



Weekly Newsletter

In This Issue

Bank & Thrift Regulatory Update

Basel Committee Releases G20 Report on Member Progress with Basel III Implementation	1
Comptroller Addresses CRE Financial Council.....	1
OCC Adopts Interim Final Rule to Modify Lending Limit Rule for Credit Exposures to Derivatives Transactions.....	2
OCC Releases Quarterly Report on Bank Trading and Derivatives Activities	2

Enterprise & Consumer Compliance

CFPB Releases Request for Information Regarding Exploitation of Seniors.....	3
Agencies Release Mortgage Servicing Guidance Related to Military Homeowners Receiving Permanent Change of Station Orders	4
Agencies Extend Filing Deadline for Foreclosure Review; Release Related Remediation Guidance and Interim Report.....	4

Capital Markets & Investment Management

SEC Approves New Rule to Implement Listing Standards Related to Compensation Committees and Compensation Advisers	5
Enforcement Actions	6

Recent Supervisory Actions	8
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Bank & Thrift

Basel Committee Releases G20 Report on Member Progress with Basel III Implementation

The Bank for International Settlements' Basel Committee on Banking Supervision ("Basel Committee") publicly released its interim *Report to G20 Leaders on Basel III Implementation* on June 11, 2012. In November 2011, the G20 Leaders had called upon the members to complete implementation of Basel II and II.5 by the end of 2011 and to begin implementation of Basel III on January 1, 2013. The report details the progress Basel Committee member countries have made through March 2012 in implementing the Basel III regulatory framework, including Basel II and Basel II.5.

The report findings were based on the Basel Committee's implementation review process, which includes three levels of review:

- Level 1: ensuring the timely adoption of Basel III - reports to be published bi-annually;
- Level 2: ensuring regulatory consistency with Basel III – the first report is due to be published in September 2012; and
- Level 3: ensuring the consistency of outcomes initially focusing on risk-weighted assets.

As of March 2012, the report states that the U.S. had finalized the Basel II requirements, had proposed rules governing the Basel II.5 requirements, and had not published proposed rules for Basel III. In mid-June, the Federal Reserve Board, Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation jointly released a final rule to implement the market risk capital rules, which finalized part of the Basel II.5 requirements. They also jointly released proposed rules to implement Basel III and the remainder of the Basel II.5 requirements.

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Comptroller Addresses CRE Finance Council

Thomas Curry, Comptroller of the Currency, spoke at the Annual Conference of the CRE Finance Council on June 13, 2012. His remarks focused on the outlook for the commercial real estate ("CRE") market, setting the tone by saying that although there have been real and tangible signs of improvement in CRE markets and CRE loan performance, "even the positive trends come with qualifications and risks." Mr. Curry provided the following examples:

- Demand for CRE space is increasing, but remains soft compared to historical norms.
- Up to half of all outstanding CRE loans will be rolled-over by 2014. Banks and CRE investors will have to resolve repayment issues, such as declining net operating income and underwater mortgages, while dealing with difficult economic conditions.
- CRE-specific non-performing and loss rates significantly exceed historical averages. Although the net charge-off rates for commercial mortgages have declined sharply it is in part because of significant charge-offs taken earlier.

Comptroller Curry said going forward, the OCC will be focusing on:

- Concentrations of credit and related risk management. The OCC released an updated concentrations handbook in December 2011.
- Increased use of rigorous scenario analyses that consider multiple variables for those banks with significant CRE concentrations. The OCC has developed a tool that can be used by banks and thrifts to assess how CRE portfolios may perform in a downturn or market disturbance.
- Appraisals, and in particular, appraiser selection and documented review and approval of the appraisals provided.

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OCC Adopts Interim Final Rule to Modify Lending Limit Rule for Credit Exposures to Derivatives Transactions

The Office of the Comptroller of the Currency ("OCC") announced on June 20, 2012 that it has adopted an interim final rule amending its lending limit rule to apply to certain credit exposures arising from derivative transactions and securities financing transactions.

Section 610 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* (the "Dodd-Frank Act") revises the statutory definition of loans and extensions of credit for purposes of the lending limit to include certain credit exposures arising from a derivative transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction. The interim final rule adopted by the OCC implements this statutory change which applies to both national banks and Federal and State savings associations. (State banks are subject to separate restrictions under section 611 of the Dodd-Frank Act.) Section 610 of the Dodd-Frank Act becomes effective July 21, 2012 and the OCC interim final rule is also effective on that date. Comments on the interim final rule are requested and should be provided no later than August 6, 2012.

A temporary exemption is provided under the interim final rule until January 1, 2013 for transactions covered by the rule, and is intended to facilitate compliance with the rule's requirements for derivatives and securities financing transactions. In addition, the rule permits, in certain circumstances, use of look-up tables for measuring the exposures for each transaction type.

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OCC Releases Quarterly Report on Bank Trading and Derivatives Activities

The Office of the Comptroller of the Currency ("OCC") released its *Quarterly Report on Bank Trading and Derivatives Activities* for the first quarter of 2012 on June 22, 2012. Highlights of the report included:

- Commercial banks and savings associations reported trading revenues of \$7.0 billion in the first quarter of 2012, 178 percent higher than in the fourth quarter of 2011, and 5 percent lower than in the first quarter of 2011;

- Net current credit exposure ("NCCE"), the primary metric the OCC uses to measure credit risk in derivatives activities, decreased \$53 billion, or twelve percent, to \$377 billion during the first quarter.
- The notional amount of derivatives held by insured U.S. commercial banks and savings associations fell by \$3.0 trillion (or 1.2 percent) from the fourth quarter to \$228 trillion. The notional amount of derivatives contracts has fallen for three consecutive quarters.
- Banks hold collateral to cover 67 percent of their NCCE. The quality of the collateral is very high, with 81 percent held in cash (U.S. dollar and non-dollar).
- Average trading risk exposure, as measured by value-at-risk, totaled \$564 million across the top five dealer firms in the first quarter, nearly 17 percent lower than \$677 million in the first quarter of 2011.
- Derivatives contracts are concentrated in a small number of institutions. The largest four banks hold 93 percent of the total notional amount of derivatives, while the largest 25 banks hold nearly 100 percent.
- Derivative contracts remain concentrated in interest rate products, which represent 81 percent of total derivative notional values. On a product basis, swap products represent 61 percent of total derivative notionals.
- Credit default swaps are the dominant product in the credit derivatives market, representing 97 percent of total credit derivatives.
- The number of commercial banks and savings associations holding derivatives increased by 213 (of which 192 were savings associations) in the quarter to 1,291.

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Enterprise & Consumer Compliance

CFPB Releases Request for Information Regarding Exploitation of Seniors

The Bureau of Consumer Financial Protection ("CFPB") announced on June 13, 2012 that through its Office for the Financial Protection of Older Americans ("Office for Older Americans") it is publishing a Request for Information on consumer financial products and services, financial literacy efforts, and fraudulent or deceptive practices impacting older Americans and their families. Comments are requested no later than August 13, 2012.

Section 1013 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* ("Dodd-Frank Act") requires the CFPB to facilitate the financial literacy of individuals aged 62 or older ("seniors") on "protection from unfair, deceptive, and abusive practices and on current and future financial choices, including through dissemination of materials on such topics." The CFPB is requesting input on the following general categories:

- Evaluation of senior financial advisor certifications and designations;
- Decision making about providers of financial advice and planning information to seniors;
- Senior certification and designation information sources;
- Financial literacy efforts tailored to seniors; and

- Financial exploitation of older Americans, including veterans of the Armed Forces.

The CFPB separately states that it will monitor certifications or designations of financial advisors who serve seniors and alert the Securities and Exchange Commission and State regulators of certifications or designations that are identified as unfair, deceptive or abusive. The Office for Older Americans will also make legislative and regulatory recommendations to Congress on best practices for disseminating information to seniors regarding the legitimacy of certifications and designations, and methods through which a senior can identify the financial advisor most appropriate for his or her needs.

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Agencies Release Mortgage Servicing Guidance Related to Military Homeowners Receiving Permanent Change of Station Orders

Five Federal agencies (Federal Reserve Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, National Credit Union Administration and Bureau of Consumer Financial Protection) released guidance on June 21, 2012 to address mortgage servicing practices that may pose risks to homeowners serving in the military.

In particular, the guidance addresses risks related to military homeowners who have informed their loan servicer that they have received Permanent Change of Station (“PCS”) orders and who might seek assistance with their mortgage loans. The guidance reminds mortgage loan servicers that their employees should be adequately trained about the options available for assisting these homeowners and should provide accurate, clear, and readily understandable information on a timely basis about available options for which the homeowner may qualify. The guidance is consistent with the *Servicemembers Civil Relief Act*.

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Agencies Extend Filing Deadline for Foreclosure Review; Release Related Remediation Guidance and Interim Report

On June 21, 2012, the Office of the Comptroller of the Currency and the Federal Reserve Board (together the “Agencies”) announced the extension of time to September 30, 2012 for eligible borrowers to request a free review of their mortgage foreclosures under the Independent Foreclosure Review.

Also on June 21, the Agencies released guidance that will be used in determining the compensation or other remedy that borrowers will receive for financial injury identified during the Independent Foreclosure Review. The guidance is intended to ensure that similarly situated borrowers who suffered financial injury as a result of errors in foreclosure actions on their homes are treated similarly. Under the guidance, remediation for injuries may include lump-sum payments, suspension or rescission of a foreclosure, a loan modification or other loss mitigation assistance, correction of credit reports, or correction of deficiency amounts and records.

Examples of some of the actions by a servicer that might have resulted in financial injury include:

- Foreclosing on a borrower in violation of the *Servicemembers Civil Relief Act*;
- Foreclosing on a borrower who was not in default on the mortgage;
- Failing to convert a qualified borrower to a permanent modification after successful completion of a written modified payment plan that was supposed to lead to permanent modification;
- Foreclosing on a borrower prior to expiration of a written modified payment plan that leads to permanent modification, while the borrower was performing all requirements of the written plan;
- Denying a borrower's loan modification application that should have been approved;
- Failing to offer loan modification options as required by an applicable program;
- Giving a borrower a loan modification with a higher interest rate than should have been charged under the relevant loan modification program;
- Foreclosing on a borrower in violation of Federal bankruptcy laws;
- Not providing a borrower with proper notification during the foreclosure process; and
- Committing errors that did not result in foreclosure, but resulted in other financial injury.

Requesting an Independent Foreclosure Review does not preclude borrowers from taking other actions related to their foreclosures.

Separately, but also on June 21, the OCC released the second interim report on the status of the Independent Foreclosure Review. Highlights included:

- 338,447 files are currently slated for review, comprised of 193,630 files where the borrower has requested a free review and 144,817 files selected by the independent consultants from servicers' portfolios through May 31, 2012
- The servicers reported completing 93 percent of the corrective actions required by the consent orders.

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Capital Markets & Investment Management

SEC Approves New Rule to Implement Listing Standards Related to Compensation Committees and Compensation Advisers

The Securities and Exchange Commission ("SEC") announced on June 20, 2012 that it has adopted a new rule (Rule 10C-1) and amendments to its proxy disclosure rules to implement Section 952 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010*, which added Section 10C to the *Securities Exchange Act of 1934* and requires the SEC to adopt rules directing the national securities exchanges and national securities associations to prohibit the listing of any equity security of an issuer that is not in compliance with certain compensation committee and compensation adviser requirements. In accordance with the statute, new Rule 10C-1 directs the national securities exchanges to establish listing standards that, among other things:

- Require each member of a listed issuer's compensation committee to be a member of the board of directors and to be "independent;"
- Permit the compensation committee to retain or obtain advice from a compensation adviser;
- Require the compensation committee to consider six specific independence factors prior to retaining or obtaining the advice of any compensation consultant, legal counsel or other adviser, other than in-house legal counsel; and
- Provide that the compensation committee is directly responsible for the appointment, compensation and oversight of compensation advisers.

The rule also applies to board of director members who oversee compensation matters in the absence of a compensation committee. It further provides that four categories of companies are exempt from the compensation committee independence requirements, including:

- Limited partnerships;
- Companies in bankruptcy proceedings;
- Open-end management investment companies registered under the *Investment Company Act of 1940*; and
- Any foreign private issuer that discloses in its annual report the reasons that the foreign private issuer does not have an independent compensation committee.

The rule will become effective 30 days following publication in the *Federal Register* and each exchange that lists securities must propose listing standards that comply with the new rule within 90 days of that effective date.

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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 a former broker for defrauding investors in a Ponzi scheme.
- The SEC charged an individual and two of his companies with defrauding public officials in a stock lending scheme that brought restricted stock to market. The individual and the firms agreed to return \$3.2 million of allegedly ill-gotten gains and the individual agreed to pay a \$500,000 penalty and to be permanently barred from the securities industry. The SEC notes that it "is continuing to clamp down on misconduct in the opaque stock-collateralized lending industry."
- The SEC charged 14 sales agents for their participation in misleading investors and illegally selling securities on behalf of a firm involved in a \$415 million Ponzi scheme.
- The CFTC announced that it obtained a Federal court order imposing more than \$5.4 million in restitution (\$1,361,897) and a civil monetary penalty (\$4,085,691) on two individuals and their companies for in connection with the operation of a commodity pool and managed accounts trading off-exchange foreign currency contracts.

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Recent Supervisory Actions against Financial Institutions

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Agency	Institution Type	Action	Date	Synopsis of Action
Federal Reserve Board	Bank Holding Company	Written Agreement	06/21	The Federal Reserve Board entered into a Written Agreement with an Arkansas-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	Bank Holding Company	Written Agreement	06/21	The Federal Reserve Board entered into a Written Agreement with a Georgia-based bank holding company to address dividends and distributions, debt and stock redemptions, and affiliate transactions 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	06/12	The Federal Reserve Board entered into a Written Agreement with a Louisiana-based bank holding company to address dividends and distributions, debt and stock redemptions, capital and the annual audit 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	06/12	The Federal Reserve Board entered into a Written Agreement with a Colorado-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	06/05	The Federal Reserve Board entered into a Written Agreement with a New Jersey-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	Prompt Corrective Acton	05/30	The Federal Reserve Board issued a Prompt Corrective Action Directive against a Colorado-based state member bank to address capital deficiencies.
Federal Reserve Board	Bank Holding Company	Written Agreement	05/15	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	Bank Holding Company	Written Agreement	05/10	The Federal Reserve Board entered into a Written Agreement with two Arkansas-based bank holding companies and their state-chartered member bank subsidiary to address deficiencies related to credit risk management, concentrations of credit, lending and credit administration, asset improvement, allowance for loan and lease losses, capital, liquidity and funds management, interest rate risk management, dividends and distributions, debt and stock redemption,
Federal Reserve Board	Bank Holding Company	Written Agreement	05/10	The Federal Reserve Board entered into a Written Agreement with a North Carolina-based bank holding company to address dividends, debt and stock redemptions and affiliate transactions to ensure that it serves as a source of strength for its state nonmember bank subsidiary.

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