KPMG
cutting through complexity

The Washington Report
for the week ended March 14, 2014

In This Issue

Bank & Thrift Regulatory Update

Comptroller Curry Discusses Community Reinvestment with the National Community Reinvestment Coalition 1

House Financial Services Committee Passes Legislation Affecting Volcker Rule 1

Basel Committee Working Paper Considers the Channels of Adjustment Banks Choose to Meet Capital Requirements 1

Federal Reserve Publishes Financial Statements 2

Enterprise & Consumer Compliance

Senate Passes Flood Insurance Reform Bill 3

Capital Markets & Investment Management

SEC Proposes Rules to Enhance Oversight of Systemically Important Clearing Agencies 3

SEC Enforcement Division Launches Municipalities Continuing Disclosure Cooperation Initiative for Issues and Underwriters 4

FINRA Modifies Certain Information Parameters for Proposed Comprehensive Automated Risk Data System Concept 4

Enforcement Actions 5

Recent Supervisory Actions 6

Bank & Thrift

Comptroller Curry Discusses Community Reinvestment with the National Community Reinvestment Coalition

Thomas Curry, Comptroller of the Currency, spoke before the National Community Reinvestment Coalition on March 12, 2014. Comptroller Curry's remarks were focused on the *Community Reinvestment Act* (CRA), and, in particular, how "national banks and federal savings associations can more effectively serve the credit needs of rural communities."

Comptroller Curry stated that he believed the CRA should play as important a role in serving the credit needs of rural America as it does in metropolitan areas. He stated the OCC and the other bank regulatory agencies have amended the CRA regulations and accompanying guidance to encourage community development activities in rural areas, including consideration for activities that benefit low- or moderate-income individuals or areas in the broader statewide or regional area that includes a bank's assessment area, as well as activities in rural, distressed and underserved middle-income areas. They believe that this is a flexible standard that will encourage community development activities in rural areas as well as in response to the needs and opportunities in a bank's or thrift's own assessment area. He stressed, however, that these are first steps and acknowledged that the OCC and the other bank regulatory agencies are evaluating other CRA-related concerns and considering additional improvements.

House Financial Services Committee Passes Legislation Affecting Volcker Rule

The House of Representatives' Financial Services Committee passed H.R. 4167, the *Restoring Proven Financing for American Employers Act*, on March 14, 2014. The bill would amend the *Bank Holding Company Act* to allow banks to invest in Collateralized Loan Obligations (CLOs) issued before January 31, 2014, and would clarify the definition of what constitutes an ownership interest in a covered fund for purposes of Section 619 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*, also known as the Volcker Rule. CLOs provide nearly $300 billion in financing to U.S. companies and the Financial Services Committee summarizes that the legislation would "prevent a "fire-sale" of CLOs that were captured by the final rule to implement the Volcker Rule."

Basel Committee Working Paper Considers the Channels of Adjustment Banks Choose to Meet Capital Requirements

The Bank for International Settlements' Basel Committee on Banking Supervision released Working Paper No. 443, *Banks and Capital Requirements: Channels of Adjustment*, on March 11, 2014. The authors offer the following concluding comments:

"The adjustment process to Basel III is not yet complete. The evidence presented here, however, suggests that most banks have achieved most of the adjustment to date through the accumulation of retained earnings. Banks in advanced economies have reduced dividend payouts as part of this process. Banks in emerging economies have enjoyed high earnings and

asset growth, and have had little trouble using some of their strong earnings to increase their capital ratios. An additional, though secondary, role has been played by the shift to assets with lower risk weights on the part of advanced economy banks. Banks in advanced economies have benefited from modestly wider net interest margins. Reductions in operating expenses do not appear to have played much of a role.

Banks in aggregate do not appear to have cut back sharply on asset or lending growth as a consequence of stronger capital standards. However, banks that had high capital ratios at the start of the process or strong profitability in the post-crisis years did tend to grow more than other banks. This [result] points to the importance of solid bank balance sheets in supporting lending.

There has been a pronounced shortfall in lending growth on the part of European banks, though European banks have accumulated other assets in the form of cash and securities. Some banks, especially in Europe, have cut back their trading portfolios.

Further research is needed to understand the interplay among these different adjustment strategies, and to trace their macroeconomic effects. It will be especially important to look more closely at the relative roles of regulation, macroeconomic factors, sovereign risk concerns, and the disposal of legacy assets in the balance sheet adjustments that have been made by the European banks."

Federal Reserve Publishes Financial Statements

On March 14, 2014, the Federal Reserve System released the 2013 combined annual financial statements for the Federal Reserve Banks, as well as statements for the twelve individual Federal Reserve Banks, the consolidated variable interest entities (VIEs) that were created to respond to strains in financial markets, and the Board of Governors. These financial statements are audited annually by an independent auditing firm.

Highlights of the financial statements include:

- The Federal Reserve Banks' 2013 earnings, inclusive of other comprehensive income, were $81.4 billion. The Reserve Banks provided for remittances to the U.S. Treasury of $79.6 billion.
- Interest income on securities acquired through open market operations--U.S. Treasury securities, government-sponsored enterprise (GSE) debt securities, and federal agency and GSE mortgage-backed securities (MBS)--totaled $90.4 billion, an increase of $9.9 billion over the previous year.
- There were no realized gains on the sales of U.S. Treasury securities in 2013, compared to $13.3 billion of gains in 2012 from the sales of short-term U.S. Treasury securities under the maturity extension program, which was completed in 2012.
- Earnings attributable to the consolidated VIEs were $181 million, $5.8 billion less than 2012.
- Interest expense on depository institutions' reserve balances during the year was $5.2 billion, losses from the daily revaluation of foreign currency denominated asset holdings were $1.3 billion, and Reserve Bank operating expenses were $6.1 billion, including assessments of $1.8 billion for Board expenses, currency costs, and the Bureau of Consumer Financial Protection.
- Total Reserve Bank assets as of December 31, 2013, were $4.0 trillion, which is an increase of $1.1 trillion over the balance on December 31, 2012.

- Holdings of U.S. Treasury securities increased by $550.2 billion, and federal agency and GSE MBS holdings increased by $583.5 billion.
- GSE debt securities holdings decreased by $20.4 billion, and balances held under central bank liquidity swap arrangements decreased by $8.6 billion.
- Asset holdings of the consolidated VIEs and the Term Asset Loan Facility, which were created during the financial crisis, continued to decrease and totaled $2.0 billion on December 31, 2013.

Enterprise & Consumer Compliance

Senate Passes Flood Insurance Reform Bill

The U.S. Senate passed H.R. 3370, the *Homeowner Flood Insurance Affordability Act*, by a vote of 72-22 on March 13 2014. H.R. 3370 was previously passed by the House of Representatives on March 4, 2014. It will now be referred to the President for his signature.

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*. 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

SEC Proposes Rules to Enhance Oversight of Systemically Important Clearing Agencies

The Securities and Exchange Commission (SEC or Commission) voted to propose new rules to enhance the oversight of clearing agencies that are deemed to be systemically important by the Financial Stability Oversight Council or that are involved in complex transactions, such as security-based swaps.

Clearing agencies covered by the proposed rules would be subject to new requirements regarding their financial risk management (including liquidity risk, credit risk, margin, and collateral), operations, governance (including qualifications and authorities for boards of directors, senior management, and internal audit), and disclosures to market participants and the public. The proposal also would establish procedures for the Commission to apply the new requirements to additional clearing agencies.

Comments will be accepted for a period of 60 days following publication in the *Federal Register*.

SEC Enforcement Division Launches Municipalities Continuing Disclosure Cooperation Initiative for Issues and Underwriters

On March 10, 2014, the Securities and Exchange Commission (SEC) announced that its Enforcement Division was offering a new "cooperation initiative" to encourage issuers and underwriters of municipal securities to self-report certain violations of the federal securities laws rather than wait for their violations to be detected. Under the Municipalities Continuing Disclosure Cooperation (MCDC) Initiative, the Enforcement Division will recommend standardized, favorable settlement terms to municipal issuers and underwriters who self-report that they have made inaccurate statements in bond offerings about their prior compliance with continuing disclosure obligations specified in Rule 15c2-12 under the *Securities Exchange Act of 1934*.

Rule 15c2-12 generally prohibits underwriters from purchasing or selling municipal securities unless the issuer has committed to providing continuing disclosure regarding the security and issuer, including information about its financial condition and operating data. The rule also generally requires that municipal bond offering documents contain a description of any instances in the previous five years in which the issuer failed to comply, in all material respects, with any previous commitment to provide such continuing disclosure.

"The Enforcement Division is committed to using innovative methods to uncover securities law violations and improve transparency in the municipal markets," said Andrew J. Ceresney, director of the SEC Enforcement Division. "We encourage eligible parties to take advantage of the favorable terms we are offering under this initiative. Those who do not self-report and instead decide to take their chances can expect to face increased sanctions for violations."

The Enforcement Division has separately released an announcement detailing the eligibility requirements for the MCDC Initiative, which include submission of a self-reporting questionnaire no later than September 10, 2014.

FINRA Modifies Certain Information Parameters for Proposed Comprehensive Automated Risk Data System Concept

The Financial Industry Regulatory Authority (FINRA) recently released an update to its Regulatory Notice 13-42, which was previously issued in December 2013. In that notice, FINRA requested comment on the concept of a new Comprehensive Automated Risk Data System (CARDS). The notice stated that as FINRA develops CARDS it would consider ways to gather account identifying information without collecting account names or other personally identifiable information. After considering the written comments on the CARDS concept proposal and the views expressed in FINRA staff's discussions with industry participants regarding investor privacy, FINRA has concluded that the CARDS proposal will not require the

submission of information that would identify to FINRA the individual account owner, particularly, account name, account address or tax identification number.

The comment period for the notice ends on March 21, 2014. FINRA encourages all interested parties to provide comment on the proposal.

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 former analyst at an affiliate of a hedge fund advisory firm with insider trading. The individual agreed to be barred from the securities industry and pay more than $200,000 to settle the SEC's charges.
- The SEC announced fraud charges and an emergency asset freeze against a promoter behind a platform of affiliated microcap stock promotion Web sites. The SEC alleges the promoter used the Web sites to commit a brand of securities fraud known as "scalping." The court's order, among other things, freezes the promoter's assets, imposes temporary restraints from further similar misconduct, requires an accounting, prohibits document alteration or destruction, and expedites discovery.
- The SEC charged a company with failing to fully and accurately disclose to investors a key aspect of its effort to thwart a hostile takeover bid. The company agreed to pay $7.5 million and admit wrongdoing to settle the SEC's charges.
- The SEC announced enforcement actions against a pair of brokers, an investment advisory firm, and several others involved in a variable annuities scheme to profit from the imminent deaths of terminally ill patients in nursing homes and hospice care.
- The SEC charged an investment bank and brokerage firm with failing to supervise employees on its mortgage-backed securities desk who were lying to customers about pricing. An SEC investigation found that representatives of the firm lied to customers about the prices that the firm paid for certain mortgage-backed securities, thus misleading them about the true amount of profits being earned by the firm in its trading. The firm's policy required supervisors to review the electronic communications of traders and salespeople in order to flag any untrue or misleading information provided customers. However, the policy was not implemented in a way to detect misrepresentations about price. The firm agreed to settle the SEC's charges by making payments to customers totaling more than $11 million, which represents not just the ill-gotten gains of $4.2 million but the full amount of profits earned by the firm on these trades. It also agreed to pay a $4.2 million penalty to the SEC and an additional $9.8 million as part of a non-prosecution agreement with the U.S. Attorney's office. The firm must retain a compliance consultant to evaluate and recommend improvements to its policies for the mortgage-backed securities desk.
- The CFTC obtained a federal court order against an individual and his company to pay a civil money penalty of more than $1.9 million and restitution to defrauded customers of more than $1.6 million in connection with a fraudulent commodity pool scheme.
- FINRA sanctioned and fined two firms $650,000 and $625,000, respectively, for failing to supervise the use of consolidated reporting systems resulting in statements with inaccurate valuations being sent to customers, and for failing to retain the consolidated reports in accordance with securities laws. One of the firms was also ordered to pay $375,000 in restitution.

.

Recent Supervisory Actions against Financial Institutions

Last Updated: March 14, 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 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.

Contact Us

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

John Ivanoski, Partner, National Leader, Regulatory Risk — jivanoski@kpmg.com

Hugh Kelly, Principal, Bank Regulatory Safety & Soundness — hckelly@kpmg.com

Amy Matsuo, Principal, Enterprise & Consumer Compliance — amatsuo@kpmg.com

John Schneider, Partner, Investment Management Regulatory — jjschneider@kpmg.com

Tracy Whille, Principal, Capital Markets Regulatory — twhille@kpmg.com

Pamela Martin, Managing Director, Americas' FS Regulatory Center of Excellence — pamelamartin@kpmg.com

Earlier editions are available at:

http://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/washington-reports/Pages/default.aspx

Additional Contacts

Asset Management, Trust, and Fiduciary
Bill Canellis wcanellis@kpmg.com

Bank Regulatory Reporting
Brett Wright bawright@kpmg.com

Capital Markets Regulation
Stefan Cooper stefancooper@kpmg.com

Capital/Basel II and III
Paul Cardon pcardon@kpmg.com

Commodities and Futures Regulation
Dan McIsaac dmcisaac@kpmg.com

Consumer & Enterprise Compliance
Kari Greathouse cgreathouse@kpmg.com

Cross-Border Regulation & Foreign Banking Organizations
Philip Aquilino paquilino@kpmg.com

Safety & Soundness, Corporate Licensing & Governance, and ERM Regulation
Greg Matthews gmatthews1@kpmg.com

America's FS Regulatory Center of Excellence
Pamela Martin pamelamartin@kpmg.com

ALL INFORMATION PROVIDED HERE IS OF A GENERAL NATURE AND IS NOT INTENDED TO ADDRESS THE CIRCUMSTANCES OF ANY PARTICULAR INDIVIDUAL OR ENTITY. ALTHOUGH WE ENDEAVOR TO PROVIDE ACCURATE AND TIMELY INFORMATION, THERE CAN BE NO GUARANTEE THAT SUCH INFORMATION IS ACCURATE AS OF THE DATE IT IS RECEIVED OR THAT IT WILL CONTINUE TO BE ACCURATE IN THE FUTURE. NO ONE SHOULD ACT UPON SUCH INFORMATION WITHOUT APPROPRIATE PROFESSIONAL ADVICE AFTER A THOROUGH EXAMINATION OF THE FACTS OF THE PARTICULAR SITUATION.

©2014 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. KPMG LLP, the audit, tax and advisory firm (www.kpmg.com/us), is the U.S. member firm of KPMG International Cooperative ("KPMG International"). KPMG International's member firms have 145,000 professionals, including more than 8,000 partners, in 152 countries.
Printed in the U.S.A. All rights reserved. NDPPS 146154