Comments Requested on Proposed Guidance for Third-Party Lending

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Companies look for ways to reduce costs and expenses, thereby being able to maximize profits and income to use that income as best deemed necessary. One major avenue that companies have utilized is co-sourcing or outsourcing of particular areas of business to help reduce costs and create efficiencies. In this article the focus is on the banking market, specifically those governed by the Federal Deposit Insurance Corp. ("FDIC").

In July 2016 the FDIC issued a proposed guidance and request for comments on a regulation that expects to provide FDIC-supervised financial institutions and examiners with strong expectations on the management and assessment of third-party lending arrangements and associated risks.

The proposed Examination Guidance for Third-Party Lending that was released on July 29, 2016, provides a supplement and development on the principles established in the FDIC's June 2008 Guidance for Managing Third-Party Risk. The 2008 guidance isn't limited to the third-party lending, but instead covered all areas of third-party usage. The newest proposal though is specifically limited to the risks associated with third-party lending arrangements and the expectations of management to appropriately address those items.

This proposal delineates third-party lending as "a lending arrangement that relies on a third party to perform a significant aspect of the lending process." In fact, taking into account this definition, the possible services that are executed by the third party could include:

- marketing;
- borrower solicitation;
- credit underwriting;
- loan pricing;
- loan origination;
- retail installment sales contract issuance;
- customer service;
- consumer disclosures;
- regulatory compliance;
- loan servicing;
- debt collection; and
- data collection, aggregation, or reporting.

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And categories of third-party lending arrangements may include but are not limited to:

- insured institutions originating loans for third parties;
- insured institutions originating loans through third parties or jointly with third parties; and
- insured institutions originating loans using platforms developed by third parties.

The proposed document is not attempting to shift oversight, in fact in the first few paragraphs it states: "An institution's board of directors and senior management are ultimately responsible for managing activities conducted through third-party relationships, including lending relationships, and for identifying and controlling the risks arising from such relationships as if the activity were handled within the institution." The FDIC does make specific attention though to the fact that managing and appropriately addressing risks can be challenging, especially when the volume of loans is high in relation to the balance sheet of the institution and/or there are numerous third-party relationships to manage.

The proposal details out many specific risks that can be associated with third-party lending. To help further address the risks, the proposal outlines a process and program to put in place. This consists of four elements: "(1) risk assessment, (2) due diligence in selecting a third party, (3) contract structuring and review, and (4) oversight."

The proposal goes in to more depth than we have time to describe in this article however areas identified as "supervisory considerations for third party lending relationships" include, but are not limited to, the following:

- Credit underwriting and administration,
- Loss recognition,
- Subprime programs,
- Capital adequacy,
- Liquidity,
- Profitability,
- Accounting and allowance for loan and lease losses,
- Consumer compliance, and the list keeps going.

My attention pauses here at consumer compliance and profitability with the current news trends. As you know Wells Fargo has been in the news recently. Why bring that up? The insights derived from this proposal are not limited to third-party arrangements. Ultimately the board of directors and senior management are responsible for managing the compliance management program. This is applicable to employees and third-party arrangements alike. And it does not stop in the banking industry. Many of the frauds or news headlines we see uncovered each day came from a breakdown in controls and the lack of appropriate supervision and oversight. The key phrase that you keep hearing is the tone at the top. in the paper or see it on television?" Thinking in that manner was always eye opening for me.

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Currently this is proposed guidance with comments due October 27, 2016, which is an extension from the prior deadline of September 12, 2016. The proposed guidance is available on the FDIC website at https://www.fdic.gov/news/news/financial/2016/fil16050a.pdf. As you are going through the proposed guidance, you may ask yourself where your risks truly lie at your organization. Maybe it is time to have an outside perspective. The Risk Advisory Services team at Whitley Penn can be that outside perspective on the risk assessment that you have just been rolling forward year to year. We would love to help address risk in your organization, whether specific to third-party lending, or other areas of significant risk.