COMPLIANCE WEEK
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Finding the hidden risks in sales practices

As financial institutions pursue aggressive new sales goals, organizations need proactive, independent review of their own sales practices, write guest columnists **Chris Sicuranza** and **Paul Noring**.

Recent compliance related scandals in banking, most notably the highly visible sales practices/inappropriate account opening matter, have struck a major blow to the reputation of at least one of our nation's financial institutions. Such matters have once again called into question the risk management, internal audit and compliance functions of financial institutions. More importantly, they are a magnet for criticism by the media, regulators, and the public at large—leading to a potential loss of consumer confidence in the banking system. Unlike other recent scandals such as LIBOR rigging, mortgage backed security offerings and the foreign exchange and commodity price fixings, this issue could potentially impact many more banks. Moreover, it is an issue that undoubtedly resonates with the public, press, and congress.

After the financial crisis of 2008-2009, many financial institutions have felt intense revenue pressure resulting from a push to make up for business wound down as part of the Dodd-Frank Act and the low interest rate environment. At banks in particular, such drivers could result in more aggressive sales tactics. Regulators are clearly zeroing in on the sales practices at many institutions and are requesting significant amounts of data and documents as part of both targeted reviews as well as in conjunction with their regularly scheduled exams. Shortcomings in compliance related to sales practices may not only trigger regulatory action, but can also inflict severe reputational damage if your institution's activities are deemed to be overly aggressive. This reputation risk can lead to significant revenue loss as customers and businesses avoid your bank.

Not an Isolated Issue. Most bankers generally have the same initial reaction: We are not them. We do things differently. But that does not always hold true, and in banking it is actually quite common to see business processes mirrored at numerous institutions. Remember when "robo signing" of foreclosure documents first broke? It was initially viewed as an issue isolated to a specific institution, but on closer examination many mortgage banks had similar practices. The same for many of the other scandals mentioned earlier like LIBOR rigging.

Therefore, why should one think that inappropriate sales practices are isolated to a single bank? Clearly, factors such as high cross-sell ratios and size may indicate a more egregious problem at the institution currently in the cross-hairs. However, all entities could benefit from an independent, objective look at where risks fall outside of senior management's or the board's tolerances. Also, banks are always well advised to get ahead of the regulators—particularly in an area where we know they will be focusing significant attention. Additionally, since the most visible case was uncovered locally, we can expect state regulators to intensify their focus on this activity, which could be compounded, given questions as to the future of the Consumer Finance Protection Bureau.

The value of an independent perspective. Some banks have attempted to quickly assess their practices via a management task force or other internal review. This is clearly commendable and much better than ignoring the issue. However, this may not be sufficient for several reasons.

First, it is possible that those performing the internal assessment may view the institution's current activities as normal—even though they may not appear normal to an outsider. The norms of proper practices in court of public opinion on this issue have clearly changed. Second, we would question the depth and comprehensiveness of such a review. Is it one-dimensional or is it scrutinizing activities through multiple lenses? For instance, if you just looked at signed foreclosure documents, one never would have identified robo-signing. Lastly, purely internal reviews do not allow an

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institution to benefit from an outsider's broad, industry-wide perspective nor to benchmark its sales activities against other comparable banks.

Risk exposure assessment. In order to properly assess the risk inherent in an institution's sales practices, we believe it is critical to review activity from four distinct perspectives, as follows:

» Sales incentive compensation plans;
» Policies, procedures, and operational practices;
» Data analytics; and
» Complaints

Multiple sub-steps would be performed for each of these broad areas. Accordingly, a sales incentive compensation plan review should specifically target understanding:

» Design/cross-sell targets;
» Organizational emphasis;
» Proportion of overall compensation;
» Monitoring and payment triggers;
» Performance versus plan;
» Payout trends and outliers; and
» Product breadth

Similar drill-down procedures should be performed for each of the other three broad areas of review. It is absolutely critical, in order for an institution to properly assess its risk, that it examine those risks from these four discrete perspectives. Moreover, it may also be prudent to broaden the review beyond the consumer portfolio, to also include small business banking.

Hopefully, every bank is absolutely clean on this issue, such that no other matters requiring Board attention, consent orders, restitution, civil monetary penalties, or lawsuits will result. And that the recent highly publicized matter is just an isolated incident that festered in one large institution. However, if history is any guide, this is probably not the case. Without doing a comprehensive review—by a party independent of the business and fully objective in assessing where current practices fall short—how will your institution know the true level of risk in your current activities? ■

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