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Bank & Thrift

Federal Reserve Proposes Rule and Policy Amendments Related to Supervision of Financial Market Utilities

The Federal Reserve Board (Federal Reserve) released proposed revisions to its Regulation HH (*Designated Financial Market Utilities*) and its *Policy on Payment System Risk* (PSR Policy) on January 10, 2014. As proposed, the revisions are intended to make the guidance consistent with standards in the April 2012 *Principles for Financial Market Infrastructures* (PFMI) that was developed jointly by the Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions. Revisions to Regulation HH would address risk-management standards for certain financial market utilities that have been designated as systemically important by the Financial Stability Oversight Council, including those that are under supervision by the Federal Reserve. The revisions proposed for the PSR Policy would amend part I of that policy, which presents the Federal Reserve's views, and related principles and minimum standards, regarding the management of risk in payment, clearing, and settlement systems. In general, the proposed revisions would establish separate standards to address credit risk and liquidity risk, a new standard on general business risk, and heightened requirements on transparency and disclosure.

Comments on both proposals are requested no later than March 31, 2014.

Federal Reserve Proposes Amendments to Its Rules Governing Check Collection and Return

Based on comments received in response to a 2011 proposed rule to amend Regulation CC (*Availability of Funds and Collection of Checks*), the Federal Reserve Board (Federal Reserve) issued revised amendments on December 12, 2013, that would impact Subparts C and D of Regulation CC to "encourage depositary banks to receive and paying banks to send returned checks electronically." The 2011 and 2013 proposal revisions to Regulation CC are intended to facilitate the evolution of the check collection system from one that is largely paper-based to one that is virtually all electronic.

The check collection and return provisions in Regulation CC currently apply only to paper checks. The Federal Reserve is proposing that electronic checks and electronic returned checks that banks exchange by agreement also be subject to these rules, unless otherwise agreed by the sending and receiving banks. In addition, comment is requested on alternative approaches to modify the current expeditious-return and notice of nonpayment requirements in order to encourage banks that require paper returns to accept electronic returns. Lastly, the Federal Reserve is proposing a new indemnity for electronic items cleared through the check-collection system that did not originate as paper checks.

Comments on the proposed changes will be accepted until May 2, 2014.

BCBS Issues Progress Report on Effective Risk Data Aggregation and Risk Reporting

The Basel Committee on Banking Supervision (BCBS or "the Committee") issued a report on December 18, 2013 entitled *Progress in adopting the principles for effective risk data aggregation and risk reporting* as a follow-up to its January 2013 publication entitled *Principles for effective risk data aggregation and risk reporting* (Principles). According to the BCBS, the Principles aim to strengthen risk data aggregation and risk reporting practices at banks to improve their risk management practices, decision-making processes, and resolvability. Firms designated as global systemically important banks (G-SIBs) are required to implement the Principles in full by the beginning of 2016.

To facilitate consistent and effective implementation of the Principles among G-SIBs, the Committee decided to use a coordinated approach for national supervisors to monitor and assess banks' progress. The first step of this coordinated approach was to issue a "stocktaking" self-assessment survey completed by G-SIBs, other large banks, and supervisors during 2013. The progress report provides a snapshot of G-SIBs' overall preparedness to comply with the Principles, as well as the related challenges they face.

Agencies Release Annual CRA Asset-Size Threshold Adjustments for Small and Intermediate Small Institutions

On December 19, 2013, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency announced the annual adjustment to the asset-size thresholds used to define small bank, small savings association, intermediate small bank, and intermediate small savings association, as required by the *Community Reinvestment Act* (CRA) regulations. Financial institutions are evaluated under different CRA examination procedures based upon their asset-size classification and those meeting the small and intermediate small asset-size threshold are not subject to the reporting requirements applicable to large banks and savings associations. Annual adjustments to these asset-size thresholds are based on the changes in the Consumer Price Index.

The definitions of small and intermediate small institutions for CRA examinations will change as follows:

- "Small bank" or "small savings association" means an institution that, as of December 31 of either of the prior two calendar years, had assets of less than $1.202 billion.
- "Intermediate small bank" or "intermediate small savings association" means a small institution with assets of at least $300 million as of December 31 of both of the prior two calendar years, and less than $1.202 billion as of December 31 of either of the prior two calendar years.

The asset-size threshold adjustments are effective as of January 1, 2014.

Agencies Extend Comment Period of Proposed Policy Statement on Assessing Diversity Policies and Practices of Regulated Entities

On December 19, 2013, the Federal Reserve Board, the Consumer Financial Protection Bureau, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Securities and Exchange Commission jointly announced an extension of the comment period for their proposed policy statement for assessing diversity policies and practices of the institutions they regulate. The agencies state

that the proposed policy statement, issued pursuant to Section 342 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*, is intended to promote transparency and awareness of diversity policies and practices within federally regulated financial institutions.

Comments on the proposed policy statement will now be accepted until February 7, 2014. Originally, comments were due by December 24, 2013.

OCC Releases Report on Risks Facing National Banks and Federal Savings Associations

The Office of the Comptroller of the Currency (OCC) released its *Semiannual Risk Perspective* for Fall 2013 on December 19, 2013. The report details risks facing the banking industry and presents data in four main areas: the operating environment; condition and performance of the banking system; funding, liquidity, and interest rate risk; and regulatory actions. It focuses on issues that pose threats to the safety and soundness of those financial institutions regulated by the OCC and is intended as a resource to the industry, examiners, and the public.

FDIC Releases Publication on Effective Interest-Rate Risk Management

The Federal Deposit Insurance Corporation (FDIC) released the Winter 2013 issue of *Supervisory Insights* on December 19, 2013. The publication provides a forum for discussing how bank regulation and policy are put into practice in the field, sharing best practices, and communicating about the emerging issues that bank supervisors face.

An article entitled "*Industry Trends Highlight Importance of Effective Interest-Rate Risk Management*" looks at how the changes many banks have made to their asset mix and funding profiles as a result of the recent sustained low interest-rate environment have resulted in increased interest-rate risk (IRR) exposure.

According to Doreen R. Eberley, Director of the FDIC's Division of Risk Management Supervision, "policies and procedures that effectively quantify and assess IRR exposure remain a critical component of a bank's overall risk management framework. We encourage banks that have experienced significant changes in their asset or funding mix during the past several years to now consider developing risk mitigation strategies, such as those described in this article, to reduce IRR exposure. These strategies are more cost-effective to implement before rates move."

Federal Reserve Releases Study on Noncash Payments Trends

The Federal Reserve Board (Federal Reserve) released its *2013 Federal Reserve Payments Study* on December 19, 2013. The study, which is conducted triennially, examines noncash payment trends in the U.S. The 2013 study has been expanded to include new information related to various payment initiation methods and unauthorized payments. To provide perspective on consumer and business payment trends over the past decade, the 2013 results are compared to previous payment studies conducted in 2004, 2007, and 2010. Among the findings, the study shows that card payments--credit and debit--now account for more than two-thirds of all noncash payments, while the number of checks paid continues to decline.

Federal Reserve Issues Guidance on Risk Transfer Considerations When Assessing Capital Adequacy

The Federal Reserve Board (Federal Reserve) issued a Supervision and Regulation (SR) Letter on December 20, 2013 advising large financial institutions to carefully evaluate transactions intended to reduce risk to ensure that, if risks are shifted to a thinly capitalized counterparty or affiliated entity of the firm, any residual risk is effectively captured in the firm's internal capital adequacy assessment and that sufficient capital is maintained to account for such risk. According to the Federal Reserve, examiners will closely consider such transactions, and potential residual risks, when evaluating an institution's capital adequacy.

The guidance applies to large financial institutions supervised by the Federal Reserve and does not apply to community banking organizations, which are defined as institutions with total consolidated assets of $10 billion or less.

Federal Reserve Proposes Amendments to Regulation A Regarding Emergency Lending Authority

On December 23, 2013, the Federal Reserve Board (Federal Reserve), working in consultation with the Department of the Treasury, proposed amendments to Regulation A (*Extensions of Credit by Federal Reserve Banks*) to implement Sections 1101 and 1103 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act). These provisions amended the Federal Reserve's emergency lending authority in Section 13(3) of the *Federal Reserve Act* and require the Federal Reserve, in consultation with the Secretary of the Treasury, to establish by regulation certain policies and procedures with respect to emergency lending.

The Federal Reserve states that the proposed rule is designed to ensure that any emergency lending program or facility is for the purpose of providing liquidity to the financial system, and not to aid an individual failing financial company.

Comments on the proposal are due by March 7, 2014.

Federal Reserve Issues Final Rule on Treatment of Uninsured U.S. Branches and Agencies of Foreign Banks

On December 24, 2013, the Federal Reserve Board (Federal Reserve) approved a final rule clarifying the treatment of uninsured U.S. branches and agencies of foreign banks under Section 716 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*, commonly known as the swaps push out provision. The final rule adopts without change the interim final rule issued by the Federal Reserve on June 5, 2013.

Section 716 of the Dodd-Frank Act generally prohibits the provision of certain types of federal assistance, such as discount window lending and deposit insurance, to swaps entities. The provisions of Section 716 became effective on July 16, 2013. Insured depository institutions that are swaps entities are eligible for a transition period of up to 24 months to comply and for certain statutory exceptions. The final rule clarifies that, for purposes of Section 716, uninsured U.S. branches and agencies of foreign banks are treated as insured depository institutions. Therefore, they are eligible to apply for a transition period and are treated as insured depository institutions for purposes of the other provisions of Section 716. The final rule also sets forth

the process for state member banks and uninsured state branches or agencies of foreign banks to apply to the Federal Reserve for the transition period.

The final rule is effective January 31, 2014.

Enterprise & Consumer Compliance

CFPB Adjusts Assets Thresholds Related to Exemptions for HMDA Reporting and Regulation Z Escrow Requirements

The Bureau of Consumer Financial Protection (CFPB or Bureau) published a final rule on December 30, 2013 that amends the official commentary that interprets the requirements of the Bureau's Regulation C (*Home Mortgage Disclosure*) to reflect a change in the asset-size exemption threshold for banks, savings associations, and credit unions based on the annual percentage change in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). The exemption threshold is adjusted to increase to $43 million from $42 million. The adjustment is based on the 1.4 percent increase in the average of the CPI-W for the 12-month period ending in November 2013. Banks, savings associations, and credit unions with assets of $43 million or less as of December 31, 2013, are exempt from collecting data in 2014.

Also on December 30, 2013, the CFPB amended the official commentary that interprets the requirements of its Regulation Z (*Truth in Lending*) to reflect a change in the asset size threshold for certain creditors to qualify for an exemption to the requirement to establish an escrow account for a higher-priced mortgage loan based on the annual percentage change in the CPI-W for the 12-month period ending in November. The exemption threshold is adjusted to increase to $2.028 billion from $2 billion. If other requirements of Regulation Z are also met, creditors with assets of $2.028 billion or less as of December 31, 2013, are exempt from establishing escrow accounts for higher-priced mortgage loans in 2014.

Agencies Publish Guidance to Address Consumer Compliance Risks Associated with Use of Social Media

On December 17, 2013, the Federal Financial Institutions Examination Council (FFIEC) published final supervisory guidance on behalf of its member agencies (Federal Reserve Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, National Credit Union Administration, Bureau of Consumer Financial Protection) that addresses issues associated with the management of consumer compliance risks related to the use of social media. The guidance became effective upon publication and is applicable to the institutions (and nonbank entities) supervised by the member agencies. The State Liaison Committee, also a member of the FFIEC, will encourage state regulatory agencies to adopt the guidance as well.

Covered financial institutions are expected to use the guidance as part of their efforts to

identify, measure, monitor, and control the potential risks posed by the use social media and to develop and implement policies and procedures to provide oversight and controls commensurate with those risks. Key features of the guidance:

- Address the applicability of consumer protection and compliance laws, regulations, and policies to activities conducted via social media
- identify potential risk areas including consumer compliance and legal risks, as well as related risks, such as reputation and operational risks, associated with the use of social media
- Outline compliance risk management expectations that allow financial institutions to identify, measure, monitor, and control risks related to social media.

Agencies Issue Clarifying Guidance for Qualified Mortgages

Four Federal financial institution regulatory agencies (Federal Reserve Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and National Credit Union Administration – collectively, the Agencies) jointly issued an interagency statement on December 13, 2013 that is intended to clarify safety-and-soundness expectations and *Community Reinvestment Act* (CRA) considerations related to Qualified Mortgage loans and non-Qualified Mortgage loans offered by regulated institutions pursuant to the Bureau of Consumer Financial Protection's (CFPB) *Ability-to-Repay and Qualified Mortgage Standards Rule* that takes effect January 10, 2014.

The Agencies state that an institution may originate both Qualified Mortgage and non-Qualified Mortgage loans, based on its business strategy and risk appetite and the Agencies will not subject a residential mortgage loan to safety-and-soundness criticism solely because of the loan's status as a Qualified Mortgage or non-Qualified Mortgage loan. The Agencies continue to expect institutions to underwrite all residential mortgage loans in a prudent fashion and address key risk areas in residential mortgage lending, including loan terms, borrower qualification standards, loan-to-value limits, documentation requirements, and portfolio- and risk-management practices, independent of whether the loan is a Qualified Mortgage or non-Qualified Mortgage.

With regard to the CRA, the Agencies state they do not anticipate an institutions' decision to originate only Qualified Mortgages, absent other factors, would adversely affect CRA evaluations.

In October 2013, the Agencies along with the CFPB released an "*Interagency Statement on Fair Lending Compliance and the Ability-to-Repay and Qualified Mortgage Standards Rule*," which addressed fair lending risk and the relationship between the Ability-to-Repay Rule and the disparate impact doctrine of the *Equal Credit Opportunity Act* and its implementing regulation, Regulation B. In that statement, the Agencies stated that a bank's decision to offer only Qualified Mortgages, absent other factors, does not raise the bank's fair lending risk from a supervisory perspective, and that creditors should continue to evaluate fair lending risk as they would for other types of product selections, including careful monitoring of their policies and practices and implementing effective compliance management systems.

Capital Markets & Investment Management

Agencies to Review Treatment of Collateralized Debt Obligations under the Final Volcker Rule

The Federal Reserve Board (Federal Reserve), Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), and the Securities and Exchange Commission (SEC) released a joint set of Frequently Asked Questions (FAQs) on December 19, 2013 to address the treatment of collateralized debt obligations backed by trust preferred securities (TruPS/CDOs) under section 619 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (the Dodd-Frank Act), more commonly referred to as the "Volcker Rule." The FAQs indicated "the question of whether an investment is covered by the statute and implementing rules depends on the facts of the structure, type and circumstances governing the particular investment." The agencies added that financial institutions could use the conformance period (up to July 21, 2015) to restructure or otherwise conform the TruPS/CDOs to the final rule.

On December 27, 2013, the four agencies issued a joint statement indicating that they are reviewing whether it would be appropriate and consistent with the Dodd-Frank Act not to subject TruPS/CDOs to the investment prohibitions of the Volcker Rule. The agencies intend to address the matter no later than January 15, 2014.

SEC Proposes Rules to Increase Smaller Company Access to Capital

On December 18, 2013, the Securities and Exchange Commission (SEC) voted to propose rules intended to increase access to capital for smaller companies. The SEC's proposal would build upon Regulation A, an existing exemption from registration for small offerings of securities up to $5 million within a 12-month period. The updated exemption would enable companies to offer and sell up to $50 million of securities within a 12-month period, as mandated by Title IV of the *Jumpstart Our Business Startup Act* (JOBS Act).

SEC Chair Mary Jo White stated, "This proposal is intended to help increase access of smaller companies to capital…In shaping this proposal, we sought to develop an effective, workable path to raising capital that, very importantly, also builds in necessary investor protections."

The SEC's proposal will undergo a 60-day public comment period after it is published in the *Federal Register*.

FINRA Announces 2014 Regulatory and Examination Priorities

On January 2, 2014, the Financial Industry Regulatory Authority (FINRA) announced the following regulatory and examination priorities related to business conduct for the calendar year 2014:

- Suitability
- Recidivist Brokers (focus on identification and investigation, as appropriate, for high risk broker such as those with a history of complaints or sales practice abuses)
- Conflicts of interest
- Cybersecurity
- Qualified plan rollovers
- Initial public offering market
- Private placements - general solicitation, advertising, due diligence, suitability
- Anti-money laundering
- Municipal advisers
- Crowdfunding portals
- Senior investors

Additional priorities were identified in the areas of fraud, financing and operations, and market regulation.

FINRA Solicits Comment on CARDS Proposal

The Financial Industry Regulatory Authority (FINRA) issued a *Regulatory Notice* on December 23, 2013 soliciting comment on a "concept proposal" called Comprehensive Automated Risk Data System (CARDS). FINRA states that CARDS will involve account reporting requirements that would allow it to collect, on a standardized, automated, and regular basis, account information, as well as account activity and security identification information that a firm maintains as part of its books and records. FINRA also states that it plans to analyze CARDS data before examining firms on site, thereby identifying risks earlier and shifting work away from the on-site exam process. Comments on the proposal are requested through February 21, 2014.

CFTC Issues Advisory on Commodity Trading Advisors and Swaps

The Commodity Futures Trading Commission (CFTC) issued guidance on requirements imposed on commodity trading advisors (CTAs) resulting from the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act) on December 23, 2013. The Dodd-Frank Act amended the statutory definition of CTA to include any person who engages in the business of advising others on swaps. Additionally, certain CTAs who were previously exempt from registration with the CFTC are now required to register because of the CFTC's rescission of Commission Regulation 4.13(a)(4) and amendments to Commission Regulation 4.5. As a result, provisions of the *Commodity Exchange Act* (CEA) and CFTC regulations applicable to CTAs might, depending on the circumstances, result in new advisory obligations.

The advisory provides guidance on the potential new advisory obligations of CTAs arising from the Dodd-Frank Act. It also informs the newly expanded class of CTAs and those previously exempt CTAs as to the general regulatory framework, including: (1) provisions of the CEA and CFTC regulations applicable generally to CTA activities; (2) CTA advisory obligations with respect to swap risk disclosures; and (3) requirements relevant to CTAs that advise Special Entities on swap transactions.

Enforcement Actions

The Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission (CFTC), and the Financial Industry Regulatory Authority (FINRA) recently announced the following enforcement actions:

- The SEC charged a foreign-based hedge fund adviser and its former U.S.-based holding company with internal controls failures that led to the overvaluation of a fund's assets and inflated fee revenue for the firms. The hedge fund and its former holding company agreed to pay nearly $9 million to settle the SEC's charges.
- The SEC charged the managing partners of an investment advisory firm for compromising their independent judgment and allowing a third party with its own interests to influence the portfolio selection process of a collateralized debt obligation (CDO) being offered to investors. The investment managers have agreed to collectively pay more than $472,000 and exit the securities industry to settle the SEC's charges.
- The SEC charged a financial management and advisory company with making faulty disclosures about collateral selection for two CDOs that it structured and marketed to investors, and maintaining inaccurate books and records for a third CDO. The company agreed to pay $131.8 million to settle the SEC's charges.
- The SEC charged three brokerage subsidiaries and two former employees of a global trading services provider with fraudulently causing many institutional clients to pay substantially higher amounts than disclosed for the execution of trading orders. The subsidiaries agreed to pay more than $107 million and admit wrongdoing to settle the SEC's charges and the former employees also agreed to admit and settle the charges against them.
- The SEC charged a brokerage firm with ignoring red flags and paying more than $400,000 in soft dollars for expenses that an investment adviser had not properly disclosed to clients. The brokerage firm agreed to pay more than $800,000 to settle the charges.
- The CFTC entered into an Order requiring an individual to make restitution of $171,297 to defrauded customers and pay a $300,000 civil monetary penalty, among other sanctions, for fraudulent misappropriation, fraudulent solicitations, and false statements related to a commodity pool trading leveraged or margined off-exchange foreign currency contracts.
- The CFTC obtained federal court Orders requiring one individual to pay a $4 million civil monetary penalty and $1,598,343 in disgorgement and another individual to pay a $1.7 million civil monetary penalty and $819,781 in disgorgement to settle CFTC charges related to a fraudulent commodity pool scheme.
- The CFTC obtained a federal court Order requiring an individual to pay a $600,000 civil monetary penalty for engaging in an illegal futures trading scheme and making false statements to clearing house representatives.
- The CFTC entered into an Order requiring the president of a foreign bank to pay a $250,000 penalty for making false and misleading statements of material fact to CFTC staff in an interview during a CFTC Division of Enforcement investigation.
- FINRA announced that it had fined a foreign bank $3.75 million for failure to preserve certain electronic records, including emails and instant messages, in the manner required ("Write-Only, Read Many" or WORM) and for the period required (ten years).
- FINRA ordered two broker-dealers to pay combined fines of $550,000 and restitution of $475,000 to 65 customers in connection with sales of leveraged and inverse exchange-traded funds. FINRA found that in some cases the recommendation to sell these funds was unsuitable for the customers and the broker-dealer failed to ensure that registered representatives and supervisory personnel were adequately trained on the risks of the products.

Recent Supervisory Actions against Financial Institutions

Last Updated: January 13, 2014

Agency	Institution Type	Action	Date	Synopsis of Action
Federal Reserve Board	State member bank	Civil Money Penalty	01/09	The Federal Reserve Board entered into an Order of Assessment of Civil Money Penalty with a Texas-based state member bank to address violations of the National Flood Insurance Act.
Federal Reserve Board	State member bank	Civil Money Penalty	01/09	The Federal Reserve Board entered into an Order of Assessment of Civil Money Penalty with a New York-based state member bank to address violations of the National Flood Insurance Act.
CFPB	Large financial institution	Consent Order	12/23	The Bureau of Consumer Financial Protection entered into a Consent Order with a large financial institution to resolve the CFPB's claims that the institution engaged in a pattern or practice of discrimination on the basis of race and national origin in residential mortgage lending in violation of the Equal Credit Opportunity Act. The Consent Order requires the institution to pay $35 million in restitution.
CFPB, OCC, FDIC	Various	Consent Order, Order for Restitution, Order for Civil Money Penalty	12/23	The Bureau of Consumer Financial Protection, Office of the Comptroller of the Currency, and Federal Deposit Insurance Corporation each participated in actions against a financial institution and certain of its subsidiaries to address unfair and deceptive marketing practices related to credit card "add on" products. Collectively, the orders require $59.5 million in restitution and civil money penalties of $16.2 million.
CFPB	Large financial institution	Consent Order, Civil Money Penalty	12/20	The Bureau of Consumer Financial Protection entered into a Consent Order to with a resolve the CFPB's claim that the financial institution, an indirect auto lender, violated the anti-discrimination provisions of the Equal Credit Opportunity Act. The institution was required to pay $80 million in damages to affected borrowers and an additional $18 million civil money penalty.
CFPB	Nonbank financial institution	Proposed Consent Order	12/19	The Bureau of Consumer Financial Protection and authorities in 49 states released a proposed Consent Order that would require a nonbank mortgage servicer to pay approximately $2 billion in principal reduction for certain borrowers that were harmed by the mortgage servicers practices. CFPB claims the company engaged in "significant and systemic misconduct…at every stage of the mortgage servicing process." The proposed Consent Order would also require the company to pay $125 million in refunds to approximately 185,000 foreclosed borrowers.
Federal Reserve Board	State member bank	Civil Money Penalty	12/12	The Federal Reserve Board entered into an Order of Assessment of Civil Money Penalty with a Virginia-based state member bank to address violations of the National Flood Insurance Act.

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