KPMG
cutting through complexity™

The Washington Report

June 6, 2011

Weekly Newsletter

In This Issue

Bank & Thrift

Fed Governor Speaks on Regulating Systemically Important Financial Institutions

Federal Reserve Board ("Fed") Governor Daniel Tarullo spoke before the Peter G. Peterson Institute for International Economics on June 3 on the topic of "*Regulating Systemically Important Financial Firms*." His remarks were focused on the more stringent capital standards that are required for systemically important financial institutions ("SIFIs") under the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (the "Dodd-Frank Act").

Governor Tarullo stated that the Basel III capital requirements, which are intended to provide for better quality of capital, improved risk weightings, higher minimum capital ratios, and a capital conservation buffer, comprise a key component of the post-crisis reform agenda – but only a component. In particular, an SIFI has no incentive to carry enough capital to reduce the chances of systemic losses. So that, where Basel III is primarily a microprudential exercise, it could be complemented by requirements for SIFIs with a macroprudential perspective. The Dodd-Frank Act "rationale for enhanced capital requirements for SIFIs is to take these costs into account, make SIFIs less prone to failure, and thereby to make the financial system safer."

While Dodd-Frank mandates an enhanced capital requirement for SIFIs, it does not specify the form of that requirement. Governor Tarullo suggested what he called "five desirable characteristics" for this enhanced capital requirement. He said:

- The additional capital requirement should be imposed and calculated using a metric based upon the impact of a firm's failure on the financial system as a whole. Factors might include: size, interconnectedness, intra-financial firm assets and liabilities, cross-border activity, and the use of various complex financial instruments.
- The metric should be transparent and replicable.
- The enhanced capital standards should be progressive in nature (e.g., increase in stringency with the systemic footprint.)
- The enhanced capital requirement should be met with high-quality capital.
- U.S. requirements for enhanced capital standards should be, to the extent possible, congruent with international standards.

The rationale for a macroprudential capital measure is to cover the amount of harm a SIFI failure will inflict on the rest of the financial system, not the amount of loss its shareholders and creditors will incur. Currently, there is no single accepted method for calibrating the amount of the additional requirement needed to reflect this concern. Governor Tarullo outlined several methodologies under consideration by the Basel Committee on Banking Supervision:

- The "expected impact" approach - which tries to determine how much additional capital would be needed to reduce the probability of failure of a SIFI sufficiently to equalize the expected impact on the financial system of the failure of a SIFI and the failure of a banking firm just outside systemic status (i.e., slighty below the SIFI criteria);

- The “long-run economic impact"”approach - which uses macroeconomic models to estimate both the costs and benefits of higher capital requirements to the economy as a whole; and
- A third methodology that tries to determine how much additional capital would be needed to offset any reduction in funding costs associated with the perceived too-big-to-fail status of SIFIs. (Governor Tarullo said the capital requirement increases implied by this approach were considerably higher than for the other two approaches though the results seemed even more sensitive to changes in reasonable initial assumptions than the other two models.)

He said that the Fed would consider all of the approaches but noted that the “expected impact” methodology has had the most influence on the Fed staff's analysis.

Finally, with regard to the resolution of SIFIs, Governor Tarullo stated that the legal and practical complexities implicated by the insolvency of a SIFI with substantial assets in many countries will make its orderly resolution “a daunting task, at least for the foreseeable future.” For this reason, he said, “the special resolution mechanism of Dodd-Frank and the enhanced capital requirements called for by that same law should be regarded as complementary rather than as substitutes.”

For additional information please contact Hugh Kelly, Principal: hckelly@kpmg.com or
Jon Greenlee, Managing Director: jdgreenlee@kpmg.com.

FDIC Forms Advisory Committee on Systemic Resolutions

The Federal Deposit Insurance Corporation (“FDIC”) announced on June 3 that it had approved the creation of the “FDIC Advisory Committee on Systemic Resolutions.” The FDIC indicates this advisory committee is intended to advise the FDIC on:

- The effects on financial stability and economic conditions resulting from the failure of a systemically important company;
- How resolution strategies would affect the stakeholders and customers of these entities;
- The tools available to the FDIC to wind down the operations of a failed organization; and,
- The tools needed to assist in cross-border relations with foreign regulators and governments when a systemic company has international operations.

The committee will not have formal decision-making authority and is expected to meet at least semiannually under a two-year charter. The first meeting is scheduled for June 21.

The committee consists of eighteen (18) members whose experience includes “managing complex firms; administering bankruptcies; working in the legal system, accounting field, and academia; and other relevant expertise.” They are joined by James Wigand, the Director of the FDIC’s Office of Complex Financial Institutions.

For additional information please contact Hugh Kelly, Principal: hckelly@kpmg.com or
Jon Greenlee, Managing Director: jdgreenlee@kpmg.com.

Basel Committee Modifies Credit Valuation Adjustment Under the Basel III Capital Treatment for Counterparty Credit Risk

On June 1, the Bank for International Settlements' Basel Committee on Banking Supervision ("Basel Committee") announced that it had made a "minor modification" to the credit valuation adjustment ("CVA") that is part of its Basel III capital treatment for counterparty credit risk.

At the time the Basel Committee released its Basel III capital framework (December 2010), it noted that the level and reasonableness of the standardized CVA risk capital charge would be subject to a final impact assessment, which was expected to be completed in the first quarter of 2011. The Basel Committee states that the results of this now completed impact study showed "that the standardised method as originally set out in the December 2010 rules text could be unduly punitive for low-rated counterparties with long maturity transactions. To narrow the gap between the capital required for CCC-rated counterparties under the standardised and the advanced methods, the Basel Committee agreed to reduce the weight applied to CCC-rated counterparties from 18% to 10%. "

All other aspects of the regulatory capital treatment for counterparty credit risk and CVA risk remain unchanged from the December 2010 Basel III rules text.

The Basel Committee is finalizing its review of capitalization of bank exposures to central counterparties and expects to finalize this rule by year end.

> For more information, please contact Hugh Kelly, Principal: hckelly@kpmg.com or
> Paul Cardon, Manager: pcardon@kpmg.com.

Enterprise & Consumer Compliance

Agencies Release 2011 List of Distressed or Underserved Nonmetropolitan Middle-Income Geographies

On June 1, the Federal bank and thrift regulatory agencies (Federal Reserve Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and Office of Thrift Supervision) announced the availability of the 2011 list of distressed or underserved nonmetropolitan middle-income geographies where revitalization or stabilization activities will receive *Community Reinvestment Act* ("CRA") consideration as "community development."

"Distressed nonmetropolitan middle-income geographies" and "underserved nonmetropolitan middle-income geographies" are designated by the agencies in accordance with their CRA regulations. The criteria for designating these areas are available on the Federal Financial Institutions Examination Council ("FFIEC") Web site. The agencies indicate the designations reflect local economic conditions, including triggers such as unemployment, poverty, and population changes.

The 2011 list and lists from previous years can be found on the FFIEC Web site, along with information about the data sources used to generate the list of distressed or underserved geographies.

For more information, contact Linda Gallagher, Principal: lgallagher@kpmg.com or Kari Greathouse, Director: cgreathouse@kmg.com.

CFPB Publishes List of Regulations and Orders That It Plans to Enforce – Comments Requested

The Bureau of Consumer Financial Protection ("CFPB") published for comment a list of the rules and orders that it will enforce after July 21, 2011. On July 21, 2011, certain consumer financial protection authorities from seven agencies (collectively the "transferor agencies" - Federal Reserve Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Office of Thrift Supervision, National Credit Union Administration, Department of Housing and Urban Development and Federal Trade Commission) will be transferred to the CFPB. Comments are requested by June 30, 2011.

After consultation with the transferor agencies, the CFPB identified the following list of rules. No orders were identified to be included on the list.

Banking Agency and NCUA Rules

- *Equal Credit Opportunity Act* (Regulation B)
- *Home Mortgage Disclosure* (Regulation C)
- *Electronic Fund Transfers* (Regulation E)
- Registration of Residential Mortgage Loan Originators
- *Consumer Leasing* (Regulation M)
- Privacy of Consumer Financial Information
- Fair Credit Reporting (with certain exceptions)
- *Truth in Lending Act* (Regulation Z)
- *Truth in Savings Act* (Regulation DD)
- Adjustable-Rate Mortgages (as applied to non-federally chartered housing creditors under the *Alternative Mortgage Transaction Parity Act* ("AMTPA"))
- Alternative Mortgage Transactions (as it relates to AMTPA)
- Loans to members and lines of credit to members (as applied to non-Federally chartered housing creditors under AMTPA)(NCUA)

Federal Trade Commission Rules

- Telemarketing Sales Rule
- Disclosure Requirements for Depository Institutions Lacking Federal Deposit Insurance
- Mortgage Assistance Relief Services
- Use of Pre-notification Negative Option Plans
- Cooling-Off Period for Sales Made at Homes or Certain Other Locations
- Preservation of Consumers' Claims and Defenses
- Credit Practices
- Mail or Telephone Order Merchandise
- Disclosure Requirements and Prohibitions Concerning Franchising
- Disclosure Requirements and Prohibitions Concerning Business Opportunities
- Fair Credit Reporting Act, (with certain exceptions)

- Procedures for State Application for Exemption from the Provisions of the Fair Debt Collection Practices Act

Department of Housing and Urban Development Rules

- Hearing Procedures
- Civil Money Penalties (as applied to the *Real Estate Settlement Procedures Act* ("RESPA") and the Interstate Land Sales Full Disclosure Act ("ILSA"))
- Land Registration
- Purchasers' Revocation Rights, Sales Practices, and Standards
- Formal Procedures and Rules of Practice
- RESPA
- Investigations in Consumer Regulatory Programs (as applied to RESPA and ILSA)

> For more information, contact Linda Gallagher, Principal: lgallagher@kpmg.com or
> Kari Greathouse, Director: cgreathouse@kmg.com.

BIS Working Paper Considers Business Models and Strategies for Financial Inclusion

The Bank for International Settlements ("BIS") released Working Papers No. 347, entitled "*On Harnessing the Potential of Financial Inclusion*," on June 1. The authors summarize the paper by stating that it describes "one commercially viable initiative" for a mobile money or branchless banking scheme that could provide essential financial services to "most people" and analyzes the types of transactions involved with it. In addition, the paper "argues that in order to harness the potential of financial inclusion it is vital to permit experimentation with different business models." The authors suggest that regulation is required to enable "such experimentation by being calibrated to the type of service offered, but which can be tightened if and when such schemes become bigger with the potential to impact financial stability: risk-proportionate regulation by service type."

The Working Paper is available on the BIS Web site.

> For more information, contact Linda Gallagher, Principal: lgallagher@kpmg.com or
> Kari Greathouse, Director: cgreathouse@kmg.com.

Securities & Investment Management

SEC and FINRA Jointly Issue Alert to Investors on Structured Notes with Principal Protection

The Securities and Exchange Commission ("SEC") and the Financial Industry Regulatory Authority ("FINRA") jointly released an investor alert on June 2 entitled "*Structured Notes with Principal Protection: Note the Terms of Your Investment*." The alert is intended to provide investors with information to help them understand how the products work, as well as about the risks of structured notes with principal protection. The agencies state that the retail market for these notes has grown in recent years, and suggests that while "these structured products have reassuring names, they are not risk-free." They add that, in some cases, the upside exposure of the notes to the underlying asset, index or benchmark is limited or capped and that protection levels can vary greatly.

For more information, contact Doug Henderson, Managing Director: douglashenderson@kpmg.com or Dan McIsaac, Director: dmcisaac@kpmg.com.

Enforcement Actions

The Securities and Exchange Commission ("SEC"), the Commodity Futures Trading Commission ("CFTC") and the Financial Industry Regulatory Authority ("FINRA") announced the following enforcement actions during the week of May 31.

- The SEC charged a former managing director of a stock exchange with insider trading after trading on confidential information obtained through the director's employment.
- The CFTC obtained a court order requiring an individual and a registered commodity pool operator to pay more than $3 million in civil money penalties and more than $1 million in restitution for misappropriation of funds and making false statement to regulators. The order also prohibits both defendants from engaging in commodity-related activity within the jurisdiction of the CFTC.
- The CFTC obtained a court order requiring an individual and his company to pay more than $500,000 in civil money penalties and more than $5.7 million in restitution for operating a commodity pool Ponzi scheme. The order also prohibits the defendants from engaging in any commodity-related activity, including trading, and from registering or seeking exemption from registration with the CFTC.
- FINRA fined a firm $600,000 for deficiencies in supervising sales of collateralized mortgage obligations (CMOs) and failure to have adequate systems in place to monitor certain high-volume securities trades, including reviewing these trades for suitability, concentration, excessive trading, excessive mark-ups or commissions, or for trading in restricted stocks.

For more information, contact Doug Henderson, Managing Director: douglashenderson@kpmg.com or Lucia Baraybar, Director: lbaraybar@kpmg.com.

Recent Supervisory Actions against Financial Institutions

Last Updated: June 6, 2011

Agency	Institution Type	Action	Date	Synopsis of Action
Federal Reserve Board	Bank Holding Company	Written Agreement	06/02	The Federal Reserve Board entered into a Written Agreement with a Georgia bank holding company that addressed dividends and distributions and debt and stock redemptions to ensure that it serves as a source of strength for its state nonmember bank and nonbank subsidiaries.
Federal Reserve Board	Bank Holding Company	Written Agreement	05/31	The Federal Reserve Board entered into a Written Agreement with a Georgia bank holding company that addressed dividends and distributions and debt and stock redemptions to ensure that it serves as a source of strength for its state nonmember bank and nonbank subsidiaries.
Federal Reserve Board	State Member Bank	Civil Money Penalty	05/31	The Federal Reserve Board issued an Order of Assessment of Civil Money Penalty against a Texas State member bank for violations of the National Flood Insurance Act.
Federal Reserve Board	Bank Holding Company	Written Agreement	05/26	The Federal Reserve Board entered into a Written Agreement with an Illinois bank holding company that addressed dividends and distributions and debt and stock redemptions to ensure that it serves as a source of strength for its state nonmember bank and nonbank subsidiaries.
Federal Reserve Board	Bank Holding Company, State Member Bank	Written Agreement	05/26	The Federal Reserve Board entered into a Written Agreement with a North Carolina bank holding company and its state member bank subsidiary to address deficiencies related to board oversight, credit risk management, lending and credit administration, appraisal program, loan grading and loan review, asset improvement, allowance for loan and lease losses, capital, dividends and distributions and debt and stock redemptions.
Federal Reserve Board	Bank Holding Company	Written Agreement	05/26	The Federal Reserve Board entered into a Written Agreement with a Texas bank holding company that addressed dividends and distributions, debt and stock redemptions and capital to ensure that it serves as a source of strength for its state nonmember bank and nonbank subsidiaries.
Federal Reserve Board	Bank Holding Company	Written Agreement	05/26	The Federal Reserve Board entered into a Written Agreement with a South Carolina bank holding company that addressed dividends and distributions and debt and stock redemptions to ensure that it serves as a source of strength for its national bank and nonbank subsidiaries.
Federal Reserve Board	Bank Holding Company	Written Agreement	05/12	The Federal Reserve Board entered into a Written Agreement with a Minnesota bank holding company that addressed dividends and distributions and debt and stock redemptions to ensure that it serves as a source of strength for its state nonmember bank and nonbank subsidiaries.

Contact Us

This is a publication of KPMG's Financial Services Regulatory Practice

Linda Gallagher, National Leader, Financial Services Regulatory Practice
Jon Greenlee, Managing Director, Bank Regulatory
Douglas Henderson, Managing Director, Broker-Dealer Regulatory
Hugh Kelly, Principal, Bank Regulatory
Amy Matsuo, Principal, Enterprise & Consumer Compliance
John Schneider, Principal, Investment Management Regulatory
David Sherwood, Insurance Regulatory

Earlier editions are available at:
http://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/washington-reports/Pages/washington-report.aspx

Asset Management, Trust, and Fiduciary

Bill Canellis	T: 973.912.4817

Bank Regulatory Reporting

Francis Gomez	T: 212.872.5662
Chris Monks	T: 617.988.1718
Brett Wright	T: 901.249.3809

Broker-Dealer Regulation

Lucia Baraybar	T: 212.872.6477
Stefan Cooper	T: 856.417.6799
Doug Henderson	T: 212.872.6687
Dan McIsaac	T: 212.954.5973

Capital/Basel II and III

Bill Canellis	T: 973.912.4817
Jon Greenlee	T: 703.286.8032
Hugh Kelly	T: 202.533.5200
Greg Matthews	T: 212.954.7784

Commodities and Futures Regulation

Dan McIsaac	T: 212.954.5973

Consumer & Enterprise Compliance

Linda Gallagher	T: 703.286.8248
Kari Greathouse	T: 636.587.2844
Amy Matsuo	T: 919.380.1509

Cross-Border Regulation

Jon Greenlee	T: 703.286.8032
Hugh Kelly	T: 202.533.5200
Craig Stirnweis	T: 212.872.5960

Foreign Banking Organizations

Francis Gomez	T: 212.872.5662
Hugh Kelly	T: 202.533.5200
Craig Stirnweis	T: 212.872.5960

Insurance

David Sherwood	T: 212.954.5861
Lisa Stimson	T: 860.297.6059

Investment Management Regulation

John Schneider	T: 617.988.1000

Privacy & Identity Theft

Linda Gallagher	T: 703.286.8248
Kari Greathouse	T: 636.587.2844

Safety & Soundness, Corporate Licensing & Governance, and ERM Regulation

Paul Cardon	T: 617.988.1282
Jon Greenlee	T: 703.286.8032
Hugh Kelly	T: 202.533.5200
Greg Matthews	T: 212.954.7784
Craig Stirnweis	T 214.840.6866