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Bank & Thrift

Agencies Finalize Stress Testing Rules

On October 9, 2012, the Federal Reserve Board ("Fed") published two final rules governing stress testing requirements for certain bank holding companies ("BHCs"), state member banks, and savings and loan holding companies ("SLHCs"). The final rules implement portions of Sections 165 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (the "Dodd-Frank Act") that require supervisory and company-run stress tests. Nonbank financial companies designated by the Financial Stability Oversight Council as systemically important and subject to supervision by the Fed will also be subject to certain stress testing requirements contained in the rules. Foreign banking organizations are not covered by the rules though U.S. domiciled BHC subsidiaries of foreign banking organizations are covered.

The first of the Fed's rules applies to BHCs with average total consolidated assets of $50 billion or more and nonbank financial companies supervised by the Fed. It requires the 19 BHCs that participated in the 2009 Supervisory Capital Assessment Program and the subsequent Comprehensive Capital Analysis and Reviews to begin compliance with the rule (including Fed-run and company-run stress tests) on November 15, 2012. Results of the stress tests will be publicly disclosed in March 2013. All other BHCs meeting the asset threshold and nonbank companies are required to begin compliance in October 2013.

The second Fed rule is applicable to BHCs with average total consolidated assets greater than $10 billion and less than $50 billion, as well as state member banks and SLHCs that have average total consolidated assets of more than $10 billion. It requires these companies to conduct (company-run) annual stress tests. In general, companies that meet the asset threshold as of December 31, 2012 are required to comply with the rule beginning October 1, 2013. BHCs and state member banks that meet the asset threshold after December 31, 2012 must comply in the year following the year in which they meet the asset threshold. Results of the first stress test will not be required to be publicly disclosed. However, state member banks that meet the asset threshold on November 15, 2012 and are a subsidiary of one of the 19 covered companies will be required to conduct their own company-run stress tests this fall, with the results to be publicly disclosed in March 2013.

Also on October 9, 2012, the Office of the Comptroller of the Currency ("OCC") released its final rule regarding company-run stress testing required by the Dodd-Frank Act. The rule applies to covered institutions (national banks and Federal savings associations) with average total consolidated assets greater than $10 billion. Like the Fed rules, institutions with average total consolidated assets of $50 billion or greater are generally required to begin conducting annual stress tests in 2012. Implementation of the stress testing requirements for covered institutions with total consolidated assets between $10 billion and $50 billion will be deferred until October 2013. The effective date of the OCC rule is October 9, 2012. The rule does not apply to Federal branches or agencies of a foreign bank.

Finally, the Federal Deposit Insurance Corporation ("FDIC") also released a comparable final rule that requires state nonmember banks and state-chartered savings associations with average total consolidated assets of $10 billion or more to conduct annual company run stress tests. Institutions with $50 billion or more in average total consolidated assets must begin compliance in 2012 and institutions with average total consolidated assets between $10 billion and $50 billion must begin compliance in October 2013.

The Fed, OCC and FDIC have coordinated on the release of their final rules and each indicate they anticipate releasing stress testing scenarios for the tests to be conducted using 2012 data by mid-November.

OCC Guidance Addresses Final Rule for Short-Term Investment Funds

The Office of the Comptroller of the Currency ("OCC") released Bulletin 2012-31 on October 10, 2012 to announce that it had published a final rule revising the requirements imposed on U.S. banks and Federal branches of foreign banks pursuant to the short-term investment fund ("STIF") rule. The final rule applies directly to national banks and Federal branches of foreign banks that act in a fiduciary capacity and manage a STIF but also indirectly to Federal savings associations. It will become effective July 1, 2013.

The OCC explains that a STIF is a type of collective investment fund ("CIF") that operates pursuant to a plan that governs a bank's management and administration of the fund. The final rule revises and also makes additions to the STIF rule, including, but not limited to, the areas of:

- Net asset value;
- Dollar-weighted average portfolio maturity;
- Portfolio qualitative standards;
- Shadow pricing procedures;
- Stress testing procedures; and
- Disclosure and notification requirements.

FDIC Releases Final Rule Modifying Certain Definitions Related to Its Large Bank Deposit Insurance Pricing

The Federal Deposit Insurance Corporation ("FDIC") released a final rule that amends certain definitions used to determine assessment rates for large and highly complex insured depository institutions, which include institutions with more than $10 billion in assets. In particular, the final rule amends the definitions used to identify concentrations in higher-risk assets including definitions related to:

- Commercial and industrial loans ("C&I") owed to a reporting bank by a higher-risk C&I borrower (as that term is defined in the final rule) and all securities issued by a higher-risk C&I borrower (as that term is defined in the final rule), except securitizations of C&I loans, that are owned by the reporting bank;
- Consumer loans (as defined in the final rule), except securitizations of consumer loans, whenever originated or purchased; and
- Securitizations of C&I and consumer loans (as defined in the final rule) issued on or after April 1, 2013, including those securitizations issued on or after April 1, 2013, that are partially or fully collateralized by loans originated before April 1, 2013.

The final rule becomes effective April 1, 2013.

Capital Markets & Investment Management

SEC Proposes Extension of Temporary Rule Governing Principal Trades with Certain Advisory Clients

The Securities and Exchange Commission ("SEC") released a proposed rule that would extend the effective date of its Rule 206(3)-3T under the *Investment Advisers Act of 1940* for a period of two years. Rule 206(3)-3T is a temporary rule that establishes an alternative means for investment advisers that are registered with the Commission as broker-dealers to meet the requirements of Section 206(3) of the *Investment Advisers Act* when they act in a principal capacity in transactions with certain of their advisory clients. The amendment would extend the date on which Rule 206(3)-3T will sunset from December 31, 2012 to December 31, 2014. Comments are requested no later than November 13, 2012.

SEC Releases Examination Information to Newly Registered Investment Advisers

The Securities and Exchange Commission's ("SEC") Office of Compliance Inspections and Examinations ("OCIE") released a letter on October 9, 2012, which is directed to Senior Executives or Principals of Newly Registered Investment Advisers and is intended to provide them with information about the National Exam Program ("NEP") administered by the OCIE. The letter is general in nature and the SEC notes that firms identified for examination will be contacted individually.

"Newly Registered" investment advisers include those entities that registered with the SEC "after the definitional and transitional rules under *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* became effective (July 21, 2011)."

The OCIE's NEP is launching an initiative to conduct focused risk-based examinations of investment advisers to private funds that recently registered with the Commission ("Presence Exams"). The Presence Exams will take place over the next two years and will have three primary phases:

- Engagement. The engagement phase encompasses the NEP's outreach initiative, which includes making available on the SEC Web site, compliance materials, staff letters, risk alerts, special studies, speeches; information and links to relevant laws and rules, staff guidance, enforcement cases, and staff issued no-action and interpretive letters. The outreach initiative also includes a program, the Compliance Outreach Program, which operates regional and national forums to provide senior officers opportunity to discuss compliance issues, share experiences, engage in discussions with Commission staff, and learn about effective compliance practices.
- Examination. During the examination phase of the Presence Exams initiative, advisers that have been selected for an examination will be subject to NEP staff review in one or more of the following risk areas:

- Marketing
- Portfolio management
- Conflicts of interest
- Safety of client assets
- Valuation

Following an on-site examination, the NEP will send an examination summary letter describing the deficiencies identified, if any, and requesting corrective action. Serious deficiencies, if any, may also be referred to the SEC's Division of Enforcement, or to a self-regulatory organization, state regulatory agency, or other regulator for possible action.

The OCIE notes the books and records of all registered investment advisers are subject to compliance examinations by Commission staff, including the records and reports of any private funds to which investment advisers, registered under the *Investment Advisers Act,* provide investment advice.

- Reporting. Observations made in the Presence Exams will be reported to the Commission and the public. These observations may include common practices identified in the risk focus areas, industry trends, and significant issues.

CFTC Actions

Between October 10 and October 12, the Commodity Futures Trading Commission ("CFTC") announced the release of:

- A Question and Answer ("Q&A") document (five pages total, 10 questions) to provide guidance on the timing of when counterparties will be required to report swap pricing and transaction data as required under part 45 of the CFTC regulations.
- A Frequently Asked Questions ("FAQs") document (six pages total, 12 questions) to provide guidance on the reporting of cleared swaps as required under part 45 of the CFTC regulations, including how to report cleared swaps, who has the obligation to report and the timing of reporting.
- Interpretive guidance to equity real estate investment trusts and asset-backed securities funds. The guidance states that equity real estate investment trusts and securitization funds that meet certain criteria are not included within the definition of "commodity pool" and their operators are not "commodity pool operators" under the *Commodity Exchange Act* ("CEA") and the CFTC's regulations.
- No action letters, issued through the Division of Market Oversight, Division of Swap Dealer and Intermediary Oversight ("DSIO"), and Division of Clearing and Risk, which will maintain the regulatory status quo for Regional Transmission Organizations and Independent System Operators, and certain government and cooperatively-owned electric utilities until the Commission finalizes related proposed orders issued in August 2012.
- An interpretative and no action letter regarding Eligible Contract Participant ("ECP") issues. The letter provides interpretations stating that swap guarantors generally must be ECPs, a non-ECP generally may not be jointly and severally liable for swap obligations, and cash proceeds from a loan may be included within the calculation of total assets for purposes of qualifying as an ECP under the CEA. The letter also provides no-action relief, subject to specified conditions, with respect to certain ECP guarantee arrangements, "anticipatory ECPs," and certain determinations regarding "amounts invested on a discretionary basis." The interpretation and letter are effective immediately, subject to certain conditions.

- An interpretative letter that clarifies the scope of the bona fide hedging exemption from the trading thresholds as applied to registered investment companies pursuant to Commission Regulation 4.5.
- No action letters addressing:
    - The swap calculation by certain foreign entities of swaps for purposes of the swap dealer and major swap participant definitions (issued by the DSIO);
    - Time-limited relief from the obligation to include any foreign exchange swap or foreign exchange forward for purposes of determining if a person is a major swap participant, or the calculation to determine if an entity is a swap dealer if the Secretary of the Treasury determines at a later date to exempt such swaps or forwards from the definition of the term "swap" under the CEA. The DSIO letter also provides similar temporary no-action relief, for the same time period, for persons who would meet the definitions of the terms commodity pool operator ("CPO") and commodity trading advisor ("CTA") in the CEA solely as a result of their foreign exchange swap and foreign forward activity, from registration in those capacities;
    - The treatment of agricultural and exempt commodities in making calculations for purposes of the swap dealer and major swap participant definitions;
    - Temporary relief from certain requirements in the de minimis exception from the definition of the term swap dealer. The no-action relief would allow non-financial entities that are active in the physical energy markets to deal in swaps with publicly-owned, government-owned or Federal agency utilities with an aggregate gross notional amount of up to $800 million per year, and not be required to register as swap dealers; and
    - Relief from registration for various swaps intermediaries until December 31, 2012, including any person who, solely by virtue of its swaps activity, would have been required to register immediately as an introducing broker, CPO, CTA, associated person ("AP"), floor broker, or floor trader. The DSIO letter also provides delay for any person who would be required to register solely because of their involvement with the transition of certain contracts on ICE and NYMEX to clearing as commodity futures and options.

Recent Supervisory Actions against Financial Institutions

Last Updated: October 15, 2012

Agency	Institution Type	Action	Date	Synopsis of Action
Four Federal Agencies	Bank Holding Company; State Nonmember Bank	Civil Money Penalty	10/01	The Bureau of Consumer Financial Protection and the Federal Deposit Insurance Corporation entered into a Joint Consent Order for Restitution and Order to Pay Civil Money Penalty with a Utah-based state nonmember bank to address deficiencies related to credit card marketing practices engaged in by the bank which the agencies found to be misleading and deceptive. In a related action, the Office of the Comptroller of the Currency entered into a Cease and Desist Order and an Order to Pay a Civil Money Penalty with a Federal savings bank affiliate of the bank. The OCC's action was directed at the savings bank's vendor management. The Federal Reserve Board also separately took enforcement action against two related bank holding companies in coordination with the other agencies' actions. Together, the enforcement actions result in the entities paying restitution of approximately $85 million to more than 250,000 customers, as well as civil money penalties of approximately $27 million.
Federal Reserve Board	Bank Holding Company	Written Agreement	10/02	The Federal Reserve Board entered into a Written Agreement with an Alabama-based bank holding company to address dividends and debt and stock redemptions and capital to ensure it serves as a source of strength for its national savings association subsidiary.
Federal Reserve Board	Bank Holding Company	Written Agreement	09/25	The Federal Reserve Board entered into a Written Agreement with a Minnesota-based bank holding company to address dividends, distributions and other payments, debt and stock redemptions and capital to ensure it serves as a source of strength for its state nonmember bank and nonbank subsidiaries.
Bureau of Consumer Financial Protection; Federal Deposit Insurance Corporation	State Nonmember Bank	Civil Money Penalty	09/24	The Bureau of Consumer Financial Protection and the Federal Deposit Insurance Corporation entered into a Joint Consent Order for Restitution and Order to Pay Civil Money Penalty with a Delaware-based state nonmember bank to address deficiencies related to marketing practices engaged in by the bank which the agencies found to be misleading and deceptive. The agencies required $200 million in restitution to be paid to approximately 3.5 million consumers and a civil money penalty of $14 million.
Federal Reserve Board	State Member Bank	Written Agreement	09/13	The Federal Reserve Board entered into a Written Agreement with an Illinois-based state member bank to address deficiencies related to board oversight, corporate governance and management review, credit risk management, lending and credit administration, loan review, asset improvement, capital, liquidity and funds management, interest rate risk management, and dividends.

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, Capital Markets Regulatory

Hugh Kelly, Principal, Bank Regulatory

Amy Matsuo, Principal, Enterprise & Consumer Compliance

John Schneider, Partner, Investment Management Regulatory

David Sherwood, Director, Insurance Regulatory

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Additional Contacts

Asset Management, Trust, and Fiduciary
Bill Canellis T: 973.912.4817

Bank Regulatory Reporting
Francis Gomez T: 212.872.5662

Capital Markets Regulation
Stefan Cooper T: 856.417.6799

Capital/Basel II and III
Paul Cardon T: 617.988.1282

Commodities and Futures Regulation
Dan McIsaac T: 212.954.5973

Consumer & Enterprise Compliance
Kari Greathouse T: 636.587.2844

Cross-Border Regulation & Foreign Banking Organizations
Philip Aquilino T: 703-286-8029

Insurance
Solomon Abuliak T: 212.954.7709

Safety & Soundness, Corporate Licensing & Governance, and ERM Regulation
Greg Matthews T: 212.954.7784