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Bank & Thrift

Financial Stability Oversight Council Finalizes Rule For Designating Nonbank Financial Companies for Supervision

On April 3, 2012, the Financial Stability Oversight Council ("Council") approved a final rule and interpretive guidance that detail the analyses and processes the Council will use to designate nonbank financial companies subject to enhanced prudential standards and supervision by the Federal Reserve Board ("Fed"). The Council released a related proposed rule in January 2011 and the final rule and guidance have been adopted "substantially as proposed, but with a number of clarifications in response to commenter concerns."

The rule closely follows the statutory criteria set out in Section 113 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* for identifying and designating a nonbank financial company. In particular, the Council will consider for each company, its:

- Leverage;
- Off-balance sheet exposures;
- Transactions and relationships with other significant nonbank financial companies and significant bank holding companies;
- Importance as a source of credit for households, businesses, and state and local governments, and as a source of liquidity for the U.S. financial system;
- Importance as a source of credit for low-income, minority, or underserved communities, and the impact that failure would have on the availability of credit in such communities;
- Managed assets compared to owned assets;
- Nature, scope, size, scale, concentration, interconnectedness, and mix of the activities;
- Oversight by one or more primary financial regulatory agencies;
- Amount and nature of financial assets;
- Amount and types of the liabilities, including reliance on short-term funding; and
- Risk-related factors identified by the Council as appropriate.

The Council will evaluate these considerations using a six-category analytic framework:

1) Size;
2) Lack of substitutes for the financial services and products provided by the company;
3) Interconnectedness with other financial firms;
4) Leverage;
5) Liquidity risk and maturity mismatch; and
6) Existing regulatory scrutiny.

The determination process will be completed through three stages:

- Stage One - an initial selection of nonbank financial companies that, based on publicly available financial data, meet or exceed quantitative thresholds for consolidated assets, outstanding credit default swaps, derivatives liabilities, outstanding loans and bonds, leverage ratios and short-term debt ratios as established by the Council. Nonbank financial companies meeting a $50 billion consolidated assets threshold and any one of the other quantitative thresholds would move to the next evaluation stage;

- Stage Two - an analysis of the risk profile and characteristics of each nonbank financial company exceeding the quantitative thresholds in Stage One prepared under the six-category analytic framework that employs "quantitative and qualitative industry- and company-specific factors"; and
- Stage Three - an analysis performed in conjunction with the Office of Financial Research and with additional information provided directly by the nonbank financial company, including consideration of the resolvability of the nonbank financial company, the opacity of its operations, its complexity and the extent of any regulatory scrutiny.

The rule will become effective 30 days after publication in the *Federal Register* and Treasury Secretary Timothy Geithner has indicated that the Council will work to make the first of the designations during 2012.

> For additional information please contact Hugh Kelly, Principal: hckelly@kpmg.com or Philip Aquilino, Director: paquilino@kpmg.com.

Fed Releases Supplemental Proposal to Earlier Proposed Rule Defining "Predominantly Engaged in Financial Activities"

The Federal Reserve Board ("Fed") released a Supplemental Notice of Proposed Rulemaking ("Supplemental NPR") on April 2, 2012 that provides clarifications to its February 2011 Notice of Proposed Rulemaking, which would amend Regulation Y to establish criteria for determining whether a company is "predominantly engaged in financial activities" and define the terms "significant nonbank financial company" and "significant bank holding company" for purposes of Title I of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (the "Dodd-Frank Act").

The Supplemental NPR is intended to clarify the scope of activities that would be considered to be financial activities under the February 2011 NPR. Under Title 1 of the Dodd-Frank Act, a company generally can be designated for Fed supervision by the Financial Stability Oversight Council if 85 percent or more of the company's revenues or assets are related to activities that are financial in nature under the *Bank Holding Company Act*.

Comments on the Supplemental NPR are requested by May 25, 2012.

> For additional information please contact Hugh Kelly, Principal: hckelly@kpmg.com or Philip Aquilino, Director: paquilino@kpmg.com.

Basel Committee Publishes Progress Report on Basel III Implementation

The Bank for International Settlements' ("BIS") Basel Committee on Banking Supervision ("Basel Committee") published its second progress report on Basel III implementation on April 3, 2012. The report outlines the progress of implementing Basel II, Basel 2.5 and Basel III by Basel Committee member countries through their national laws and regulations and in accordance with the internationally-agreed timeframes.

The Basel Committee also released the methodology to be used by the Basel Committee and its members for conducting peer reviews to assess whether the members' national rules and regulations are consistent with the globally agreed minimum standards.

The Basel Committee notes that it expects to release before year end the initial findings from its review of the results delivered by national rules regarding the calculation of risk-weighted assets in both the banking book and the trading book. The review was conducted to determine whether the outcomes are consistent across banks and jurisdictions.

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

Fed Approves Rules Addressing Reserve Requirements, Collection of Checks and Funds Transfers, and Overnight Overdrafts

The Federal Reserve Board ("Fed") approved a final rule on April 5, 2012 that is intended to simplify the administration of reserve requirements and reduce administrative and operational costs for depository institutions and Federal Reserve Banks. In particular, the rule, which amends Regulation D (*Reserve Requirements of Depository Institutions*), simplifies reserves administration by

- Creating a common two-week maintenance period;
- Creating a penalty-free band around reserve balance requirements in place of using carryover and routine penalty waivers;
- Discontinuing as-of adjustments related to deposit report revisions and replacing all other as-of adjustments with direct compensation; and
- Eliminating the contractual clearing balance program.

The amendments to Regulation D will be implemented in two phases:

- Amendments related to the elimination of contractual clearing balances and as-of adjustments, and those related to the provision of direct compensation, will take effect on July 12, 2012.
- Amendments on the creation of a common two-week maintenance period and replacement of carryover and routine waivers with a penalty-free band around reserve balance requirements will take effect on January 24, 2013. The Fed indicates that it will provide the public with notice no later than November 1, 2012, if the January 24, 2013, date will be delayed.

The Fed also approved a final rule amending Regulation J (*Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers through Fedwire*) to eliminate references to "as-of adjustments," consistent with the final amendments to Regulation D, and to make clarifications about the handling of checks sent to the Federal Reserve Banks and the application of Regulation J's funds transfer rules to remittance transfers. The final amendments to Regulation J will take effect on July 12, 2012, concurrent with the implementation of the corresponding amendments to Regulation D on the elimination of as-of adjustments.

Finally, the Fed announced two modifications to its overnight overdraft policy that will take effect on July 12, 2012. These modifications include:

- A change in the reference rate for computing charges for overnight overdrafts from the effective Federal funds rate to the primary credit rate and
- A multiday charge on overnight overdrafts incurred immediately before a weekend or holiday.

> For additional information please contact Hugh Kelly, Principal: hckelly@kpmg.com or Bill Canellis, Director: wcanellis@kpmg.com.

Fed Issues Policy Statement for Rental of OREO Properties

The Federal Reserve Board ("Fed") released a policy statement on April 5, 2012 that addresses *Rental of Residential Other Real Estate Owned Properties*. The policy statement reiterates that statutes and Fed regulations permit rental of residential properties acquired in foreclosure as part of an orderly disposition strategy and also outlines supervisory expectations for residential rental activities.

The Fed generally expects banking organizations to make good faith efforts to dispose of foreclosed properties (also known as "other real estate owned" or "OREO"), including single-family homes, at the earliest practicable date. Banking organizations may rent residential OREO properties within legal holding-period limits without demonstrating continuous active marketing of the property for sale, provided that suitable policies and procedures are followed. To the extent that OREO rental properties meet the definition of community development under the *Community Reinvestment Act* ("CRA") regulations, the banking organizations would receive favorable CRA consideration. In all respects, banking organizations that rent OREO properties are expected to comply with all applicable Federal, state, and local statutes and regulations, some of which the policy statement highlights. Specific supervisory expectations are provided for banking organizations with a larger number of rental OREO properties, generally more than 50 properties available for rent or rented.

The policy statement applies to banking organizations for which the Fed is the primary Federal supervisor, including state member banks, bank holding companies, non-bank subsidiaries of bank holding companies, savings and loan holding companies, non-thrift subsidiaries of savings and loan holding companies, and U.S. branches and agencies of foreign banking organizations.

For additional information please contact Hugh Kelly, Principal: hckelly@kpmg.com or Craig Stirnweis, Director: cstirnweis@kpmg.com.

Enterprise & Consumer Compliance

CFPB Issues Bulletin on Compensation Rules Related to Loan Originators

The Bureau of Consumer Financial Protection ("CFPB" or "Bureau") issued Bulletin 2012-02 on April 2, 2012 to provide guidance regarding the payment of compensation to loan originators under Regulation Z. In particular, the Bulletin concludes that financial institutions may make contributions to Qualified Plans (qualified profit sharing, 401(k), and employee stock ownership plans) for loan originators out of a pool of profits derived from loans originated by employees under the Regulation Z Compensation Rules.

Loan originator compensation rules were originally adopted by the Federal Reserve Board in September 2010 and covered institutions were required to comply with the provisions on April 6, 2011. Pursuant to Title X of the *Dodd-Frank Wall Street Reform and Consumer Protection*

Act ("Dodd-Frank Act"), rulemaking authority for Regulation Z transferred to the Bureau in July 2011.

Subject to certain narrow exceptions, the Regulation Z Compensation Rules provide that no loan originator may receive (and no person may pay to a loan originator), directly or indirectly, compensation that is based on any terms or conditions of a mortgage transaction. The Commentary to the Regulation clarifies that compensation includes salaries, commissions, and annual or periodic bonuses and that the terms or conditions of a transaction include the interest rate, loan-to-value ratio, or prepayment penalty. The Commentary also provides that compensation may not be based on a factor that is a proxy for a term or condition, such as a credit score, when the factor is based on a term or condition such as the interest rate on the loan. Finally, examples are also provided in the Commentary of when compensation is not based on a transaction's term or condition, such as basing compensation on the long-term performance of the loan and whether the consumer is an existing customer of the creditor or a new customer.

Title XIV of the Dodd-Frank Act also contains provisions that address loan originator compensation for which the Bureau is required to adopt final rules no later than January 21, 2013. The CFPB indicates that it anticipates issuing a proposed rule for public comment "in the near future" on these loan origination provisions and that proposed rule will provide greater clarity on the application of the Compensation Rules to profit-sharing arrangements or plans that are not in the nature of Qualified Plans.

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

Regulatory Reporting

FDIC Guidance Addresses March 31 Call Report Date

The Federal Deposit Insurance Corporation ("FDIC") released Financial Institution Letter 18-2012 on April 5, 2012 to provide guidance related to the Consolidated Reports of Condition and Income ("Call Report") for the March 31, 2012 report date. Except for certain institutions with foreign offices, the completed Call Report must be filed by April 30, 2012.

The guidance notes that, beginning March 31, 2012, all savings associations must file the Call Report instead of the Thrift Financial Report, which has been eliminated. Supplemental Instructions are provided and include a separate section for savings associations.

Call Report revisions taking effect in the first quarter relate to the initial filing of Call Reports by all savings associations and also include certain instructional changes. For the first quarter 2012 Call Report, institutions may provide reasonable estimates for any new or revised Call Report item initially required to be reported as of March 31, 2012, for which the requested information is not readily available. The first quarter 2012 reporting changes include:

- New items in Schedule RC-M, Memoranda, in which savings associations and certain state savings and cooperative banks will report on the test they use to determine compliance

with the Qualified Thrift Lender requirement and whether they have remained in compliance with this requirement;

- Revisions to two existing items in Schedule RC-R, Regulatory Capital, used to calculate the leverage ratio denominator to accommodate certain differences between the regulatory capital standards that apply to the leverage capital ratios of banks versus savings associations; and
- Instructional revisions addressing:
  - The reporting of the number of deposit accounts of $250,000 or less in Schedule RC-O, Other Data for Deposit Insurance and FICO Assessments, by institutions that have issued certain brokered deposits; and
  - The accounting and reporting treatment for capital contributions in the form of cash or notes receivable in the Glossary.

For more information, contact Hugh Kelly, Principal: hckelly@kpmg.com or Francis Gomez, Manager: fgomez@kpmg.com.

Securities & Investment Management

SEC Reopens Proposal for Target Date Retirement Funds

The Securities and Exchange Commission ("SEC") announced on April 3, 2012 that it is reopening the comment period for a June 2010 proposed rule that is intended to provide enhanced information to investors concerning target date retirement funds and to reduce the potential for investors to be confused or misled regarding these and other investment companies. In particular the proposed rule would:

- Require a target date retirement fund that includes the target date in its name to disclose the fund's asset allocation at the target date immediately adjacent to the first use of the fund's name in marketing materials;
- Require marketing materials for target date retirement funds to include a table, chart, or graph depicting the fund's asset allocation over time, together with a statement that would highlight the fund's final asset allocation;
- Require a statement in marketing materials to the effect that a target date retirement fund should not be selected based solely on age or retirement date, is not a guaranteed investment, and the stated asset allocations may be subject to change; and
- Provide additional guidance regarding statements in marketing materials for target date retirement funds and other investment companies that could be misleading.

The SEC has reopened the comment period to allow interested parties to provide comment on the results of an SEC-sponsored survey that tested investors regarding target date retirement funds. Comments must be submitted no later than May 21, 2012.

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

- The SEC sued two former executives of a firm (the chief executive officer and the chief financial officer) to recover bonus compensation and stock sale profits they received during an accounting fraud at the company.
- The SEC obtained a court order freezing the assets of six foreign nationals and one foreign entity charged with insider trading.
- The SEC charged a bank's former executives for their involvement in a fraudulent scheme designed to conceal the deterioration of the bank's loan portfolio and inflate its reported earnings during the financial crisis.
- The SEC charged an investment manager with defrauding investors by making false claims about his investment track record and providing bogus account statements that reflected fictitious profits.
- The CFTC charged and simultaneously settled with a bank for the handling of customer segregated funds. The order imposed a $20 million civil money penalty and required the bank to undertake efforts to ensure the proper handling of customer segregated funds, including the release of funds.
- The CFTC filed a complaint charging a foreign bank operating in the U.S. with conducting a multi-hundred million dollar wash sale scheme in connection with exchange-traded stock futures contracts.

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

Recent Supervisory Actions against Financial Institutions

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Agency	Institution Type	Action	Date	Synopsis of Action
Office of the Comptroller of the Currency	National Bank	Cease and Desist	04/05	The Office of the Comptroller of the Currency issued a cease and desist order against a national bank for violations of the Bank Secrecy Act and its underlying regulations. In particular, the bank's compliance program was found to have deficiencies related to internal control, customer due diligence, independent BSA and money laundering audit function, monitoring of its remote deposit capture and international cash letter instrument processing in connection with foreign correspondent banking, and suspicious activity reporting related to that monitoring.
Federal Reserve Board	Bank Holding Company; Money Transmitter	Cease and Desist; Civil Money Penalty	04/02	The Federal Reserve Board issued a consent Order to Cease and Desist and Order to Assess Civil Money Penalty with a foreign bank holding company and its money transmitter subsidiary to resolve allegations that the bank holding company operated representative offices in the U.S. without required notices or approvals under the International Banking Act.
Federal Reserve Board	Bank Holding Company; State Member Bank	Written Agreement	03/29	The Federal Reserve Board entered into a Written Agreement with a Pennsylvania bank holding company and its State member bank subsidiary to address deficiencies related to board oversight, management review, credit risk management, lending and credit administration, asset improvement, allowance for loan and lease losses, capital planning, internal audit, liquidity and funds management, interest rate risk management, dividends and payments and debt and stock redemptions.
Federal Reserve Board	Bank Holding Company	Written Agreement	03/22	The Federal Reserve Board entered into a Written Agreement with a Minnesota-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	02/23	The Federal Reserve Board entered into a Written Agreement with a Minnesota-based bank holding company to address allowance for loan and lease losses, 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 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.

Contact Us

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

Linda Gallagher, National Leader, Financial Services Regulatory Practice
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, Director, Insurance Regulatory

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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

Philip Aquilino	T: 703-286-8029
Bill Canellis	T: 973.912.4817
Paul Cardon	T: 617.988.1282
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

Philip Aquilino	T: 703-286-8029
Hugh Kelly	T: 202.533.5200
Craig Stirnweis	T: 212.872.5960

Foreign Banking Organizations

Philip Aquilino	T: 703-286-8029
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

Philip Aquilino	T: 703-286-8029
Paul Cardon	T: 617.988.1282
Hugh Kelly	T: 202.533.5200
Greg Matthews	T: 212.954.7784
Craig Stirnweis	T 214.840.6866