory action, we will delve into what constitutes an effective complaint management system at the institutional level.

What is a "complaint"?

- A "complaint" is a consumer's or customer's allegation of dissatisfaction with a financial product, practice, service or employee.
- "Dissatisfaction" can be concern or confusion related to a financial institution's products, practices or services including, but not limited to, account maintenance, terms and conditions, product features or costs.
- A complaint is not dependent on whether the customer's concern is valid.
- Defining what constitutes a "complaint," including defining the avenues through which a customer can validly submit a complaint (e.g., when, where, how, to whom), will determine the breadth and scope of an institution's complaint management program.
- **In contrast**, an "inquiry" is defined as a request for service support where no allegation of dissatisfaction with an institution's product, practice, service or employee is expressed, such as asking for more information on a product.
- Disputes and inquiries may or may not be included within the definition of "complaint," but if not, institutions must still manage them in accordance with all regulatory timeframes and other requirements. In these cases, complaint administration may be separate and distinct from the administration of regulatory disputes, errors and/or information requests under Regulations E (Electronic Funds Transfer Act), V (Fair Credit Reporting Act), X (Real Estate Settlement Procedures Act) and Z (Truth in Lending Act).

"Consumer" versus "Customer": Taking a Hint from the Regulators

In reviewing the legal definitions and analyzing developments from regulators, it may be prudent to refer to all complaints as customer complaints as opposed to consumer complaints.

UDAAP applies not just to consumer (personal, family or household) transactions, but also to business-purpose transactions (agricultural, business or commercial) pursuant to Section 5 of the Federal Trade Commission Act, which outlaws fraud and deception in connection with all U.S. commerce, not just consumer transactions.

Since 2008, the FDIC has cited financial institutions for UDAP violations stemming from business-purpose credit transactions, using "customer" to mean not just individual consumers. Furthermore, in December 2016, the CFPB announced a new priority is protecting small businesses, particularly those owned by women and minorities. This trend makes it critical for institutions to review complaints from all consumers and customers, and even non-customers in some cases (complaints arising from interactions that do not result in the establishment of customer relationship).

What are some of the avenues through which parties may contact an institution?

Both customers and non-customers may attempt to contact an institution through a variety of channels. Consider different departments within the institution (not only front-line staff, but also potentially departments such as human resources) and different channels, such as offices, branches, call centers, websites, mobile applications, social media platforms and third parties. The FRB mentioned in their webinar that It is important to check institution contact information listed in multiple places, including online, in print materials, transaction receipts, lobby notices and even phonebooks.

Institutions are often surprised to find how many ways a party can submit a complaint or inquiry, and understanding all these windows can help streamline the system and more accurately tune procedures to effectively process and escalate complaints.

Managing Complaints and Third Parties

As part of managing both complaints and third parties, an institution should clearly define its rights to and capability of accessing customer complaints submitted to third-party partners. It is important to monitor these complaints for a few reasons. In some cases, the root of the complaint may lie within the institution's control, and the onus of finding a solution would therefore be on the institution itself. In other situations, an underlying systemic issue could exist in the policies or practices of the third party, and it is entirely possible, if not probable, that an institution will be held responsible for the shortcomings of third parties that created customer harm.

Because of these unique risks, it is prudent for an institution to clearly delineate its right to accessing and monitoring third-party complaints. Additionally, institutions should check service-level agreements to better understand the legal aspects of requiring a third party to change its practices if necessary, as well as which party is ultimately responsible for various errors or omissions.

What are the specific components of a complaint management program?

1. CAPTURE:

- **a.** Ensure your institution is capturing all customer complaints, both oral and written.
- **b.** Consider formalizing your complaint intake process and include processes for effective and timely complaint resolution, plus monitoring to confirm timely responses.
- **c.** Train staff to understand what constitutes a “complaint” and how and what to note when capturing a complaint. This should include who (customer information), what (the complaint description from the customer’s viewpoint), where (bank branch, division, channel, third-party, etc.) and when (date complaint received).

2. REVIEW:

- **a.** Review and investigate complaints.
- **b.** Identify areas of concern, track the complaints, and incorporate clear controls for levels of escalation depending on potential risk.
- **c.** Clearly define what constitutes a “high-risk” complaint, such as those that may indicate a violation of law, and incorporate a system for escalating these complaints to senior management and/or legal counsel.
- **d.** Define roles in the process and a create a system that effectively maps certain types of complaints to the appropriate staff.
- **e.** If the customer’s concern is difficult to understand, it may be necessary to reach out with questions. No complaint should be closed without a clear understanding of the complaint itself.
- **f.** Train staff on the processes for investigating both high-risk and non-high-risk complaints.

3. ANALYZE:

- **a.** Find the root cause of the complaint.
- **b.** A pattern may indicate certain systemic weaknesses, emerging issues or developing trends.
- **c.** Assess complaints as indicators of where to focus internal or external compliance reviews.
- **d.** Run an impact analysis from the institution’s perspective, including monetary, regulatory, safety, soundness and reputation.

4. REMEDIATE:

- **a.** Find a resolution, if necessary, for an individual complaint and/or for any larger gaps involving underlying factors.
- **b.** Ensure the customer feels heard and receives a timely answer, or at least is kept abreast of the process — a “We’re working on it,” is better than no communication at all, otherwise the customer might feel forgotten or ignored.
- **c.** If no remediation is necessary, the customer should still get a response. It is prudent to restate the submitted complaint so the customer feels heard, and to consider what channel the customer used. Customers often expect an electronic submission to have a faster escalation and response time.
- **d.** If there is a violation or error, take steps to avoid future recurrence.
- **e.** Don’t forget to identify specialized training opportunities for management and front-line staff.

5. INFORM:

- **a.** Communicate with senior management and possibly the board of directors, depending on the level of risk, regarding complaints against your institution, their resolution and policy changes to prevent recurrence.

What are some early indicators in complaints of compliance errors?

According to the FRB's CA 13-19, the following may suggest potential regulatory violations:

- Complaints directly to the institution's staff or to its regulating agency
- Concerns community contacts raise during CRA examinations
- Complaints to other federal or state agencies
- Lawsuits by any party (private or government)
- Other federal or state agencies' inquiries or investigations
- Complaints generated through websites and/or social media
- Press articles raising concerns about the institution's practices

DIFFERENCES IN REGULATORY REQUIREMENTS FOR COMPLAINT PROCESSING

If a customer complaint is deemed valid, it is important to remember that there are varying requirements for error resolution, depending on what regulations apply to the product, service or practice in question. Some complaints could imply errors in operations (e.g., CRA and UDAAP/UDAP violations), deposits (e.g., Regulation E violations) or lending (e.g., Regulation Z and Regulation X violations).

Some of the most important items to note are the operational considerations for each type of potential regulatory violation. There are often differences between these requirements, depending on the regulation. Some areas to watch out for include obligations regarding capturing, retaining and responding to complaints. Additionally, there are often variances in how regulations define common terms, and it is important to note the implications of these different definitions for business operations.

Tips for the process:

- Document procedures and all work done on each complaint case.
- Ensure a timely response, even when you don't have a complete answer.
- Create open communication with the customer to gather necessary information or simply appease customer fears.
- Be flexible since not all complaints are exactly alike, but be consistent in methodology.
- Try to view complaints through the perspective of the customer.
- Dig deep to define the root cause rather than getting caught up in superficial issues. A complaint that may seem innocuous, ridiculous or unrelated could boil down to a legal violation or serious risk exposure.
- Do not underestimate customer service issues, as these can reveal deeper issues.
- Create controls to extinguish the possibility of recurrence.

WHAT TO EXPECT FROM EXAMINERS

How financial institutions handle all types of complaints is a key element of an examiner's evaluation of the financial institution's overall compliance management system. As part of an effective compliance management system, institutions should be responsive in handling customer complaints and inquiries as examiners will be looking for the following:

1. Are complaints and inquiries, regardless of where submitted, recorded and categorized?

2. Are complaints and inquiries, whether regarding the entity or its service providers, addressed and resolved promptly?

3. Are complaints that raise legal issues involving potential consumer harm from unfair treatment or discrimination, or other regulatory compliance issues, appropriately escalated?

4. Do complaint data and individual cases drive adjustments to business practices, as appropriate?

5. Do the complaints show a pattern that reveals systemic issues?

6. Does corrective action, if appropriate, occur after receipt and review of customer complaints?

7. Do weaknesses in the compliance management system exist, based on the nature or number of substantive complaints from consumers?

Regulators will review complaint records, and sometimes even speak with employees to determine how well-trained and knowledgeable they are of what constitutes a "complaint" and of proper complaint procedures. Often, an examination team will have already checked its own complaint database to find any trend analysis, and may request copies of both the policy and procedures for complaint processing and complaints and inquiries received. They will place particular emphasis on timeliness, thoroughness, tone and corrective action.

Next, examiners will look at what the financial institution does with the information it receives from the complaints. It will be necessary to show data analysis efforts and, if a trend is found, appropriate corrective action. Being prepared for this part of an exam can be very beneficial.

In the FRB's webinar, Senior Examiner of the Federal Reserve Bank of Kansas City Alinda Murphy said she has seen times when an institution has gained loyalty or even new customers by handling complaints well: "It may be hard to overestimate the usefulness of complaints. Consider and welcome them as feedback from your customers and roads toward continuous organization improvement." ❖

Do you have questions about customer complaint management systems? Capco is here to help! Please reach out to Robert.Cardwell@Capco.com to learn more about finding the best solutions for your institution.

HOW TO CREATE 'QUALITY'

UNDERSTANDING YOUR INSTITUTION'S QA AND QC OBJECTIVES

"QUALITY" — REDUCING RISK TO AN ACCEPTABLE LEVEL AS EFFICIENTLY AND EFFECTIVELY AS POSSIBLE

For many institutions, the idea of mitigating risk means creating systems that both prevent and detect problems with products, services or operations. To truly manage risk, it is essential to have both sides. This is where quality assurance (QA) and quality control (QC) programs come into play.

QA is the process of managing for quality; this is the prevention side.

- QA is proactive and process-oriented. It assures quality before a product or service is final.
- QA consists of a set of activities with the goal of ensuring quality in a final product or service by focusing on the processes used to develop products or services. These QA activities are often grouped and described as "preventive controls."
- The goal is to design/improve processes so that defects do not arise in delivery of the product or service.
- Generally, everyone on the development and operations teams is responsible for QA.
- As a tool, QA's structure is managerial.
- The overarching question behind QA efforts is: is the pre-production product complying with applicable laws and regulations, as well as institution-specific policies, procedures and quality levels?
- Examples of QA include:
  - / process checklists,
  - / dual review (e.g., underwriters both underwriting each other's loan applications, exception review of denied applications by managers),
  - / sampling and evaluation of pre-production outputs (e.g., documents before they are sent),
  - / information system controls (e.g., data fields that disallow letters within fields that require numeric values, pull-down menus that force selection of a limited set of choices into a data field),
  - / information system design (e.g., rigorous testing of calculation functions within an information system), and
  - / methodology and standards development and implementation.

QC is the process of verifying quality; this is the detection side.

- QC is reactive and product-oriented. It focuses on identifying and correcting defects and/or process flaw(s) that created defects.
- QC consists of a set of activities with the goal of ensuring quality in products and services by focusing on identifying defects in the actual products and services produced. These QC activities are often grouped and described as "detective controls."
- The goal is to identity defects after a product or service is developed and delivered to a consumer.
- A specific team that tests products and services generally has QC responsibility.
- As a tool, QC's structure is corrective.
- QC controls the damage within the process by looking at quality after-the-fact and:
  / fixing the process, and/or
  / making the consumer "whole" in some way, generally with revised information and/or monetary reimbursement.
- Examples of QC include:
  / sampling and inspection/checking,
  / in rare instances of extreme error rates, 100 percent inspection/checking,
  / reporting, and
  / peer review.

QA AND QC SYSTEMS

After an institution produces a product or service, and implements QA and QC measures, it is essential to make those measures part of a QA/QC system that includes:

- Reporting results
- Tracking and remediating issues that arise
- Capturing items that "slip through" the QA/QC system, such as errors reported by customers about:
  / Employee-customer interactions, and
  / Business transactions.

An institution's first line of defense can help provide an objective review through collecting and reporting its QA and QC results, so that it can be formally documented, analyzed and interpreted. Interpreted information can then be reported to ensure timely feedback to management.

SAMPLING

Both QA and QC involve testing. Unless an institution has near-unlimited resources, that testing will require a sampling approach. Given the wide variety of regulatory requirements, choosing the most appropriate sampling approach is a major challenge at many financial institutions. The most common approaches include:

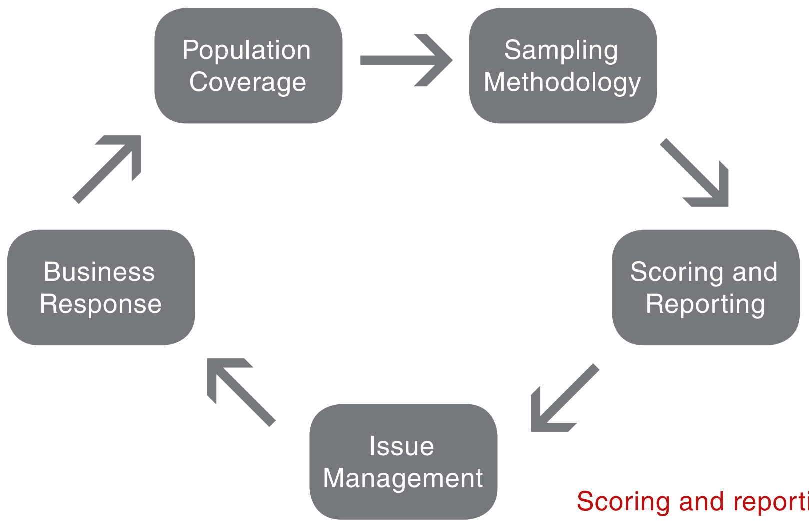
- Sampling according to published regulatory guidance or specific (e.g., consent order) mandate
- Sampling mandated either by senior management or customer (e.g., a government-sponsored-entity that purchases loans)
- Static sampling (i.e., a fixed quantity or percentage)
- Judgmental sampling
- Statistically valid sampling

In many instances, the selection of a sampling approach is unique, and based upon factors that include:

- Product/service complexity,
- Impact of errors on consumers, and
- An institution's:
  / Current and previous states of compliance/adherence, and
  / History of process controls.

The approach is best decided collaboratively, with input from those with operational and legal/compliance expertise.

THE QA PROCESS: AN EXAMPLE OF THE QA CYCLE



Population coverage

- Create written policies for how to define populations from which samples will be drawn (e.g., from system-generated reports using criteria specific to the process being tested).
- Keep in mind that testing operational processes may require data from business partners or from source systems, when possible (e.g., volume or performance metrics reports).
- Populations identify items processed within specified periods of time, and/or with certain characteristics. Those characteristics can include focus on specific employees to support coaching and feedback.

Sampling methodology

- Performance testing at the employee/associate level may also look at response time and customer experience, potentially identifying lack of associate understanding of the product or service.
- The methodology for sample selection in testing products and services takes into account population, employee focus, product/service complexity and process and regulatory risk. Any of a variety of sampling techniques can be used, as previously described.

Scoring and reporting

- Operations management and selected staff (e.g., Compliance Committee) receives completed QA/QC review reports. If there is a failing exception percentage, it is escalated.
- Thresholds for review failure can be set at both a regulatory exception percentage and a procedural exception percentage.
- Operations management should be responsible for remediation of any regulatory exceptions.

Issue management

- It may be prudent to create a centralized tracking system to ensure appropriate leaders are aware of regulatory and procedural exceptions, and to enable tracking of the resulting remediation activities.

Business response

- Business leadership teams may maintain, update or enhance associate accountability standards, training initiatives, processes and/or documentation, as necessary.
- Issue management and tracking helps achieve precise and timely:
  / Remediation action definition,
  / Completed actions, and
  / Validation that action(s) fully addressed the initial issue(s).

QUESTIONS EXAMINERS MAY ASK

Taking into consideration that an institution should have QA and QC systems in place, examiners may ask questions about these systems. In preparing for an examination, it is helpful to have answers (and documented support for these answers) to questions such as:

- Does the first line understand the inherent risks?
- Does the first line take ownership of the risk?
- Has the risk appetite level been defined at the management level?
- Does the second line of defense augment and fill in the gaps of the first line?
- Does the institution have some confidence level that the residual risk level is mitigated to within acceptable levels?

Beyond its regulators' specific concerns, an institution should not overlook the QA/QC of its customer service which, if neglected, can create reputational risk that often cannot be known until after the fact.

WHAT TO KEEP IN MIND WHEN DESIGNING QA/QC SYSTEMS

As an institution designs or reviews the architecture of its QA and QC systems, there are a few things to keep in mind:

1. Set expectations early and clearly.
2. Focus on what is important.
3. Results must be logically based on regulatory and internally acceptable requirements.
4. Data and reports should inform, not confuse.
5. Find ways to translate data into degrees of risk.
6. Results should create dialogue at appropriate levels of the institution.
7. Accuracy of reporting goes straight toward credibility of QA and QC systems. ❖

EXAMPLES OF QUALITY CERTIFICATIONS

If you are unsure of how to manage your institution's QA and QC programs, it may be prudent to seek support from a certified party. Examples of certifications that can lead you to a subject matter expert who can provide relevant guidance include:

- Certified Regulatory Compliance Manager (CRCM), offered by the American Bankers Association
- Certified Financial Services Auditor (CFSA), offered by the Institute of Internal Auditors
- Certified Risk Management Assurance (CRMA), offered by the Institute of Internal Auditors
- Certified Quality Auditor (CQA), offered by ASQ
- Certified Manager of Quality/Organizational Excellence (CMQ/OE), offered by ASQ

Do you have questions about the QA/QC process? Capco is here to help! Please reach out to Gene.Collett@Capco.com to learn more about finding the best solutions for your institution.

ABOUT CAPCO

Capco is a global business and technology consultancy dedicated to the financial services industry, plus a dedicated energy division. Capco delivers innovative solutions in Banking & Payments, Capital Markets and Wealth & Asset Management, designed to withstand market forces, continual regulatory change and increasing consumer demand.

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