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INDUSTRY INSIGHTS

The Next Phase of Consumer Protection: A Fairness Framework as a Strategic and Reputational Differentiator

By Mike Scarpa and Lynne Johnston

In the last few weeks, Acting Comptroller of the Currency Michael Hsu has given two speeches regarding expectations of fairness in banking above and beyond current regulatory compliance risk management efforts. Here is an illustrative remark from the first speech, to drive home his point:

> **"Banks' deployment of more and better resources can improve the effectiveness of their compliance risk management programs, as can their adoption of modern technologies. In many cases both are necessary. But they may not be sufficient. In environments of change, executing well-designed and resourced compliance programs is just half the challenge. The other half is adapting and anticipating where compliance risks are likely to emerge. To do that, having a strong sense of fairness can be important."**

According to Hsu, a financial product or service may be legal and provided in compliance with regulations, but that doesn't always mean it's safe and appropriate for the consumer. His remarks around this unwritten fairness component may set a precedent that would likely require a customized assessment coupled with an enterprise fairness framework applied to new or existing products and activities. Hsu intimates that each customer should get the benefit of a fairness assessment prior to the purchase of a financial product or service. Although the feasibility of this is questionable on the banking side, there are existing capital markets rules and regulations that account specifically for customer appetite and sophistication when it comes to the buying and selling of securities or investment advisory services (e.g., Reg BI, suitability, fiduciary, etc.).

In addition to the "new" regulatory expectation of *de facto* fairness assessments based on the Comptroller's speeches, the current and future banking environment may also require fairness criteria applied from both a strategic view (re: new product/activity/client experience) and a reputational risk management standpoint (re: public perception of the bank as a market share driver). With the rise of digital banking and contraction of branch locations, there are fewer in-person consumer touchpoints. And with less customer in-person interaction, perceived fairness is now more important than ever to retain customers. Pricing, product offerings, product popularity and usage, and overall customer treatment/experience need to be considered by senior management. The board should ultimately approve customer experience/treatment modifications. Firms must adapt to this new reality emanating from the Office of the Comptroller of the Currency (OCC) and focus their efforts on profits aligned with fairness principles—and not simply on codified fairness compliance obligations—or they risk losing customers at a pivotal time in banking. The most successful banks in this environment seem to be the ones that provide a win/win for firm profits and customer service. It is important to note that transparency in services and associated fees is just as important as the product and service fees themselves.

U.S. regulators are not the only ones calling for fairness to be part of financial product and service offerings. The United Kingdom, through its regulators, has been championing a similar initiative for almost 20 years around understanding the needs and interests of clients and treating them fairly, according to six outcomes with recent additions in the last three years. U.S. regulators have made it clear that their expectations are higher with regard to customer fair treatment, even if not specifically codified through and required by formal guidance or regulation.

Implications for Financial Services Firms

Firms may need their board and senior management to incorporate additional fairness-based criteria into their enterprise risk appetite and risk management programs, product-level risk assessments, and provisioning of products and services. Firms may want to assess their financial services from a holistic and customer experience standpoint (expanding on the basics of ability to repay and other regulatory requirements). Firms may need to educate themselves through interviews and questionnaires on customer demand, expectations, and outcomes. Banks may need to provide staff and customers with education, training, and plain language documentation, rather than legal jargon regarding terms and conditions. Banks may even need to take a more personal approach (not an AI chatbot) to customer loans in default, customer complaints, due diligence and underwriting, and dispute handling, to name a few areas where complaints and compliance violations often arise.

Hsu suggests:

> **"(Banks) having a clear sense of where this fairness line is prior to the development and launch of such a product can help a bank avoid compliance risk issues down the road, when the product has grown and consumer harms are more apparent."**

This fairness dimension or "input" will have to be standardized at the board level, applied consistently and specifically across businesses and customers, and documented across the enterprise and within first-line business units. First-line risk and product officers as well as the internal audit team will need to assess the consistent application of this criteria. Compliance and legal departments will most certainly require consultation in the development of this criteria to ensure *de jure* compliance. Internal board and management reporting will need to evolve to account for business unit- and product-specific quantitative metrics and qualitative parameters such as excerpts from the customer experience.

Models and tools will need to be complemented by qualitative fairness factors since even in the best models, unfair results and disparate impacts can still result. In his second recent speech, Hsu provided the following insight:

> **"To guard against this, banks need to have appropriate oversight and governance of the models they use. This includes monitoring for fair lending impacts as credit models are developed, validated, monitored, and tested."**

Appropriateness and suitability may be added to the due diligence, underwriting, and contracting process. Staff will require expanded training on the fairness standards applied and the unique fairness elements that should be added to the customer service/lifecycle process that will be needed. Public statements should be made about the new vision and mission to account for fairness within financial services provided. Customer expectations will need to be accounted for and incorporated into any standard. Customer complaints can also serve as a valuable guidepost for development and evolution of the fairness framework.

Critical Elements of a Fairness Framework

Consumer protection laws, rules, and regulations are the beginning of the fairness journey—requiring appropriate mapping of regulatory obligations to controls. Robust monitoring, testing, and issue management programs that can quickly identify and address common customer concerns are also essential. There must be clear resolution of past bad behavior at both the individual and enterprise level. There must be a zero-tolerance policy toward unfair behavior toward customers with clear and documented repercussions both at the time an issue is discovered and during performance and compensation reviews. Any explanatory documentation provided to the client should be clear, concise, and truthful—not buried in legally dense terms, conditions, and disclosures. The financial picture of the consumer must be more broadly understood when offering a product or service. Lastly, public actions taken by federal and state banking regulators should be formally reviewed in a regulatory change management process, with findings incorporated into the fairness doctrine of a firm. Fairness will evolve as more data points are ingested and evaluated.

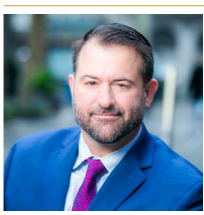
Achieving all of this is no easy task, and it will take a substantial amount of thought, integration, and implementation. That being said, banks endeavoring to do this and do it well are likely to reap substantial profit and customer satisfaction benefits. There will likely be a reduction in complaints and issues as well. On the other hand, failure to engage in seeking more fairness in banking could lead to heightened regulatory and reputational risk. In our experience, firms that proactively engage in compliance and risk management gain and maintain a strategic advantage over peers.

How Treliant Can Help

Our teams are well-equipped to address:

- **Regulatory Expectations:** Our professionals bring a distinctive blend of experience as former regulators, regulatory attorneys, auditors, and Chief Compliance Officers within all types of financial institutions. We have extensive regulatory compliance and consumer protection expertise in assisting financial firms through each new phase of consumer compliance supervision. Our contextual understanding of consumer protection regulation enables us to design programs that not only cover the letter but the spirit of regulations and supervisory expectations.

- **Methodology and Approach:** Our broad and deep expertise allows us to provide an approach that combines distinctive insights and practical advice to our clients. We guide clients through the process of building and/or enhancing their compliance programs, in a way that not only meets evolving regulatory expectations but actually sets financial institutions apart from a client satisfaction standpoint. Our teams assist with providing a perspective on not just industry leading practices but innovative ways to ensure fairness and customer satisfaction in financial services.



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