

Regulatory Examinations – Surviving!

We all know over the last few years examinations weren't occurring with the same frequency pre pandemic. But should you sit idly by and wait for that first day letter or start preparing now? That is what most people working for financial institutions are contemplating now. Most are being reactive instead of being proactive. This approach is nothing new, being reactive is the corporate mantra. But does it have to be? Of course not!

So, let's take a step back. What's the purpose of an examination?

The purpose of an examination is to check whether an organization has done something that is against rules or regulations. An examination is intended to assess the financial institution's compliance program and the institution's compliance with the regulatory requirements.

Regulators want to make sure you are controlling risk properly. Typically, they will look for whether:

- Policies & procedures are up to date,
- Audits and other problems have been resolved,
- Your compliance program is appropriate based on your risk profile,
- Other, depending on the scope of the exam,

Within the financial services industry, we have the opportunity to be overseen by many regulators. Yes, an opportunity! It really depends on a multitude of topics.

- What are the products & services offered?
- Are you domestic or global?
- Where are your customers based?

Depending on your answers to the above, there is a long list of regulators in financial services which is so lucky for us. Some of them include:

- FDIC: Preserves and promotes public confidence in the U.S. financial system by insuring deposits in banks and thrift institutions.
- SEC: protects investors, maintains fair, orderly, and efficient markets, and facilitates capital formation.
- OCC: charters, regulates, and supervises all national banks, federal savings associations, and federal branches and agencies of foreign banks.
- NCUA: is an independent federal agency that insures deposits at federally insured credit unions, protects the members who own credit unions, and charters and regulates federal credit unions.
- CFPB: enforces federal consumer financial laws and protects consumers in the financial marketplace.

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- FINRA making sure the broker-dealer industry operates fairly and honestly.
- State Banking Agencies: charters and conducts examinations at state level.

This is the main list, but you have even more to consider. I'm not trying to scare you at all with this long list since only one or a few apply.

Different Types of Examinations

Yes, there are different types of examinations. They might be called something differently, but the main premise is the same.

- 1) Scope Examinations: Typical exams where a regulator has a set list of items to review. Regulators will inspect the firm's financial, operational and other practice areas to determine whether it is in compliance with applicable laws, rules and regulations.
- 2) Targeted Examinations: These are generally based on targeted letters or priority letters. Recently these examinations included cybersecurity, social media and communications, and trading practices. Looking at the examination priorities is a huge help on this one.
- 3) Cause Examinations: This is not the happy type of examination! They are prompted by prior enforcement actions, complaints, self-reporting, or whistleblower items.
- 4) Sweep Examinations are used to review a compliance issue that the SEC considers a risk across multiple firms. typically involve multiple firms in a specific industry.
- 5) Oversight Examinations: SEC conducts "oversight" examinations of firms that have been recently inspected by FINRA.

As I mentioned above, they can be called something a little differently, but these are the main areas examinations occur.

How do I prepare for an examination?

Please don't prepare the day you get your first day letter. Please!! During the year, I always have a periodic check of anything relevant to examinations. I'm talking about your policies, procedures.... Do not be reactive, get ahead of the game.

This is what I typically do:

1. Review previous examinations: Look back at the last few years, check the findings, whether everything was addressed.
2. What was examined? Was it a periodic examination or something for cause.
3. Audit reports: similar to examinations, check to see whether all comments were addressed.
4. Responses: How were they handled? Who handled them?
5. Check for any correspondence between your firm and regulators: see if anything particular stands out and whether responses were sent for any type of inquiries.

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6. Review policies & procedures: Determine if everything is up to date. Typically, there should be some type of alert that is triggered for reviews.
7. Regulators examination priorities list: this usually changes year by year but check your regulators website for a full list and whether it is applicable.
8. Communication to staff the do's and don'ts during the examination process (I.e., Clean Desk policy)

This is not an exhaustive list, but a really good start. Preparation is key!!!

Getting the First Day Letter

This is the day you were dreaming of and where all the preparations come into play. You have the first day letter!!!! I know there is a level of excitement but try to contain yourselves. Now we get to work!

I'm going to map out my approach to what I have done previously and currently.

Within the letter should be your regulatory contact or lead examiner. Regardless of what you have been told, you should absolutely reach out to the examiner in charge. You want to build a rapport with the examiners. If any request is too large for your staff to handle by the due date, or if you need more time, reach out to the examiner. Don't be afraid to ask!! This is an important part of managing a regulatory examination is having open communication with your examiner. This also shows confidence in your abilities to run a compliance program or be a point person.

Next up is the documents that are typically requested for routine examinations that are usually limited to a specified period of time. These could include internal audit reports, transactions, policies, procedures, emails, and other materials.

In case you find any type of issue while gathering the requested documents, you should immediately try to close it out and let the examiners know when they are on site.

Now, I am going to provide some tips and tricks when dealing with the request. It's not as hard as you think but does require time and effort.

- 1) Always make two copies of each request. It should be one for the regulator and one for your files.
- 2) Make sure you number every item submitted corresponding to the item number provided by the regulator.
- 3) All documents should be sent via the regulator's website. This will provide you with an audit trail and acknowledgment of the documents submitted. For some reason, if you don't receive a link to the site, call the examiner in charge immediately.
- 4) IMPORTANT!!! Only submit what was asked for, not anything more or anything less. Firms get in trouble for providing too much information since can create many more avenues for examiners to examine. Limit the scope of the exam!

Oh, I almost forgot about discussing the duration of an examination. Well, it really depends. The duration varies based on a few factors: size of a firm and the number of examiners involved. If you are part of a

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larger firm, an examination may take six months or longer. But remember, most of this time is provided to regulators so they can spend time analyzing materials and following-up with particular questions based on your responses.

Something to consider as well. Regulators will do pre-work prior to the examination. Examiners spend a good amount of time gathering and reviewing the available information relating to the firm they examine. Typically, they will look at prior examinations, complaints, litigation... So, if they are going to be prepared, you should be too!

Preparing and nailing the interviews

Now, this is the fun part. The onsite interviews. You may have been told previously how to handle them and the proper structure to stay within. In my experience, running regulatory affairs and working for a regulator, this is where people screw up!

Once you get the interview request list from the regulator, you need to brief everyone involved. They need to understand the scope, reasoning, and what might be asked of them by the regulators. The biggest part is the preparation of the interviewees. They need to be prepped at nauseum. One dry run might not do it, so schedule accordingly and provide the right expectations.

The dry runs should be conducted with someone who has a lot of experience and knowledge of dealing with regulators. Remember, this is important. You don't want someone unprepared for the interviews. This could have a real negative impact on the overall examination.

During the dry run, you need to stress the importance of the following:

- Short and sweet
- Provide clear and direct answers.
- Convey only what was asked.
- Have the CCO, internal audit or head of reg affairs included in each interview.

The interview allows an examiner to get to know your firm and the individuals who run key areas. The goal is for them to understand granular details. Of course, with do's, comes by don't list. Here are a few:

- Don't spill the beans – narrow the scope of your examination and keep it that way.
- Don't be evasive – Regulators will know. Just answer the question in a short and sweet manner.
- No coaching: this means during the interview, not before. It looks bad!
- Don't answer questions outside the scope – keep to the scope.
- Don't attend alone – you MUST have someone with a high skill area of regulatory compliance attend as a chaperone.

Very IMPORTANT. The regulators realize that need an internal expert in regulatory examinations to chaperone interviews with business leaders, or any employee in general. Think of what would happen if an employee attended alone. I mean really, you have to think about it. It is not a good look!

On-Site (or virtual) Examination

Everyone gets so nervous about the on-site portion of the examination. I don't think it's a big deal as long as you are prepared. Those who are nervous might want to take some extra time with preparation. Especially if you had negative examination results in the past.

So, I'll share my tips, opinion and advice.

When the regulators get to your office make sure you have a space for them that is out of the way. Typically, they will be on-site for up to a week, sometimes longer depending on their findings. When they arrive make sure that the appropriate staff members are around to greet them and make sure they settle in. This should be the CCO, head of regulatory affairs, senior management and possibly others.

Also, remember to alert other staff members or the office as a whole. You have policies that speak to this portion such as the Clean Desk policy. Regardless, send out a communication with all the necessary protocols that staff need to follow.

Now, you should be ready to go. Here are some other tips when dealing with examiners:

- Educate the examiners: Help them understand your business, staff, products & services...You want to be on the same playing field before questions and requests occur.
- Any type of requests received, make sure they are sent to the examiners based on the due date. If you need more time, definitely let them know.
- Documentation and audit trails are important. Make sure the examiners put everything in writing.
- If you don't have the records requested at the time, you must let the examiners know ASAP. You don't want them to find themselves on their own.

After the examiners leave the on-site portion, they will look at all the documents, interviews and other materials to determine the next steps. The next steps could be nothing, potentially additional requests or something more severe. Just be prepared for all requests and make the appropriate preparations to avoid any issues.

Exit Interview

Now, this is the part everyone waits for: The feedback and potential regulatory actions against your firm. You will have an opportunity to discuss the findings and see if any clarification is necessary. The examiners do not get it right all the time. Sometimes there is a lack of information, knowledge, or inexperience. Regardless, don't argue with the examiners because it won't work out well.

Like any other regulatory response, your letter should contain either an acceptance and understanding of the exception/recommendation, a reason for the items, and a corrective action.

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It is a good best practice to provide your General Counsel or CCO a copy of the letter once you receive it, as well as a draft of your response (and exhibits) at least 10 days prior to the due date so they have a chance to review all documents and provide guidance.

If there are issues found, the examiners want to make sure they are corrected very soon. They have very little sympathy for your firm, so do the right thing and follow your internal guidelines.

Lastly, you must keep the information received by examiners such as the memo, exam letter, and your responses in a file in case they are needed again.

Conclusion

Everything I indicated in this article is some the practices I learned throughout the years. This is not an exhaustive list since the article would turn into a 100-page paper. Use the information the best you can but look for guidance within your firm for direction. Your CCO should be your partner in crime during the entire examination process. I wish everyone the best of luck!