

Examination Guidance for Third-Party Lending

As of July 29, 2016

Purpose

Third-party lending arrangements may provide institutions with the ability to supplement, enhance, or expedite lending services for their customers. Engaging in third-party lending arrangements may also enable institutions to lower costs of delivering credit products and to achieve strategic or profitability goals. However, these arrangements also present a number of risks that require effective management. This guidance provides information on third-party lending activities¹ and supplements the FDIC's Guidance for Managing Third-Party Risk ("Third-Party Guidance").

The Third-Party Guidance applies to any of an institution's third-party arrangements, including lending. This guidance expands upon the principles in that guidance by setting forth safety and soundness and consumer compliance measures FDIC-supervised institutions should follow when lending through a business relationship with a third party.

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 will evaluate lending activities conducted through third-party relationships as though the activities were performed by the institution itself. The institution, its board, and senior managers retain the ultimate responsibility to conduct lending activities in a safe and sound manner, in accordance with existing supervisory guidance, and in compliance with applicable laws and regulations.

A listing of applicable guidance, regulations, and laws are cited at the end of this guidance.² Management should consider the principles addressed in this guidance and ensure that appropriate procedures are in place, taking into account the type of lending activity, complexity, volume, and number of third-party lending relationships. Institutions that engage in new or significant lending activities through third parties will generally receive increased supervisory attention. Third-party lending arrangements will be considered significant if, for example, they have a material impact on revenues, expenses, or capital; involve large lending volumes in relation to the bank's balance sheet; involve multiple third parties; or present material risk of consumer harm.

Background

¹ For purposes of this guidance, the terms "lending" and "loan" include any credit or financing arrangement, even if the transaction is not categorized as a loan on the institution's balance sheet.

² This is not an all-inclusive list, and depending on the type of product, service or relationship, other guidance, regulations, or laws may apply.

Third-party lending is a lending arrangement that relies on a third party to perform a significant aspect of the lending process, such as some or all of the following: 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.

Third-party lending arrangements may include the following:

- **Insured institutions originating loans for third parties** – In these situations, an insured institution typically serves as the originator for an entity that lacks the necessary licenses or charter to lend on its own behalf or seeks to take advantage of the institution’s ability to export interest rates.³ Often, the insured institution does not retain significant amounts of loan volume generated, but rather holds the loan for only a short period of time before selling it to the third party, which typically secures the ultimate funding source. In some of these arrangements, the loan volumes passing through insured institutions exceed by many multiples the bank’s balance sheet.
- **Insured institutions originating loans through third-party lenders or jointly with third-party lenders** – In these arrangements, an insured institution relies on a third party to generate loan volume for the institution by authorizing the agent to offer loans on the institution’s behalf. Loans generated through this model are typically retained by the insured institution, and in some situations, insured institutions may utilize multiple agents, sometimes numbering into the thousands and sometimes geographically dispersed. In other instances, third-party lenders and insured institutions act jointly to originate and fund credit.
- **Insured institutions originating loans using platforms developed by third parties** – In these situations, an insured institution relies on a third party to create and support a nearly end-to-end lending platform for the institution’s use. Most often, loans generated through this model are retained by the bank

Potential Risks Arising from Third-Party Lending Relationships

As noted in the Third-Party Guidance, there are numerous risks that may arise or be heightened from a financial institution’s use of third parties. The Third Party Guidance describes general risks associated with any type of third-party arrangement and the consequences that may occur from failure to adequately manage or mitigate these risks. Institutions should be aware of those risks as a baseline, but should also be aware of risks that are particularly associated with third-party lending programs. Not all of the following risks will be applicable to every third-party lending relationship and there may be other risks not described below.

³ Federal law authorizes state-chartered depository institutions to charge interest on loans to out of state borrowers at rates authorized by the state where the financial institution is located, regardless of usury limitations imposed by the state laws of the borrower’s residence. See Section 27 of the Federal Deposit Insurance Act, 12 U.S.C. § 1831d (enacted as section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980). However, courts are divided on whether third-parties may avail themselves of such preemption. See e.g., *CashCall, Inc v Morrissey*, Mo 12-1274, 2014 WL 2404300 (W Va. May 30, 2014).

Strategic Risk

Strategic risk is the risk arising from adverse business decisions, or the failure to implement appropriate business decisions in a manner that is consistent with the institution's strategic goals. As a core banking function, the use of third parties to perform functions related to lending or to offer products or services that do not help the institution achieve corporate strategic goals exposes the institution to strategic risk. For instance, the potential misalignment of incentives or goals between the institution and the third party partner may elevate strategic risk.

Operational Risk

Operational risk is the loss resulting from inadequate or failed internal processes, people, and systems or from external events. Third-party lending relationships integrate the internal processes of other organizations with the bank's processes and can increase the overall operational complexity. Due to the nature of many third-party lending relationships, key operational factors such as underwriting, servicing, or other customer interaction may be completed at another location and/or by employees not under the direct supervision of the insured institution.

Transaction Risk

Transaction risk arises from problems with service or product delivery. Particularly in situations where large volumes of loans are originated or multiple third parties or agents are involved, insured institutions can be significantly exposed to transaction and operational risks. Significant amounts of and/or growth in customers, transactions, and documents exposes insured institutions to heightened levels of concern regarding adequate safety and soundness and consumer protection compliance capacity, technology weaknesses, human error, weak controls, or fraud or other serious weaknesses at the third party, among other things.

Transaction risk can be particularly acute in situations involving multiple relationships where the third parties may have limited resources to ensure compliance with the institution's parameters, supervisory expectations and guidelines, and applicable regulations and laws. Transaction risk is also heightened when the third party itself relies on other third-party vendors as part of its business process. Transaction risk can also be associated with legal risks unique to third-party relationships. For example, insured institutions may incur liability in connection with joint activities or by operation of law that governs assignees of certain credit transactions.

Pipeline and Liquidity Risk

Pipeline risk relates to the risks associated with transactions failing to be consummated and funded as expected. Institutions originating loans through third-party arrangements in which the loans are expected to be sold, are subject to pipeline risk, and as a result, liquidity and funding risk, should the third party responsible for purchasing the loan production not be able to perform as agreed.

Model Risk

Model risk occurs when a financial model used to generate or value transactions or measure a firm's risks does not perform the tasks or capture the risks it was designed to or is used improperly in an institution's decision-making process. Some third-party lending relationships are heavily dependent on quantitative models developed by third parties, particularly in those arrangements in which institutions originate loans for third parties or use third party lending platforms. Model risk can be significant if a large portion of the third-party lending process is dependent upon models and/or if the models developed and used by the third party are not adequately understood by the insured institution's management. Insured institutions can also be exposed to increased compliance risk if models do not comply with consumer protection laws and regulations.

Credit Risk

Credit risk is the risk that a third party, or any other creditor necessary to the third-party relationship, is unable to meet the terms of the contractual arrangements with the insured institution or to otherwise perform as agreed. Institutions engaging in lending activities are exposed to credit risk, and the ability to manage credit risk can be more challenging when origination volumes are significant or there are numerous third-party relationships. These challenges can be exacerbated because incentives of third parties involved in lending may not be aligned with those of the institution. For example, often in third-party lending arrangements, third parties are paid fees for providing lending-related services regardless of transaction quality. Additionally, in other arrangements, third parties sometimes have an incentive to make or price loans in order to complete another transaction, such as a retail sale of a good or service, which may result in less attention to the quality of the loan. Certain loans may be underwritten off-site, increasing the risk that agents or employees of third-party lenders may misrepresent information about the loans or increase credit risk by failing to adhere to established underwriting guidelines.

Credit risk should not be disregarded if loans are sold, particularly if the institution is subject to repurchase requirements. Even where an insured institution properly seeks to mitigate the risks of third-party lending arrangements through contracts that provide indemnifications, parameters around representations and warranties, and/or limits on repurchases, such agreements do not insulate the institution from its ultimate responsibility to conduct lending activities in a safe and sound manner and in compliance with laws and regulations.

Compliance Risk

Compliance risk is the risk arising from violations of laws, rules, or regulations, or from noncompliance with internal policies or procedures or with the institution's business standards. Compliance risks are heightened when an institution engages in third-party lending activities. These heightened risks exist throughout the life of the borrower's relationship with the lender and may relate to compliance with requirements with respect to lending activities.

Consumer Compliance Risk

Consumer compliance risk may arise in numerous areas related to lending activities, including fair lending; debt collection; credit reporting; privacy; and unfair and deceptive acts or practices, among others. Specific risks and the potential for consumer harm can be elevated in these relationships depending on the inherent risk in the product offered, the level of third-party involvement throughout the life of the customer relationship, the number of third parties utilized by the institution, the size and volume of third-party lending as part of the institution's lending activity, and the extent to which an institution has implemented an effective compliance management system that incorporates the activities of third parties.

Bank Secrecy Act/Anti-Money Laundering (BSA/AML)

Institutions that rely on a third party to conduct any aspect of BSA/AML, such as customer information collection, due diligence, and suspicious activity monitoring and reporting, may be exposed to increased compliance risk, as third parties may lack specialized BSA/AML expertise, staffing, training, structure, and systems to facilitate and ensure compliance.

Third-Party Lending Risk Management Program

As described in the Third-Party Guidance, the key to the effective use of a third party in any capacity, including third-party lending relationships, is for the financial institution's management to appropriately assess, measure, monitor, and control the risks associated with the relationship. Engaging in a third-party lending arrangement may enable the institution to achieve strategic or profitability goals, but reduces management's direct control. Therefore the use of third parties to engage in lending activities increases the need for strong risk management and oversight around the entire process, including a comprehensive compliance management system.

To this end, institutions should establish a third-party lending risk management program and policies prior to entering into any significant third-party lending relationships. The program and policies should be commensurate with the significance, complexity, risk profile, transaction volume, and number of third-party lending relationships. Moreover, institutions engaging in third-party lending activities need a process for evaluating and monitoring specific third-party relationships. This process is described in the Third-Party Guidance as comprising of four elements: (1) risk assessment, (2) due diligence in selecting a third party, (3) contract structuring and review, and (4) oversight.

Developing a Third-Party Lending Risk Management Program

Strategic Planning

Institutions should incorporate third-party lending activities into the strategic planning process and should establish clear risk tolerance limits around the size of the overall program based on appropriate objectives, projections, and assumptions. The institution should ensure it has the necessary management, staffing, and expertise to conduct the appropriate due diligence, manage,

and oversee the program and the third-party lending relationships. Strategic planning regarding third-party lending arrangements should also consider economic conditions, operational and informational technology capacity, risk-return tradeoffs, the need to establish an appropriate allowance for loan and lease losses, and capital support. Strategic planning should also incorporate back-up plans in the event that third-party lending arrangements do not go as planned.

Third-Party Lending Policies

Third-party lending program policies should be developed by management and approved by the institution's board, and should at a minimum:

- Establish limits as a percent of total capital for each third-party arrangement and for the program overall, relative to origination volumes, credit exposures (including pipeline risk), growth, loan types, and levels of credit quality (such as delinquency, losses, and charge-offs).
- Establish responsibilities, authorities, and approval requirements for selecting individual third-party lending relationships.
- Establish minimum performance standards for third parties; requirements for independent reviews of each third party; and a program for management oversight of each third-party arrangement.
- Establish monitoring, both for individual third parties and as part of the institution's overall lending activity, to identify, assess, and mitigate risks, such as fair lending.
- Establish reporting processes (including board reporting).
- Require access to data or other program information.
- Define permissible loan types.
- Establish credit underwriting, administration, and quality standards.
- Establish a consumer complaint process that provides for timely identification and resolution of complaints, complaint monitoring, and periodic reporting.
- Address capital and liquidity support and allowance for loan and lease loss considerations.
- Ensure the compliance officer has necessary authority, accountability, and resources; ensure that he or she has knowledge and understanding of relevant consumer protection laws and regulations that apply to the third-party lending arrangements.
- Maintain an adequate training program that incorporates laws, regulations, guidance, and policies and procedures and that the institution ensures appropriate training is provided to relevant third-party personnel.

Elements for Evaluating and Monitoring Third-Party Relationships

Risk Assessment

As discussed in the Third-Party Guidance, risk assessment is fundamental to the initial decision of whether to enter into individual third-party relationships. A risk assessment will inform the institution of the risks associated with providing credit through third parties so that the institution, in turn, can decide how it can mitigate such risk.

The risk assessment should ensure that the proposed third-party lending relationship fits within the institution's strategic plan and business model and that management has the requisite knowledge to analyze, and later oversee, the appropriateness of a particular third-party lending relationship. Management's ability to oversee third-party lending relationships can be particularly difficult when, for example, the institution originates large, rapidly growing lending volumes, or engages multiple, geographically dispersed third parties. Management should fully understand and assess the benefits, costs, and potential risks associated with the third-party relationship prior to entering into the relationship, and conduct a new risk assessment if a third party changes its operations or the institution's lending operations change over time.

Due Diligence and Ongoing Oversight

Management should conduct due diligence on each third-party lending relationship to identify the suitability of the relationship, including whether management will be able to appropriately oversee the relationship going forward. Comprehensive due diligence and oversight involves a review of all available information about a third party, focusing on the entity's policies and procedures, financial condition, its specific experience and quality of management, and the effectiveness of its operations and controls.

The scope of such reviews, and in the case of ongoing reviews, the frequency, should be commensurate with the risk of the relationship activities, and for significant arrangements, may need to be more frequent. For example, institutions originating loans for third parties in volumes that exceed the size of the institution's balance sheet by many multiples or relationships with large, or multiple, widely dispersed third parties, would be expected to oversee the third-party lending arrangements on an ongoing basis.

While an institution may hire another party to perform certain due diligence and oversight functions, doing so does not diminish its due diligence or oversight responsibilities. Due diligence and ongoing monitoring findings should be reported to the board. The following is a listing of minimum expectations for due diligence and oversight. Comprehensive due diligence involves a review of all available information related to the third party, so institutions should not limit due diligence and ongoing reviews to the items in the Third-Party Guidance or listed here:

- Policies and procedures;
- Credit quality of loans solicited or underwritten by the third party;
- System of internal controls and extent of internal and external audit;
- Knowledge and experience of management and staff, particularly firm principals;
- Repurchase activity and volume;
- Management information systems;
- Compliance management systems;
- Results of the institution's monitoring of its third party data;
- Consumer complaints received;
- Information security program to protect consumer information;
- Litigation or enforcement actions;

- Earnings strength and adequacy of capital; and
- Stability of funding sources and back-up sources of liquidity

Ongoing oversight should include an audit or other independent verification of third-party activities, including an assessment of the third party's compliance with policies, procedures, contracts, and guidance, regulations, and laws applicable to the activities it performs on the institution's behalf. Institutions should periodically test a sample of transactions and conduct site inspections to assess the adequacy and compliance of the third party's operations and to ensure the third party is conducting business in line with expectations and requirements. The audit/independent verification, transaction testing, and site inspection scope depends on the complexity, size, and risk profile of the third-party lending program and may need to be continuous for significant programs with large volumes and multiple third-party relationships. Findings should be reported to the board, and exceptions should be tracked through final remediation. Corrective action (including updates to the third party's policies and procedures, additional training, enhancements to the institution's monitoring and restitution) may be necessary. Depending on the type and level of risk posed by the third-party arrangement, institutions should consider establishing a mystery shopper program.

- Model Risk Management

Institutions need to understand models used by third parties in lending arrangements. Institutions should review model development documentation and independent model validation, ongoing monitoring, outcomes analysis, annual reviews, and audits prior to model use, and periodically thereafter based on the level of model reliance and model significance, to:

- Develop an understanding of the model's design, theory, logic, and methodologies;
- Assess data and model quality, conceptual soundness, and reliability;
- Determine that the model reflects the institution's underwriting standards or pricing policies;
- Ensure that models consider fluctuations in the economic cycles and are adjusted to account for other unexpected events; and
- Ensure the models are developed and operated in compliance with applicable consumer protection laws and regulations, including fair lending.

Such assessments should be performed by objective and independent personnel that are competent and have relevant technical knowledge and modeling skills. Additionally, institutions should assess the adequacy of the third party's model implementation, use, governance, policies, and controls.

- Vendors Used by Third Parties

The institution should assess the adequacy of the third party's vendor management or third-party risk management process. For material vendor relationships, the institution should review the third party's due diligence, risk assessment, and oversight. Risks related to the third party's use of vendors or other entities should be incorporated into the risk assessment of the third-party

relationship, and transaction testing and site visits of the third party's vendors should be considered, as appropriate, for large or significant vendors.

Contract Structuring and Review

As described in the Third-Party Guidance, third-party lending relationships and loan sale/purchase agreements should be governed by written contractual agreements that clearly establish the rights and responsibilities of each party to the contract. For third-party lending arrangements in particular:

- Indemnification, representations, warranties, and recourse terms should limit the institution's exposure and should not expose the institution to substantial risk.
- Legal counsel review should include an analysis of the program and agreements to identify legal risk and an opinion concerning any potential recourse to the institution.
- Agreements should not limit the institution's ability to sell loans to another entity if the third party is unable to purchase loans under the agreement.
- Termination rights should be sought for excessive risk exposure, material deterioration in the institution's or third party's financial condition, or if required by the state regulators or the FDIC.
- Contracts should provide the institution full discretion and authority to require the third party to implement policies and procedures for any function or activity it outsources to the third party or that are integral to joint activities with the third party.
- Contracts should allow the institution to have full access to any information or data necessary to perform its risk and compliance management responsibilities, including access to loan performance data, internal and external audits, and funding information.
- Establish protections for the institution due to a third party or subcontractor's negligence, such as insurance.

Supervisory Considerations for Third-Party Lending Relationships

The following are some of the supervisory considerations related to third-party lending relationships.

Credit Underwriting and Administration

Whether an institution is originating loans for a third party, through/jointly with a third party, or using platforms developed by a third party, credit underwriting and administration standards must be established by the institution, not the third party. Standards must comply with existing safety and soundness principles, guidelines, and regulations; be commensurate with the board's risk appetite and strategies; and be supported by adequate capital, funding sources, and an appropriately funded allowance for loan and lease losses. The institution should establish a process to ensure that loan approvals by the third party comply with the institution's standards. Institutions should ensure that pre-approved offers sent to potential borrowers are consistent with the institution's credit standards.

Management should establish ongoing monitoring of loans generated through/jointly with a third party or using platforms developed by a third party using key measures, such as production volumes and trends, approval rates, decline rates, losses, delinquencies, and collections. Such measures should be monitored by various segments to allow meaningful analysis of credit quality, such as by individual third parties, loan type, origination period or vintage, and credit grade or score bands. Performance should be compared to projections. The cause of significant variance should be determined.

Monitoring results should be used to assess whether underwriting standards are appropriate. If monitoring reflects significant credit deterioration, weaker than projected loan performance, or heightened losses, management should re-assess credit standards and document support for changes or lack thereof. Institutions should also periodically perform sensitivity analysis to assess how changes in credit or economic conditions will affect the portfolio. Loans sold should be included in performance monitoring or sensitivity analysis.

Loss Recognition

For loans generated through/jointly with a third party or using platforms developed by a third party, the Board and management are expected to identify adversely classified loans and promptly charge-off loans deemed uncollectible. For retail credits, adverse classifications and losses should be identified at least according to the parameters outlined in the *Uniform Retail Credit Classification and Account Management Policy*. If loans do not have a contractual due date, the institution should establish a delinquency calculation that reflects more traditional repayment terms.

Subprime Programs

If third-party lending arrangements include subprime lending programs, existing subprime guidance applies, including the interagency *Expanded Guidance for Subprime Lending Programs* (“Subprime Guidance”) and the FDIC’s *Guidelines for Payday Lending*, as appropriate. The Subprime Guidance applies to programs with aggregate credit exposure greater than or equal to 25% of tier 1 capital, but may also be applied to certain smaller subprime programs.⁴ Because of the challenges in overseeing risks related to third-party lending and because the threshold is not meaningful when institutions sell the majority of loans after origination, the Subprime Guidance will be applied to all subprime programs in third-party lending arrangements, regardless of whether the threshold is met.

Bank-defined prime lending programs that allow credit underwriting standards with subprime credit characteristics are not eligible for the exclusion from the Subprime Guidance. Similarly, prime programs that do not consider credit criteria (such as delinquencies, bankruptcies, foreclosure, repossession, and charge-off) that are commonly considered to categorize subprime are also not eligible for exclusion from the Subprime Guidance. Institutions originating

⁴ “The Agencies may also apply these guidelines to certain smaller subprime portfolios, such as those experiencing rapid growth or adverse performance trends, those administered by inexperienced management, and those with inadequate or weak controls.” *Expanded Guidance for Subprime Lending Programs*, page 2.

subprime loans, including payday loans, should establish policy concentration limits, as a percentage of total capital.

Capital Adequacy

Institutions engaged in third-party lending arrangements should determine the amount and level of capital necessary to reflect the risk in the institution's third-party lending program. Capital assessments based on loan volume without consideration of loans originated and sold and associated risks are insufficient. Institutions engaging in significant third-party lending activities are expected to maintain capital well-above regulatory minimums. Institutions engaged in subprime third-party lending are expected to comply with the heightened capital requirements in the Subprime Guidance.

Liquidity

Institutions engaged in third-party lending arrangements should maintain appropriate liquidity to reflect the funding risk in the institution's third-party lending program. In particular, institutions that originate loans for third parties and rely on loan sales to the third party should assess concentrations in funding sources and have appropriate back-up funding arrangements to address pipeline risk. Additionally, institutions should conduct sensitivity analysis to determine the potential impact in the event of a delay or halt in loan sales.

If cash collateral funds are in place to mitigate liquidity and pipeline risk, the institution should document how that collateral level was deemed appropriate and how often the level is reassessed to ensure risk exposure does not increase to unacceptable levels. The institution should also be able to demonstrate that it has the ability to access the collateral if a third party fails to purchase loans pursuant to contract.

Profitability

Institutions should project and budget costs and earnings of each relationship and for the third-party lending program overall prior to entering into relationships and periodically thereafter. Monitoring should compare budget and projections to actual performance to evaluate profitability, which should be considered in decisions to maintain the relationship. Projections should be tested to consider changes in economic conditions, interest rates, investor demand, and borrower demand.

Institutions should monitor reliance on income, revenues, and fees from each arrangement and program overall. Cost to exit a relationship, including the cost to obtain replacement services, and the impact on the financial condition if earnings were to cease should be incorporated in the profitability analysis, with potential impact on capital incorporated into the capital analysis.

Institutions should demonstrate that the fees paid to or by the institution are supported and provide the institution with an acceptable risk-adjusted return.

Accounting and Allowance for Loan and Lease Losses

Institutions should report purchased interests in accordance with applicable generally accepted accounting principles. Financial reporting considerations include, but are not limited to: true loan sale treatment, residuals, loan sale commitments, valuations / mark to market accounting, credit enhancing representations and warranties, and bookkeeping accuracy between the third party and the institution. An appropriate allowance for loan and lease losses should be maintained.

Consumer Compliance

As with other types of third-party relationships, partnering with third-party lenders does not relieve the institution from compliance with applicable laws and regulations. The institution is ultimately responsible for ensuring all aspects of third-party lending activities are in compliance with consumer protection and fair lending requirements to the same extent as if the activities were handled within the institution itself. In addition, the institution should have systems in place to ensure third parties utilized by the institution have the appropriate authority to conduct business on behalf of the institution, such as appropriate licensure. An institution's compliance management system should be appropriate to the size, complexity, and scope of its third-party lending relationships to effectively address emerging issues and to proactively identify and address compliance deficiencies. Third parties that have direct contact with borrowers, develop customer-facing documents, or provide new, complex, or unique loan products require enhanced compliance-related due diligence and oversight by the institution to ensure areas of potential consumer harm are identified and mitigated. Institutions that conduct a significant volume of lending through dispersed networks of third parties should be particularly attuned to potential elevated fair lending risks, especially when the institution's program permits significant levels of discretion.

Bank Secrecy Act/Anti-Money Laundering (BSA/AML)

Similarly, partnering with third-party lenders does not relieve the institution from compliance with BSA/AML requirements. If the institution relies on a third party to perform BSA/AML functions on its behalf, the institution is ultimately responsible for that third party's compliance with the BSA/AML requirements. Institutions should have written agreements in place that clearly outline each party's obligations and establish adequate controls and review procedures.

Safeguarding Customer Information

Institutions engaged in third-party lending relationships must also ensure that customer information is safeguarded when held by third parties. Specifically, institutions retain the responsibility to ensure compliance with the interagency guidelines establishing standards for safeguarding customer information issued by the banking agencies pursuant to the Gramm-Leach-Bliley Act. The interagency guidelines, which appear in Appendix B to Part 364 of the FDIC Rules and Regulations, require institutions to implement a written information security program to protect the security, confidentiality, and integrity of customer information. The guidelines further require institutions to assess reasonably foreseeable internal and external threats that could result in unauthorized uses or destruction of customer information systems, and

to design a security program to control those risks. An institution's board of directors should approve the written program and oversee its implementation. Institutions engaged in third-party lending should establish written expectations, training and oversight measures to ensure that third parties are safeguarding customer information in accordance with the interagency guidelines and reporting any breaches to the institution to ensure proper and timely notification to customers.

Information Technology

Institutions should be in compliance with the information technology expectations for third-party arrangements (including the third party's subcontracting activities) established in the *FFIEC Information Technology Handbook*, "Outsourcing Technology Services."

Examination Procedures for Third-Party Lending Relationships

Examiners will assess third-party lending relationships in conjunction with this guidance, the Third-Party Guidance, and any other applicable guidance, regulations, and laws (see resource list at the end of this document for examples).

For institutions with significant third-party lending programs relationships, the examination cycle will be at least every 12 months and include concurrent risk management and consumer protection examinations. Risk management examinations will include information technology and BSA/AML examinations. More frequent examination activities, such as visitations or ongoing examinations should be performed if significant risk is identified, such as significant increases in origination volumes and/or number of third-party arrangements; the third-party arrangements are a material portion of the institution's operations and strategy; or material weaknesses in the management of the third-party relationships is identified or a significant risk management, financial, or operational weakness is noted in the third party itself. In such situations, additional ongoing off-site monitoring should also be performed, including periodic reports on volumes, third-party relationship changes, consumer complaint trends, and credit performance.

Examiners will conduct targeted examinations of significant third-party lending arrangements and may also conduct targeted examinations of other third parties where authorized. Reviews should be of sufficient scope and frequency to assess the level of risk posed to the institution by the third-party arrangement, whether the risk is appropriately managed by the institution, and whether the third party is appropriately implementing agreed-upon policies and procedures and is in compliance with guidance, regulations, and laws applicable to the activities it performs on the institution's behalf. Third-party lending examination activities would typically include, but not be limited to, a review of corporate governance; financial strength; compliance management system; credit underwriting and administration; model risk management; vendor management; internal controls; audit program; BSA/AML; safeguarding of customer information, information technology; consumer complaints; and litigation. In certain cases, examination activities will include targeted reviews of compliance with fair lending laws, such as when lending through a

dispersed network of third parties poses a heightened fair lending risk or when an institution is employing a model with untested or unproven inputs.

Reviews of third parties should also include transaction testing of individual loans to assess compliance with consumer compliance regulations, underwriting and loan administration guidelines, credit quality, appropriate treatment of loans under delinquency, and re-aging and cure programs. The sample size of individual credit testing should be meaningful, and underlying documents and data inputs (including automated system inputs) should be reviewed.

Findings of third party reviews will be reflected in the Report of Examination. When examiners determine that management of safety and soundness or compliance risks is deficient, they should criticize management and initiate corrective action. Weaknesses should be reflected in applicable component ratings, the Management rating, and the composite rating in accordance with the Uniform Financial Institutions Rating System. Corrective actions may include formal or informal enforcement action. When serious deficiencies exist, enforcement actions may instruct institutions to discontinue third party lending.

For questions about this guidance, institutions should contact their appropriate FDIC Regional Office.

Resources

(This is not an all-inclusive list. Depending upon the type of product, service, or relationship, a listed item may not apply and other guidance, regulations, or laws may apply.)

[Guidance for Managing Third-Party Risk \(Financial Institution Letter \(FIL\) 44-2008, June 6, 2008\)](#)

[Safety and Soundness Standards \(Section 39 of the Federal Deposit Insurance Act\)](#)

[Interagency Guidelines Establishing Standards for Safety and Soundness \(Appendix A to Part 364 of the FDIC Rules and Regulations\)](#)

[Real Estate Lending Standards \(Part 365 of the FDIC Rules and Regulations\)](#)

[Uniform Retail Credit Classification and Account Management Policy \(FIL-40-2000, June 29, 2000\)](#)

[Interagency Guidance on Subprime Lending \(FIL-20-99, March 4, 1999\)](#)

[Expanded Guidance for Subprime Lending Programs \(FIL-9-2001, January 31, 2001\)](#)

[Statement on Subprime Mortgage Lending \(FIL-62-2007, July 10, 2007\)](#)

[Guidelines for Payday Lending \(FIL-14-2005, March 1, 2005 \(revised November 2015\)\)](#)

[Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation for Banks and Savings Institutions](#)

[Interagency Guidelines Establishing Information Security Standards \(Appendix B to Part 364 of the FDIC Rules and Regulations\)](#)

[Privacy of Consumer Financial Information \(Part 332 of the FDIC Rules and Regulations\)](#)

[FFIEC Information Technology Handbook, “Outsourcing Technology Services”](#)

[Interagency Guidance on Response Programs for Unauthorized Access to Customer Information and Customer Notice \(FIL-27-2005, April 1, 2005\)](#)

[Policy Statement on Discrimination in Lending \(April 15, 1994\)](#)

[Interagency Guidance Regarding Unfair or Deceptive Credit Practices \(FIL-44-2014, August 22, 2014\)](#)

[Unfair or Deceptive Acts or Practices by State-Chartered Banks \(FIL-26-2004, March 11, 2004\)](#)

[Social Media: Consumer Compliance Risk Management Guidance \(FIL-56-2013, December 11, 2013\)](#)

[Interagency Guidance on Mortgage Servicing Practices Concerning Military Homeowners with Permanent Change of Station Orders \(FIL-28-2012, June 21, 2012\)](#)

[FDIC's Supervisory Policy on Predatory Lending \(FIL-6-2007, January 22, 2007\)](#)

[Advisory Statement on Encouraging Financial Institutions to Work with Student Loan Borrowers Experiencing Financial Difficulties \(FIL-35-2013, August 1, 2013\)](#)