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Bank & Thrift

Agencies Issue Final Dodd-Frank Act Stress Test Guidance for Medium-Sized Firms

On March 5, 2014, the Federal Reserve Board (Federal Reserve), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) issued final guidance describing supervisory expectations for stress tests conducted by financial companies with more than \$10 billion and less than \$50 billion in total consolidated assets. These "medium-sized" companies are required to conduct annual, company-run stress tests under rules issued by the agencies in October 2012 to implement a provision under Section 165 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act). These companies are required to perform their first stress tests under the Dodd-Frank Act by March 31, 2014.

The final guidance is substantively similar to proposed guidance issued by the agencies last year and clarifies certain aspects in response to comments received. The final guidance confirms that companies with total consolidated assets between \$10 billion and \$50 billion are not subject to the Federal Reserve's capital plan rule, the Federal Reserve's annual Comprehensive Capital Analysis and Review, the Dodd-Frank Act supervisory stress tests, or related data collections, which apply to bank holding companies with total consolidated assets of \$50 billion or more.

The agencies' state that the stress test rules are flexible to accommodate different risk profiles, sizes, business mixes, market footprints, and complexity for companies in the \$10 billion to \$50 billion asset range. Consistent with this flexibility, the final guidance describes general supervisory expectations for these companies' Dodd-Frank Act stress tests, and, where appropriate, provides examples of practices that would be consistent with those expectations. Specifically, the guidance contains information on the following elements of Dodd-Frank stress testing:

- Dodd-Frank stress test timelines;
- Scenarios for Dodd-Frank stress tests;
- Dodd-Frank stress test methodologies and practices;
- Estimating the potential impact on regulatory capital levels and capital ratios;
- Controls, oversight, and documentation;
- Reports to supervisors; and
- Public disclosure of Dodd-Frank stress tests.

OCC Releases Interim Final Rule on Basel III Conforming Amendments

The Office of the Comptroller of the Currency (OCC) issued an interim final rule on March 7, 2014 requesting comments on technical and conforming amendments to its regulations governing national banks and federal savings associations. The interim final rule, which is effective March 31, 2014, amends various regulations in order to make them consistent with the recently adopted Basel III Capital Framework. The Basel III final rule revised the OCC's

regulatory capital rules, adding a new common equity tier 1 requirement, revising the definitions of tier 1 and tier 2 capital, and integrating federal savings associations into 12 CFR part 3 and 12 CFR part 6 (Prompt Corrective Action). The interim final rule makes technical, clarifying, and conforming amendments to the OCC's rules, by providing cross-references to new capital rules, where necessary, and deleting obsolete references. The interim final rule also makes changes to rules governing subordinated debt to clarify the requirements subordinated debt must meet and procedures required to issue and redeem it.

Comments on the interim final rule must be received by March 31, 2014.

Comptroller Highlights Risk Management Issues Related to Third Parties in Remarks to Community Bankers

Thomas Curry, Comptroller of the Currency, spoke before the Independent Community Bankers of America on March 4, 2014. In his remarks, Comptroller Curry stated that "no area of emerging risk is more important today than the cyber threats that are increasingly common in our interconnected environment." He noted that "many community banks look to third-party service providers for IT services, in the area of data security, among others" but cautioned that while this is an "effective tool," third parties can also be "the weak link in [their] information systems security and resiliency." He stressed the importance of implementing risk management practices that are commensurate with the risks posed by a third-party service provider, including conducting due diligence that assesses the vendor and the vendor's relationships.

Comptroller Curry also outlined "other concerns about third-party relationships," including the:

- Extent to which service providers are consolidating, which he stated means that more financial institutions are dependent upon a single vendor. As such, deficiencies at one vendor have the potential to affect a large number of banks simultaneously.
- Increased reliance by banks, directly and indirectly, on foreign-based subcontractors to support critical activities. He said that third-party service providers and subcontractors of third parties that operate in foreign jurisdictions present unique problems and banks must consider the legal and regulatory implications of where their data is stored or transmitted, and make a determination whether geographic limitations are needed in their contracts.
- Access third parties have to large amounts of sensitive bank or customer data, where a single data breach involving confidential customer information can be extremely costly.

Comptroller Curry also stated that he thought it important for banks to have access to information from regulatory examinations of third-party servicers as early in the process as possible, and acknowledged the OCC was exploring ways to disseminate the reports more quickly.

Bank Regulatory Agencies and CDFI Fund to Sponsor National Interagency Community Reinvestment Conference

The federal bank regulatory agencies (Federal Reserve Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation), the Federal Reserve Bank of San Francisco, the Federal Reserve Bank of Chicago, and the Community Development Financial Institutions Fund announced they will host the 2014 National Interagency Community Reinvestment Conference in Chicago between March 31 and April 2. This biennial conference offers participants the opportunity to learn about the *Community Reinvestment Act* (CRA) and its

regulations, as well as the chance to network with colleagues and discuss best practices and emerging challenges in community development.

The conference agenda includes keynote presentations by Janet Yellen, Chair of the Board of Governors of the Federal Reserve System, Martin J. Gruenberg, Chairman of the Federal Deposit Insurance Corporation, and Thomas J. Curry, Comptroller of the Currency.

KPMG and RMA Release the *Operational Risk Management Excellence—Get to Strong Survey Executive Report*

On March 3, 2014, KPMG LLP (KPMG) and The Risk Management Association (RMA) released the results of a study entitled the *KPMG/RMA Operational Risk Management Excellence – Get to Strong Survey Executive Report* to the Survey's participants. The Executive Report highlights key results from the Survey, including responses grouped by Advanced Measurement Approach (AMA) and non-AMA institutions, analysis of areas of operational risk management (ORM) strength and areas for further enhancement, and anonymized participant comments. KPMG collaborated with the RMA to conduct this Survey of global North American financial institutions with the objective of providing insights into leading industry ORM practices in support of enhanced business value, heightened regulatory expectations, and Basel AMA use test compliance.

For additional information about the Survey, please contact Hugh Kelly at hckelly@kpmg.com.

Enterprise & Consumer Compliance

CFPB Recovers More Than \$1 Million for Service Members, Veterans, and their Families

The Consumer Financial Protection Bureau (CFPB or Bureau) announced on March 6, 2014 that servicemembers, veterans, and their families who submitted complaints to the CFPB about financial products or services have recovered more than \$1 million. The relief was reported in the CFPB's second snapshot of complaints from military consumers, which also highlighted how some military families are not receiving the added consumer protections they have earned. The report covers more than 14,000 complaints from service members, veterans, and their families received by the CFPB from July 21, 2011 through February 1, 2014.

"Military families make enormous sacrifices for our nation and deserve to be protected," said CFPB Director Richard Cordray. "I am pleased that the Bureau has assisted thousands in cutting through red tape when dealing with their financial institutions. However, the complaints show that many service members, veterans, and their families are not getting the protections accorded to them by federal laws and that raises concern."

The *Dodd-Frank Wall Street Reform and Consumer Protection Act*, which created the CFPB, established the Office of Servicemember Affairs to address specific consumer protection concerns for the nation's military community. A priority of the office is to monitor the consumer complaints the Bureau receives from active-duty service members, veterans, and their families.

House of Representatives Passes Flood Insurance Reform Bill

On March 4, 2014, the House of Representatives passed H.R. 3370, the *Homeowner Flood Insurance Affordability Act*. The bill would reverse some of the changes to the National Flood Insurance Program (NFIP) introduced by the *Biggert-Waters Flood Insurance Reform Act of 2012*. Earlier this year in January, the Senate passed its own version of flood insurance legislation, referred to as S. 1926. The two bills must now be reconciled.

Features of H.R. 3370 would provide, among other things:

- A limit on the annual average rate increase for a class of properties and a limit on the annual rate of increase for individual policies;
- Repeal of the property sales trigger;
- Repeal of the new policy sales trigger; and
- Reinstatement of the grandfathering provisions.

Capital Markets & Investment Management

CFTC to Host Public Roundtable to Discuss Dodd-Frank End-User Issues

The Commodity Futures Trading Commission (CFTC) announced that it will hold a public roundtable on April 3, 2014 to discuss issues concerning end-users and the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act). The CFTC indicates that it has received a number of comments and requests for clarification from commercial end-users that have been impacted by the Dodd-Frank Act.

The roundtable will consist of three panels, discussing (1) the obligations of end-users under Regulation 1.35 concerning recordkeeping for commodity interest and related cash or forward transactions; (2) the appropriate regulatory treatment of forward contracts with embedded volumetric optionality; and (3) the appropriate regulatory treatment for purposes of the \$25 million (special entity) de minimis threshold for swap dealing to government-owned electric utilities.

CFTC, FERC Implement Information Sharing MOU

On March 5, 2014, Commodity Futures Trading Commission (CFTC) Acting Chairman Mark Wetjen and Federal Energy Regulatory Commission (FERC) Acting Chairman Cheryl LaFleur

announced the initial transmission of market data under the recently-adopted CFTC-FERC Memorandum of Understanding (MOU) for use in analyzing market activities and protecting market integrity.

Acting Chairman Wetjen and Acting Chairman LaFleur also announced the creation of a staff-level Interagency Surveillance and Data Analytics Working Group to coordinate information sharing between the agencies and focus on data security, data sharing infrastructure, and the use of analytical tools for regulatory purposes.

As directed by Congress under the *Dodd-Frank Wall Street Reform and Consumer Protection Act*, the CFTC and FERC entered into an MOU on January 2, 2014 to share information for use in analyzing market activities and protecting market integrity. The MOU ensures that information requests related to markets within the respective jurisdiction of each agency are properly coordinated to minimize duplicative information requests and to address the treatment of confidential information.

[CFTC Provides Time-Limited No-Action Relief to Certain Affiliated Counterparties](#)

On March 6, 2014, the Commodity Futures Trading Commission's (CFTC) Divisions of Clearing and Risk (DCR) and Market Oversight (DMO) provided time-limited no-action relief to certain affiliated counterparties. The DCR issued a no-action letter extending the time-limitation contained in the alternative compliance frameworks available to certain affiliated counterparties pursuant to CFTC regulation 50.52(b)(4)(ii)-(iii) (DCR's No-Action Letter). The DMO issued a no-action letter providing time-limited no-action relief from the requirements of the trade execution requirement in *Commodity Exchange Act* (CEA) section 2(h)(8) to Eligible Affiliate Counterparties, as defined in CFTC regulation 50.52(a), that engage in swap transactions with one another that involve a swap subject to the trade execution requirement (DMO's No-Action Letter).

On April 11, 2013, the CFTC published a final rule providing an exemption from required clearing for swaps between certain affiliated entities, known as Eligible Affiliate Counterparties, subject to specific requirements and conditions (Inter-Affiliate Exemption), in CFTC regulation 50.52. One of those conditions, known as the "treatment of outward-facing swaps condition," requires the clearing of swaps between Eligible Affiliate Counterparties claiming the Inter-Affiliate Exemption and unaffiliated counterparties. The Inter-Affiliate Exemption contains several temporary alternative compliance frameworks to satisfy the treatment of outward-facing swaps condition, all of which expire on March 11, 2014.

The DCR's No-Action Letter provides relief from the March 11, 2014 date for Eligible Affiliate Counterparties that are otherwise eligible to use the alternative compliance frameworks in CFTC regulation 50.52(b)(4)(ii)-(iii) until December 31, 2014. This relief may promote the adoption of comparable and comprehensive clearing requirements. In addition, this extension will allow for a more orderly transition as jurisdictions establish and implement clearing requirements and the CFTC issues comparability determinations with regard to those requirements.

In order to be eligible for this relief:

- The Eligible Affiliate Counterparties claiming the Inter-Affiliate Exemption must otherwise satisfy all of the requirements of CFTC regulation 50.52;

- A counterparty to the swap must not be located in a non-U.S. jurisdiction in which the CFTC has determined a comparable and comprehensive clearing requirement exists; and
- The Eligible Affiliate Counterparties electing the relief provided by this no-action letter shall promptly provide to DCR, upon request, documentation regarding their compliance with any aspect of this no-action letter and CFTC regulation 50.52.

The CFTC also previously determined that swaps entered into by Eligible Affiliate Counterparties that elect and comply with the provisions of the Inter-Affiliate Exemption would not be subject to the trade execution requirement. The DMO's No-Action Letter, provides temporary relief, likewise until December 31, 2014, from the trade execution requirement to Eligible Affiliate Counterparties that do not elect the Inter-Affiliate Exemption.

During this period of relief, the DMO states that it will continue to evaluate, based on ongoing observations of inter-affiliate market activity occurring both on and off of swap execution facilities (SEFs) and designated contract markets (DCMs), whether such swap transactions should be subject to the trade execution requirement. In particular, the DMO will assess whether applying the trade execution requirement to inter-affiliate swap transactions would promote pre-trade price transparency in the swaps market. Lastly, the DMO will continue to consider the implications of this relief on the policy goals of the conditions set forth in the Inter-Affiliate Exemption.

Enforcement Actions

The Securities and Exchange Commission (SEC) recently announced the following enforcement actions:

- The SEC announced the largest-ever monetary sanction for Rule 105 short selling violations against a Long Island-based proprietary trading firm and its owner, who agreed to pay \$7.2 million to settle the charges. Rule 105 prohibits short selling of an equity security during a restricted period, generally five business days before a public offering, and the subsequent purchase of that same security through the offering. The rule applies regardless of the trader's intent, and promotes offering prices that are set by natural forces of supply and demand rather than manipulative activity. The rule therefore prevents short selling from interfering with offering prices.
- The SEC announced an emergency enforcement action to stop a fraudulent pyramid scheme by phony off-shore companies masquerading as a legitimate international investment firm.
- The SEC charged five executives and finance professionals with facilitating a \$150 million fraudulent bond offering by an international law firm where they worked. The SEC alleges that the five turned to accounting fraud when the firm needed money to weather the economic recession and steep costs from a merger.

Recent Supervisory Actions against Financial Institutions

Last Updated: March 10, 2014

Agency	Institution Type	Action	Date	Synopsis of Action
CFPB	Mortgage lender	Notice of Charges	1/29	The Bureau of Consumer Financial Protection initiated an administrative proceeding against a New Jersey-based mortgage lender and its affiliates for a mortgage insurance kickback scheme. The Bureau is seeking a civil fine, a permanent injunction to prevent future violations, and restitution.
CFPB	Mortgage lender	Consent Order	1/16	The Bureau of Consumer Financial Protection ordered a Missouri-based mortgage lender and its former owner and current president to pay \$81,076 for funneling illegal kickbacks to a bank in exchange for real estate referrals.
OCC	Large financial institution	Order for Civil Money Penalty	1/7	The Office of the Comptroller of the Currency announced a \$350 million civil money penalty against three affiliated banks for Bank Secrecy Act (BSA) violations. The penalty follows a January 2013 cease and desist order in which the three banks were directed to correct deficiencies in their compliance programs.
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 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.

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