DREHER TOMKIES LLP

ALERT

FOR CLIENTS AND FRIENDS OF DREHER TOMKIES LLP

August 5, 2016

FDIC ISSUES EXAM GUIDANCE ON THIRD PARTY LENDING

On July 29th, the Federal Deposit Insurance Corporation (FDIC) published draft examination guidance for third-party lending to supplement the FDIC's existing Guidance for Managing Third-Party Risk. The guidance (i) identifies potential risks arising from third-party lending relationships, (ii) outlines the elements of an effective third-party lending risk management program, (iii) provides supervisory considerations for third-party lending and (iv) sets forth general examination procedures for third-party lending relationships. Comments are due October 27th.

The guidance covers "third-party lending" defined as a lending arrangement that relies on a third party to perform a significant aspect of the lending process, such as marketing, credit underwriting, loan origination, customer service, regulatory compliance, loan servicing, debt collection and data collection, aggregation or reporting. The FDIC identified three models of third-party lending arrangements:

- *Originate Loans For Third Parties*: The insured institution serves as the loan originator for an entity wanting to take advantage of the institution's exportation authority. The institution typically sells loans to the third party shortly after origination. The FDIC noted that courts are divided on whether third-party lenders can rely on an institution's exportation authority under this model and cited *CashCall v. Morrisey*.
- *Originate Loans Through Third-Party Lenders or Jointly with Third-Party Lenders*: The institution engages one or more third parties to market loans on behalf of the institution. The institution originates loans independently or jointly with a third party lender and typically retains loans.
- *Originate Loans Using Platforms Developed By Third Parties*: The institution relies on a third party to create and support an "end-to-end" lending platform for the institution's use. The institution typically retains loans under this model.

Third-Party Lending Risks. In addition to the general risks associated with any type of third-party arrangement, the FDIC identified the following special risks with regard to third-party lending relationships:

- *Strategic Risk* comes from a third party's decision-making that is inconsistent with an institution's strategic goals.
- *Operational Risk* arises from integrating the internal processes of the third party and the institution and the complexity that such integration brings.
- *Transaction Risk* with service or product delivery is heightened in third-party lending by large loan volume, multiple third parties providing services, significant program growth or third parties relying on other third-party vendors to perform services.
- *Pipeline and Liquidity Risk* is created when third parties are unable to purchase loans or arrange for the purchase of loans as expected.
- *Model Risk* stems from the reliance on financial models developed by third parties to generate transactions and measure risk.
- *Credit Risk* in heightened in third-party lending by large loan volume, multiple third parties providing services, service fees that are not connected to transaction quality and off-site underwriting of loans by third parties.
- *Compliance Risk* includes consumer compliance risk and Bank Secrecy Act (BSA)/Anti-Money Laundering (AML) compliance risk that can be heightened if the third party lacks compliance expertise, fails to follow the institution's policies or the institution's compliance management system does not incorporate the activities of a third party.

Third Party Lending Risk Management Program. The FDIC expects insured institutions to follow existing guidance on managing third party risk when evaluating and monitoring any significant third-party lending relationship and develop third-party lending program policies that meet certain minimum requirements. As part of an institution's due diligence, an insured institution should review, among other things, (i) the third party's consumer information security program, (ii) the stability of funding sources for loans, (iii) the models used by third parties, including model development documentation and independent model validation and (iv) the third party's vendor management or third-party risk management process. The agreement for third-party lending relationships should, among other things, (i) not limit the institution's ability to sell loans to another entity if the third party is unable to purchase loans and (ii) give the institution full discretion to require a third party to implement policies or procedures for any activity outsourced by the third party.

Supervisory Considerations for Third-Party Lending. The draft

Darrell L. Dreher
ddreher@dltlaw.com

Elizabeth L. Anstaett
eanstaett@dltlaw.com

Margaret M. Stolar
mstolar@dltlaw.com

Robin R. De Leo
robin@dreher-la.com

Susan M. Seaman
sseaman@dltlaw.com

2750 HUNTINGTON CENTER
41 S. HIGH STREET
COLUMBUS, OHIO 43215
TELEPHONE: (614) 628-8000 FACSIMILE: (614) 628-1600
WWW.DLTLAW.COM

To see previously sent ALERTS, visit our website at www.dltlaw.com

Michael C. Tomkies
mtomkies@dltlaw.com

Charles V. Gall
cgall@dltlaw.com

Judith M. Scheiderer
jscheiderer@dltlaw.com

Susan L. Ostrander
sostrander@dltlaw.com

Emily C. Barlage
ebarlage@dltlaw.com

guidance reminds institutions that they are ultimately responsible for a third party's compliance and should evaluate lending activities performed by a third party as if the institution performed the activities. The supervisory considerations related to third-party lending include credit underwriting and administration, capital adequacy, liquidity, profitability, accounting and allowance for loans and lease losses, compliance with applicable laws (especially BSA/AML compliance), safeguarding customer information and information technology.

Examination Procedures for Third-Party Lending. Institutions that engage in new or significant lending activities through third parties generally will receive increased supervisory attention. A third party lending arrangement will be deemed significant if the arrangement (i) has a material impact on revenues, expenses or capital, (ii) involves large lending volumes relative to the bank's balance sheet, (iii) involves multiple third parties or (iv) presents a material risk of consumer harm. Institutions with such arrangements will be examined at least every 12 months and the exam will include concurrent risk management and consumer protection examinations. Third-party lending examination activities may include a review of corporate governance, financial strength, compliance management system, credit underwriting and administration, model risk management, vendor management, internal controls, audit programs, BSA/AML compliance, safeguarding of customer information, information technology, consumer complaints and litigation. A sample of individual loans will be reviewed. Targeted reviews of fair lending compliance may occur in certain circumstances, including when an institution uses a new model with untested inputs or when lending is conducted through a disbursed network of third parties.

The FDIC indicated that the goal of the draft guidance is to improve the transparency and clarity of the FDIC's supervisory policies and practices for third party lending. The FDIC has extended the comment period for this guidance until October 27th, 2016. ❑

✧ *Mike Tomkies and Susan Manship Seaman*