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In This Issue

Bank & Thrift

Agencies Issue Guidance on ALLL for Mortgage Loan Credits

The Federal Reserve Board, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Office of the Comptroller of the Currency (collectively, the "Agencies") jointly issued supervisory guidance on January 31, 2012 that addresses estimation practices for the allowance for loan and lease losses ("ALLL") associated with loans and lines of credit secured by junior liens on one- to four-family residential properties.

The Agencies state they issued the guidance in response to the ongoing uncertainties in the economy, and the housing market in particular, in order to reiterate policy and to remind regulated financial institutions to monitor all credit quality indicators relevant to credit portfolios, including junior liens (such as second mortgages and home equity lines of credit taken out by mortgage borrowers). The guidance also reiterates key concepts included in generally accepted accounting principles and existing ALLL supervisory guidance related to the ALLL and loss estimation practices. Institutions are also expected to follow appropriate risk-management principles in managing junior lien loans and lines of credit.

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FDIC Guidance Addresses Risks of Third-Party Payment Processor Relationships

The Federal Deposit Insurance Corporation ("FDIC") released Financial Institution Letter 3-2012 on January 31 to provide insured depository institutions with revised guidance on the risks associated with payment processor relationships.

The FDIC highlights the following information from the guidance:

- Account relationships with third-party entities that process payments for merchants require careful due diligence, close monitoring, and prudent underwriting.
- Account relationships with high-risk entities pose increased risks, including potentially unfair or deceptive acts or practices.
- Certain types of payment processors may pose heightened money laundering and fraud risks if merchant client identities are not verified and business practices are not reviewed.
- Financial institutions should assess risk tolerance in their overall risk assessment program and develop policies and procedures addressing due diligence, underwriting, and ongoing monitoring of high-risk payment processor relationships.
- Financial institutions should be alert to consumer complaints or unusual return rates that suggest the inappropriate use of personal account information and possible deception or unfair treatment of consumers.
- Financial institutions should act promptly when fraudulent or improper activities occur relating to a payment processor, including possibly terminating the relationship.

- Improperly managing these risks may result in the imposition of enforcement actions, such as civil money penalties or restitution orders.

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Enterprise & Consumer Compliance

Federal and State Agencies Announce Significant Mortgage Servicer Settlement Agreement

On February 9, 2012, the Department of Justice, the Department of Housing and Urban Development, the Conference of State Bank Supervisors and 49 state Attorneys General announced that they had jointly reached an agreement ("Settlement Agreement") with the five largest mortgage servicers to address issues associated with mortgage loan servicing and foreclosures. The Settlement Agreement is reported to require the five mortgage servicers to commit as much as $25 billion in total over the next three years to financial relief for certain distressed homeowners and to payments to Federal and state governments. Among other things, the Settlement Agreement requires the mortgage servicers to: reduce principal balances and provide refinancing for certain underwater borrowers; implement new mortgage loan servicing standards; and conduct reviews for violations of the *Servicemembers Civil Relief Act* and provide compensation to harmed servicemembers.

Compliance with the Settlement Agreement will be overseen by an independent monitor that may impose penalties of up to $1 million per violation (or up to $5 million for certain repeat violations); and publish regular public reports that identify any quarter in which a servicer fell short of the standards imposed in the settlement.

The Federal Reserve Board ("Fed") separately released a statement on February 9 stating that it had reached an agreement in principle with the same five mortgage servicers subject to the Settlement Agreement. The Fed's agreement imposes monetary sanctions totaling $766.5 million to address unsafe and unsound processes and practices in residential mortgage loans servicing and foreclosure processing identified by examiners in reviews conducted between November 2010 and January 2011. Corrective measures for these issues were required as part of formal enforcement actions issued in April 2011. The $766.5 in monetary sanctions is included in the $25 billion required by the Settlement Agreement.

Similarly, the Office of the Comptroller of the Currency ("OCC") released a statement on February 9 announcing that it had reached an agreement in principle with the four national bank mortgage servicers subject to the Settlement Agreement. The OCC's agreement imposes civil money penalties of $394 million in connection with unsafe and unsound processes and practices in residential mortgage loans servicing and foreclosure processing identified during earlier reviews and identified in the April 2011 enforcement actions. The OCC states that it will hold in abeyance imposition of the penalties provided the servicers make payments and take other actions under the Settlement Agreement with a value equal to at least the penalty amounts.

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FDIC Schedules Teleconference on Mortgage Loan Originator Compensation under Truth in Lending

The Federal Deposit Insurance Corporation released Financial Institution Letter 6-2010 on February 2, 2012 to announce that its Division of Depositor and Consumer Protection ("DCP") has scheduled several banker teleconferences during 2012. The teleconferences are intended to help maintain open lines of communication as well as to provide transparency and updates on banking regulations and emerging issues in the compliance and consumer protection areas.

The first teleconference is scheduled for February 21, 2012 and will focus on the mortgage loan originator compensation rule under the *Truth in Lending Act* and its impact on a bank's ability to compensate mortgage loan originators based on profitability. The FDIC indicates that the information presented will be based on consultations with other Federal regulators, including the Bureau of Consumer Financial Protection ("CFPB").

Additional teleconferences have been scheduled for June 5, September 27 and November 15 though future topics have yet to be determined.

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CFPB Town Hall Meeting to Focus on Checking Accounts

The Bureau of Consumer Financial Protection ("CFPB") announced that it will host a town hall meeting in New York City on February 22, 2012. The town hall meeting is intended to provide consumers with opportunity to provide information on their experiences with consumer financial products and services but will have a particular focus on checking accounts. A similar town hall meeting was conducted in Birmingham, Alabama in January with a focus on payday lending activities.

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Securities & Investment Management

CFTC and SEC Submit Report to Congress on International Swap Regulation

The Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC") released a joint report to Congress on February 1, 2012 that identifies how swaps are regulated in the United States, Asia and Europe. The report, which complies with the requirements of the Section 719 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*, identifies areas of regulation that are similar and other areas for better harmonization.

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CFTC Committees to Focus on Automated and High Frequency Trading; Nominations for Membership Requested

The Commodity Futures Trading Commission ("CFTC") released a statement on February 9, 2012 to announce the creation of four new subcommittees under its Technology Advisory Committee ("TAC"). The first of the subcommittees will focus on automated and high frequency trading with the goal of developing recommendations for the definition of high frequency trading "in the context of the larger universe of automated trading."

The CFTC is seeking twenty individuals interested in participating in the subcommittee. Interested parties from "industry, exchanges, academia, international regulatory and/or advisory boards, groups representing interests or organizations involved in and/or affected by the development, design and operation of automated trade systems and high frequency trading, and government agencies" are encouraged to submit nominations to the CFTC.

The three other subcommittees will focus on:

- Determining whether there should be multiple categories of high frequency trading (i.e., how distinctions should be identified);
- Understanding how high frequency trading systems behave compared to other automated systems (through oversight, surveillance and economic analysis; and
- Identifying possible micro market disruptions that might be provoked by automated trading systems.

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CFTC Issues Final and Proposed Rule for Reporting Requirements of CPOs and CTAs

The Commodity Futures Trading Commission ("CFTC") released a final rule on February 9, 2012 that amends the compliance obligations of commodity pool operators ("CPOs") and commodity trading advisers ("CTAs"), including a requirement for CPOs and CTAs registered solely with the CFTC to file reports similar to those required by the CFTC and the Securities and Exchange Commission ("SEC") on Form PF. This reporting information includes, among other things, a description of assets under management, use of leverage, counterparty credit risk exposure, and trading and investment positions for each pool.

Compliance will begin:

- 60 days after the end of a CPO's first calendar quarter ending after July 2, 2012 for CPOs having at least $5 billion in assets under management.
- 60 days after the end of a CPO's first calendar quarter ending after December 14, 2012 for CPOs having at least $1.5 billion in assets under management.
- 90 days after calendar year end 2012 for all other CPOs and CTAs.

The CFTC also released a proposed rule that would amend the reporting requirements applicable to certain investment companies registered under the *Investment Company Act of 1940* whose advisers would be required to register with the CFTC as CPOs. In particular, any CPO whose units of participation will be offered and sold pursuant to an effective registration statement under the *Securities Act of 1933* would be permitted to claim relief from certain delivery and acknowledgement, periodic financial reporting, and records maintenance requirements. Comments on the proposed rule are due within 60 days of publication in the *Federal Register*.

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Enforcement Actions

The Securities and Exchange Commission ("SEC") and the Commodity Futures Trading Commission ("CFTC") recently announced the following enforcement actions:

- The SEC charged an individual with illegal insider trading and seeks a final judgment for the individual to repay the ill gotten gains, pay financial penalties and pre-judgment interest as well as to prevent the individual from serving as a director or officer of a public company.
- The SEC charged a foreign firm with violations of the *Foreign Corrupt Practices Act* stemming from payment made by its U.S. subsidiary and another subsidiary to foreign individuals in exchange for business. The firm agreed to settle the charges by making a $22 million payment.
- The SEC charged two related individuals with naked short selling for failing to locate and deliver shares involved in short sales with broker-dealers. The SEC is seeking disgorgement of ill-gotten gains, prejudgment interest, financial penalties, and a censure or a suspension or bar from association with any broker-dealer.
- The CFTC obtained a Federal court consent order that permanently bars a foreign firm from soliciting or accepting orders to trade foreign currency from U.S. customers who are not Eligible Contract Participants and permanently bars the firm from offering to be the counterparty to U.S. customers' foreign exchange transactions, without registering with

the CFTC. The firm is also required to display prominently on its Web site that it does not provide services to U.S. customers.
- The CFTC filed an enforcement action against an individual for operating an off-exchange foreign currency fraud, and charged him with solicitation fraud, issuing false accounting statements, misappropriating pool participant's funds, and failing to register with the CFTC.

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Financial Services Legislation

House Subcommittee Holds Hearing on Legislative Proposals to Modify the Structure of the CFPB

The House Committee on Financial Services' Subcommittee on Financial Institutions and Consumer Credit conducted a hearing on February 8, 2012 to consider "*Legislative Proposals to Promote Accountability and Transparency at Consumer Financial Protection Bureau*." Four witnesses provided testimony including three representatives from industry organizations (American Bankers Association, U.S. Change of Commerce, and American Financial Services Association) and a law professor.

Three pieces of legislation were discussed:

- H.R. 1355, the *Bureau of Consumer Financial Protection Accountability and Transparency Act*. The legislation is intended to make the funding of the CFPB subject to Congress appropriation.
- H.R. 2081. This legislation would remove the CFPB Director from the Board of Directors of the Federal Deposit Insurance Corporation ("FDIC") and replace him with the Chairman of the Federal Reserve Board ("Fed").
- H.R. 3871, the *Proprietary Information Protection Act of 2012*. The legislation provides legal certainty that the disclosure of privileged information requested from financial institutions by the CFPB does not waive attorney-client privilege and open up the institutions to third-party subpoenas.

The law professor opposed H.R. 1355 and H.R. 2081. In particular, he stated that subjecting the CFPB to funding by Congress would destroy the CFPB's independence and leave it vulnerable to political and industry influences. He cited a number of examples where he said that, based on lobbying efforts, Congress had ultimately not provided sufficient funding to certain agencies. With regard to H.R. 2081, he stated that placing the Fed Chairman on the Board of the FDIC would give the Fed "undesirable influence" over the FDIC, especially with respect to decisions to invoke the FDIC's systemic risk exception. He also suggested that the CFPB Director's presence on the Board of the FDIC would allow the Director to understand the safety and soundness concerns of the bank regulatory counterparts, thus bridging the separation of consumer protection and safety and soundness supervision. The witness had no objection to H.R. 3871.

The other three witnesses supported the legislative proposals though one suggested that H.R. 3871 should be modified to clarify that it applies to all entities regulated by the CFPB including non-depository financial companies.

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Senate Holds Hearing on CFPB

The Senate Committee on Banking, Housing and Urban Development conducted a hearing on January 31, 2012 bearing the title "*Holding the CFPB Accountable: Review of the First Annual Report*." Richard Cordray, Director of the Bureau of Consumer Financial Protection ("CFPB") was the sole witness at the hearing.

Mr. Cordray's testimony outlined the CFPB's first six months of operation under the direction of Raj Date, who served as the Special Advisor to the Secretary of the Treasury. The testimony included discussion of the CFPB's Know Before You Owe initiatives, collection of consumer complaints, collection of consumer "stories," and simplifying disclosures for mortgages, student loans and credit card agreements. He identified nonbank supervision, and payday lending in particular, as well as a new database to track individuals who target scams against the military as the CFPB's "next steps."

The Republican Senators on the committee directly challenged the validity of Mr. Cordray's appointment of CFPB Director, which occurred as a recess appointment on January 4. 2012 while the Senate had been conducting pro-forma sessions. One Senator indicated that he suspected the decision would ultimately have to be settled by the Supreme Court; another suggested that the possibility of Mr. Cordray's appointment being overturned called into question the CFPB's exercise of new authorities, including publication of new rules and expansion to nonbank supervision, granted by the *Dodd-Frank Wall Street Reform and Consumer Protection Act*.

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Recent Supervisory Actions against Financial Institutions

Last Updated: February 13, 2012

Agency	Institution Type	Action	Date	Synopsis of Action
Federal Reserve Board	Bank Holding Company	Written Agreement	02/07	The Federal Reserve Board entered into a Written Agreement with a South Carolina-based bank holding company to address dividends and debt and stock redemptions to ensure that it serves as a source of strength for its state nonmember bank subsidiary.
Federal Reserve Board	Bank Holding Company	Written Agreement	02/07	The Federal Reserve Board entered into a Written Agreement with a Wisconsin-based bank holding company to address 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	02/07	The Federal Reserve Board entered into a Written Agreement with an Iowa-based bank holding company to address dividends and distributions, debt and stock redemptions and capital 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	01/19	The Federal Reserve Board entered into a Written Agreement with a Tennessee-based bank holding company to address 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	01/17	The Federal Reserve Board entered into a Written Agreement with a Florida-based bank holding company to address 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	Written Agreement	01/10	The Federal Reserve Board entered into a Written Agreement with an Arizona state member bank to address deficiencies related to asset improvement, allowance for loan and lease losses, capital, and dividends
Federal Reserve Board	Bank Holding Company	Written Agreement	12/27	The Federal Reserve Board entered into a Written Agreement with a Louisiana-based bank holding company to address 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	State Member Bank	Civil Money Penalty	12/22	The Federal Reserve Board issued an Order of Assessment of Civil Money Penalty against an Ohio state member bank to address violations of the National Flood Insurance Act.
Federal Reserve Board	State Member Bank	Civil Money Penalty	12/22	The Federal Reserve Board issued an Order of Assessment of Civil Money Penalty against a Virginia state member bank to address violations of the National Flood Insurance Act.

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