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This multi-part series, entitled "Regulatory Relationship Management," sets forth key principles and practical strategies for establishing and maintaining productive regulatory relationships, with an emphasis on banks and banking regulators. Through effective regulatory relationship management, banks can streamline and simplify supervisory oversight, reduce risk of regulatory sanctions, and enhance their own and the industry's reputation for compliance and competence.

Regulatory Relationship Management: Building Trust, Credibility With Regulators

BY JO ANN BAREFOOT AND LORI J. SOMMERFIELD

The cornerstones of a successful working relationship between a regulated financial institution and its functional regulator are *trust* and *credibility*. A regulator lacking trust and confidence in his business contact at a banking organization, or in the information provided by that contact, can cause serious problems for the bank. Moreover, similar fact patterns or operational circumstances can result in significantly different outcomes for institutions that use effective regulatory relationship management tools and those that do not. In this article, we use the shorthand "RRM" to refer to the function of regulatory relationship management.

Establishing trust and credibility, whether with business partners, customers or regulators, is not achieved overnight by any banking organization. Focused efforts and constant vigilance, combined with time, are the necessary ingredients. The more complex the business and the rules governing it, the more time will be required for the development of a relationship of trust between the financial institution and its regulator.

Banking organizations may have more than one regulator — for example, a federal and state regulator, or two different federal regulators for the bank and its holding company. This regulatory complexity compounds the need for effective RRM.

Creating credibility is a process, which advances only through honest, continuous communication between the banking organization and its regulators. Credible communications are informed and nurtured by diligent efforts on the company's part to understand the legal and regulatory framework in which it operates.

The myriad and complex rules governing banking today, combined with the often-cited loss of trust by the banking industry during the recent financial crisis, have increased the effort required to digest and comply with regulatory requirements. Achieving and maintaining successful regulatory relationships in an era of expanding regulation make adoption of RRM principles mandatory for financial institutions. The major elements of RRM are outlined below.

The RRM Function Should be Centralized

Based on our experience, having served as regulators and as in-house attorneys or external consultants to regulated entities, the RRM function should be centralized so that one individual ultimately manages regulatory affairs on behalf of a banking organization. There may be several points of contact for the regulatory agency, but one executive or senior-level manager should ultimately have accountability for the relationship. Where there are several points of contact, the circle should be kept small and for all purposes, it

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should report up to the regulatory relationship manager. This chain of command structure should be well-communicated internally so that all parties are aware of it. Alternatively, it can be thought of as a ''hub and spokes'' approach, with the regulatory relationship manager at the center.

Under either theory, the regulatory relationship manager should have knowledge about all regulatory activities currently underway or planned, including any examinations, investigations or inquiries. The regulatory relationship manager should be advised of any meetings with regulators in advance and offered the opportunity to attend. If he or she cannot attend, then the regulatory relationship manager should send a delegate or the participants should immediately provide a recap to the regulatory relationship manager.

Participants in regulatory meetings should avoid making commitments or irrevocable decisions if the regulatory relationship manager is not present. Similarly, any conversation held between an employee of the financial institution and a regulator should immediately be shared with the regulatory relationship manager. The regulatory relationship manager must receive contemporaneous or nearly immediate knowledge of any conversations that occur with the banking organization's regulatory agency to effectively manage the relationship.

RRM Requires Thorough Knowledge of Applicable Laws, Regulations

As a threshold matter, effective regulatory relationship management requires those who interface with regulators to become knowledgeable about the laws and regulations applicable to their operations; this requires research, training and self-study appropriate to the industry and the extent to which it is regulated. Because banking is so highly regulated, it is essential to pay close attention to the unique rulemaking process for the rule at issue, which can itself provide a useful window into and understanding of the direction that regulatory agencies are taking (or plan to take). Those responsible for the regulatory relationship management function must be not only well-versed in all rules that govern their business but they should strive to gain an appreciation for their regulators' overall agendas, even in advance of specific rulemaking proposals.

For example, regulatory relationship managers must be intimately familiar with the applicable requirements of the Dodd-Frank Wall Street Reform & Consumer Protection Act of 2010, which impacts all financial institutions, and simultaneously, they must attempt to discern how this legislation will inform agency activity in the future. In this connection, it can be useful for regulatory relationship managers to study the regulatory agendas of supervisory banking agencies. The FDIC's Semiannual Regulatory Agenda (December 20, 2010), for example, describes that agency's intended rulemaking on Alternatives to the Use of Credit Ratings in the Risk Based Capital Guidelines of the Federal Banking Agencies. The implications of the intended rulemaking are not inconsequential for banks: indeed, the FDIC requested comment on the potential for unintended consequences associated with adoption of different methods of eliminating reliance on credit ratings for purposes of risk-based capital guidelines.

Commenting on a proposed rulemaking allows banks to be heard on the advantages and disadvantages of forthcoming agency action. In addition to the real potential for influencing regulatory developments, participation in rulemaking proceedings enhances the bank's reputation in important ways because regulators gain a sense of trust in those who they perceive to have ''done their homework'' and who do not need to be tutored about applicable laws and regulations.

Understanding the regulatory structure and key agency personnel is as important as learning the underlying rules. Obviously, the regulatory relationship manager must be responsible for knowing who the company's functional regulators are, but it is just as important to have a clear grasp of the supervisory responsibilities of those regulators. A conscientious manager will delve into diverse sources of information, such as agency websites, agency organizational charts, and the publications, speeches, press releases and other news items about the agency itself. The manager should routinely review its regulator's website, making note of new personnel (and their backgrounds), announcements addressed to regulated entities, notices of enforcement actions taken, and the like. Registering for news announcements from one's supervisory agency is a helpful tool to stay abreast of current developments and monitor emerging issues.

Despite the effort required to gain deep knowledge of applicable rules and an understanding of a supervisory agency's role, mastery of this knowledge is not automatically apparent to regulators. It is incumbent on the regulatory relationship manager to demonstrate the company's expertise in an overt, consistent manner.

In addition to current, thorough knowledge of the rules affecting the institution, the regulatory relationship manager must be adept at accurately describing all details of the company's business to its regulators. Knowledge of laws and rules alone is insufficient to demonstrate to regulators that the institution places high value on regulatory compliance. The ability to appropriately implement regulatory requirements is a function of the manager's grasp of his organization's business strategies and operations, *in the context of those requirements*.

The Role of Information-Sharing in RRM

An effective regulatory relationship manager may occasionally find himself a source of information to regulators, who, despite their opportunities to examine and supervise multiple institutions, will not understand business operations at any particular bank as well as the bank's own personnel. The ability of a manager to make nuanced observations about an organization's business also contributes to creating the credibility referred to above. An effective regulatory relationship manager can — and sometimes should — provide information about general industry developments, as well as its own activities, to help the regulator put the business in context and perspective. Information sharing of this nature can be risky, though — if not communicated with finesse, a regulator may balk at attempts to educate him on general banking issues. Even sticking to explanations of one's own institution's operations can be perilous; for example, presenting the bank's own documents or information without cogent and full explanations can diminish an institution's credibility and may

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lead to more stringent approaches to future examinations or investigations.

How much information should be shared with regulators? In an examination context, the agency expects that an institution will provide information requested prior to the commencement of the exam or while the examiners are on-site. Be mindful, however, of the risk of unfettered discussions with regulators. It is a human tendency to reveal more than is needed, particularly during conversations, so those managing regulatory relationships — and those being interviewed — must be trained to identify and control this urge. While financial institutions should be open and honest with their regulators, it is wise to stay focused. Tangential conversations can lead an organization down a potentially adverse investigative path for which it may be unprepared. ''Just the facts, ma'am,'' as Joe Friday would say on *Dragnet*. This approach helps ensure that examiners stick to the scope of the examination without going off topic.

To illustrate this point, we recall a loan officer at a community bank who, during the course of a Community Reinvestment Act (''CRA'') examination, was explaining the institution's CRA assessment area. While describing the assessment area composition and demographics to the examiner, this loan officer inadvertently disclosed that the bank did not like to lend in a neighborhood where the homes tended to be over 40 years old. The area in question was predominately Hispanic. By virtue of this disclosure, the loan officer created a fair lending redlining issue for his institution.

The greatest challenge faced by regulatory relationship managers in the vital information-sharing sphere is balancing the necessity of answering all regulators' questions and providing all requested information without venturing into over-sharing.

RRM Requires Collaborative Communications

Successful regulatory relationship management requires *collaboration* between the regulated institution and its regulators. This collaboration is usually the result of ongoing dialogue between the two. Ongoing dialogue is not simply the back-and-forth that takes place during the examination process — it is a continuous communication that is not confined to an examination cycle. Because achieving ongoing dialogue may involve periodic meetings with a regulator, it is up to the bank to initiate these out-of-cycle conversations. A regulator kept ''in the loop'' by a company manager is more likely to approach periodic examinations or reviews in a less adversarial manner. A regularly scheduled quarterly meeting is advisable for highly regulated or very large institutions.

Another way for a bank to keep lines of communication open with regulators is to provide them with periodic management reports of important business developments or risk management committee topics. Most bank regulators would find this voluntary information sharing refreshing and welcome, and it may also save them time during examinations if they have an opportunity to review new developments or issues under management in advance.

Depending on the circumstances, a bank might even consider sharing business proposals with its regulator in advance to solicit informal feedback. Regulators, after all, are often savvy about what is going on in the industry and their input may be valuable in strategic planning. In general, significant business proposals should be shared with a regulator in advance if implementation (or the inability to implement) may have a material impact on the institution's business plan. For example, a regional banking organization was considering acquiring a sub-prime mortgage lender at the height of the sub-prime lending era in 2006 (shortly before sub-prime lending crashed in 2007-2008). The bank decided to proactively run the proposal by its regulator and found that the regulator had a very negative reaction to both the product and the proposed target institution. As a result, the bank scuttled its plan to acquire the sub-prime lender and saved itself the time and expense of a lengthy application process that likely would have been denied by the regulator.

A collaborative approach doesn't mean a bank should share only good news; rather, its credibility factor is enhanced if potentially bad news is disclosed voluntarily and proactively. The consequences may be harsher for a bank that tries to ''hide the ball'' and see if the regulator finds it. High on any list of what *not to do* to promote effective regulatory relationships is relying on a supervisory examiner to find problems in a company's operations.

Conducted appropriately, disclosure of potentially negative news should not be a mere tell-all — even negative disclosures provide an opportunity for a company to advocate or defend its position about why a certain action was taken, or not taken. To illustrate, a large banking organization discovered that its computerized system for sending adverse action notices required by Regulation B had developed a glitch, and several thousand customers failed to receive the required notice on a timely basis over the course of one month. Upon discovering the problem, the institution immediately conducted root cause analysis, developed an action plan to address the issue, and scheduled a meeting with its regulator to alert the agency to the issue before the next examination. The institution also took this as an opportunity to upgrade its computer system to the latest technology. This proactive strategy reflected well on the large institution in the eyes of its regulator.

It should be noted that the regulatory relationship manager, while constantly nurturing the regulatory relationship, is bound to protect his company in the process and to ensure that any proprietary information provided to the regulator is kept confidential. Advocacy for the company's positions need not be argumentative, but may require the input of corporate counsel or other specific individuals with knowledge of the pertinent facts.

Disclosures and Privilege

In disclosing potentially compromising information to a regulator, issues of privilege must be considered. Some information may be exempt from disclosure based on an attorney/client privilege, while other kinds of information may be privileged by application of the agency's own examination procedures. The regulatory relationship manager (and/or legal counsel) must be familiar with the laws of privilege and invoke them when appropriate. Although in many instances a regulator may be entitled even to privileged documents, it is advisable to attach a ''non-waiver of privilege'' stamp to the privileged documents to prevent further disclosure.

A further key element in a collaborative, trust-based relationship with a regulator is responsiveness. The bank must deal with regulatory inquiries promptly, making them a business priority. Some inquiries from regulators are received on short notice, but even then, responsiveness is vital. If no other option is available, the bank may consider offering an interim response, making its response subject to revision, or even asking for more time to respond, but the key to responsiveness is avoiding delay in acknowledging the inquiry and offering a realistic timeframe for a full response.

After committing to a response date for a regulatory request, the financial institution must keep its commitment. Hard-won trust and credibility can vanish overnight following unkept oral or written promises and missed deadlines. Spreadsheets, calendaring programs and databases are all useful tools for monitoring responsiveness. To avoid any misunderstandings about what has been promised, and when, the regulatory relationship manager should document the outcome of any meetings or requests, and obtain the regulator's acknowledgement about any identified follow-up tasks. Management's responses to examination findings and corresponding corrective action plans should also be monitored and tracked to completion.

The Human Factor

Other small gestures are also helpful in the successful management of regulatory relationships, which, in the final analysis, are relationships among individuals. The human factor in regulatory relationships cannot be overstated and therefore should not be overlooked. Common courtesies include providing food and beverages for lengthy meetings to avoid hunger fatigue, and a coat room for visiting regulators to secure their possessions. However, even the extension of these simple courtesies can create opportunities for reinforcing relationships. Ham and cheese sandwiches won't appeal to vegetarians, for example; a variety of choices, even though not extravagant, reflects sensitivity to others.

By the same token, the arrangement of a conference table need not necessarily be bank personnel on one side and regulators on the other — open seating may encourage a more open and friendly dialogue. Nonverbal defensive cues such as arms crossed over chests can inhibit conversation and should be avoided.

It is advisable to end meetings with regulators with a recap of what was specifically discussed and agreed upon, as well as next steps, to ensure a ''meeting of the minds.'' For example, it may be appropriate to discuss what progress has been achieved by the organization to date, what open issues remain to be resolved, and the time frame for addressing any open issues to facilitate a clear understanding of expectations by both parties. If written reports or documents are to be issued, the anticipated date for that documentation should be discussed and agreed upon. Appropriate members of management and corporate counsel should be fully apprised by the regulatory relationship manager of the results of any investigation or examination, and involved in any decisions pertaining to settlements, agreements or sanctions.

Although the concept of building trust and credibility with a regulator may appear daunting at first, there are many small steps that a financial institution may take through its RRM approach to promote its regulator's confidence in the organization. This long-term goal is critical to achieving an effective RRM program, which ultimately leads to a banking organization's ability to accomplish its business goals successfully in consultation with its regulator.

The next article in this series will discuss planning, organizing and managing regulatory examinations.

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