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Bank & Thrift

Federal Reserve Announces Intent to Extend Conformation Period for CLOs under Volcker Rule

The Federal Reserve Board (Federal Reserve) announced on April 7, 2014 that it intends to exercise its authority under Section 619 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (commonly referred to as the Volcker rule) to give banking entities two additional one-year extensions to conform their ownership interests in, and sponsorship of, certain collateralized loan obligations (CLOs). The Federal Reserve indicates that it intends to act on these extensions in August of this year and the next year.

The Federal Reserve previously extended the conformance period for all activities and investments covered by Section 619 by one year to July 21, 2015. To ensure effective compliance, the Federal Reserve has now announced that it intends to grant banking entities two additional one-year extensions, which together would extend until July 21, 2017, the period available to banking entities to conform their ownership interests in and sponsorship of CLOs to the statute. Only CLOs in place as of December 31, 2013, that do not qualify for the exclusion in the final rule for loan securitizations would be eligible for the extension.

A banking entity would not have to include ownership interests in CLOs to determine its investment limits under the final rule, and a banking entity would not be required to deduct CLO investments from tier 1 capital under the final rule until the end of the relevant conformance period.

Agencies Approve Final Rule to Impose Enhance Supplementary Leverage Ratio and Proposed Rule to Modify Calculation of Total Leverage Exposure

The Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively, the Agencies) approved a final rule on April 8, 2014 that imposes an enhanced supplementary leverage ratio (SLR) requirement on any top-tier U.S. bank holding company (BHC) that has more than $700 billion in total consolidated assets or more than $10 trillion in assets under custody (covered BHCs) as well as any insured depository institution (IDI) of those covered BHCs. Under the rule, beginning January 1, 2018:

- Covered BHCs will be required to hold additional Tier 1 capital to exceed a 2 percent leverage buffer (the enhanced SLR) in addition to the minimum SLR of 3 percent (which is applicable to entities subject to the Advanced Approaches risk-based capital rules (AA Banks) under the U.S. rules implementing the Basel III capital framework (US Basel III rules)); and
- IDIs of the covered BHCs will be required to meet at least a 6 percent SLR (3 percent above the minimum Basel III SLR) in order to be considered "well capitalized" for Prompt Corrective Action purposes.

Covered BHCs that fail to exceed the 2 percent enhanced SLR will face restrictions, subject to a sliding scale, with regard to dividend distributions and discretionary bonus payouts. IDIs not achieving classification as "well capitalized" are similarly subject to regulatory limitations.

Also on April 8, the Agencies adopted a proposed rule that would revise the denominator used to calculate a banking organization's SLR under the U.S. Basel III rules. The revisions would modify the treatment of on- and off-balance sheet exposures to "more closely align the Agencies' rules on the calculation of total leverage exposure with international leverage ratio standards," which were modified by the Basel Committee on Banking Supervision in January 2014. Comments on the proposed rule are due to the Agencies no later than June 13, 2014. The proposed rule is applicable to all banks, savings associations, bank holding companies, and savings and loan holding companies that are AA Banks, including covered BHCs subject to the enhanced SLR rule.

Basel Committee Publishes Final Standard for Calculating Regulatory Capital for Bank's Exposures to Central Counterparties

On April 10, 2014, the Bank for International Settlements' Basel Committee on Banking Supervision (Basel Committee) published a final standard for calculating regulatory capital for banks' exposures to central counterparties (CCPs).

The final standard will replace the Basel Committee's interim capital requirements rules that were published in July 2012 when it takes effect on January 1, 2017. Although retaining many of the interim requirements, the final standard differs by:

- Including a single approach for calculating capital requirements for a bank's exposure that arises from its contributions to the mutualized default fund of a qualifying CCP (QCCP);
- Employing the standardized approach for counterparty credit risk (as opposed to the Current Exposure Method) to measure the hypothetical capital requirement of a CCP;
- Including an explicit cap on the capital charges applicable to a bank's exposures to a QCCP;
- Specifying the treatment of multi-level client structures whereby an institution clears its trades through intermediaries linked to a CCP; and
- Incorporating responses to frequently asked questions posed to the Basel Committee in the course of its work on the final standard.

Comptroller Speaks Before ABA on Risk Management; OCC Schedules Risk-Related Bank Director Workshops

Thomas Curry, Comptroller of the Currency, spoke before the ABA Risk Management Forum on April 10, 2014. He focused his remarks on corporate governance and risk management, and in particular, the Office of the Comptroller of the Currency's (OCC) recently proposed "heightened expectations" guidelines. Comptroller Curry stated directly that the heightened expectations program was intended for large, complex banks and that the guidelines would be applied to institutions with total assets below the $50 billion threshold only in "extraordinary circumstances."

However, Comptroller Curry stated that, in the wake of the financial crisis, "more is expected of U.S. financial institutions of all sizes in terms of their operational and financial probity." He also suggested that "the American people have 'heightened expectations' for the regulators to do their job in a way that keeps the banking system safe and sound and avoids anything like what the country endured in the last decade." To that end, he said, the OCC wants all banks, including community banks, to: maintain strong capital and take advantage of the analytical tools that can help them prepare for an uncertain future; focus on having risk management capabilities commensurate with their size and complexity; and "do all the things we associate with strong corporate governance, especially in regard to the responsibilities and capabilities of their boards of directors."

Consistent with the OCC's continued focus on risk, the agency announced that it had scheduled two workshops for directors of national community banks and federal savings associations on "Compliance Risk" and "Risk Assessment." The "Compliance Risk" workshop focuses on major compliance risks and consumer protection regulations, such as the Qualified Mortgage Rule and the *Bank Secrecy Act*, along with key elements of an effective compliance risk management program. The "Risk Assessment" workshop discusses the OCC's approach to risk-based supervision, and best practices to identify, measure, monitor, and control risk. Focus areas include enterprise risk management, operational risk, and cybersecurity. The workshops will be conducted in San Diego, California on May 6 and 7.

FDIC Re-issues Technology Outsourcing Documents; OCC Issues Handbook on Oil and Gas Production Lending

The Federal Deposit Insurance Corporation (FDIC) released Financial Institution Letter 13-2014 on April 7, 2014, to re-issue three Technology Outsourcing documents that it states would be useful informational resources to community banks when outsourcing technology products and services. The FDIC cautions, however, that the documents are not considered to be examination procedures or official guidance. The documents are entitled:

- *Effective Practices for Selecting a Service Provider*;
- *Tools to Manage Technology Providers' Performance Risk: Service Level Agreements*; and
- *Techniques for Managing Multiple Service Providers*.

On April 9, 2014, the Office of the Comptroller of the Currency (OCC) issued the "Oil and Gas Production Lending" booklet, which is new to the *Comptroller's Handbook*. This booklet provides guidance on oil and gas production lending, including an overview of oil and gas markets, lending structures, types of reserves, associated risks, and supervisory expectations for risk management. The OCC summarizes that the booklet:

- Provides guidance to bankers and examiners in identifying risks that are pertinent to oil and gas production lending;
- Establishes supervisory expectations pertaining to risk management of oil and gas production loans; and
- Includes expanded examination procedures, an internal control questionnaire, and verification procedures for examiners.

FDIC Guidance Outlines Call Report Changes for First Quarter 2014

The Federal Deposit Insurance Corporation (FDIC) released Financial Institution Letter 14-2014 on April 7, 2014 to alert institutions to certain revisions to their Consolidated Reports of Condition and Income (Call Report) that will take effect for the quarter ended March 31, 2014. In particular, beginning March 31, 2014, institutions will begin to report:

- Responses to yes-no questions about international remittance transfer activity, and institutions with more than 100 transactions per calendar year will report additional information including the estimated number and dollar value of international remittance transfers. This information will be collected initially as of March 31, 2014, and, in general, semiannually thereafter as of each June 30 and December 31;

- Trade names (other than an institution's legal title) used to identify physical offices and the addresses of public-facing Internet Web sites at which the institution accepts or solicits deposits from the public;
- A response to a yes-no question asking whether the reporting institution offers any deposit account products (other than time deposits) primarily intended for consumers; and
- For institutions with $1 billion or more in total assets that offer one or more deposit account products (other than time deposits) primarily intended for consumers, the total balances of these consumer deposit account products.

The announcement also notes that revisions to Call Report Schedule RC-R, Regulatory Capital, that are consistent with the revised regulatory capital rules approved by the banking agencies in July 2013 will begin to be implemented this quarter. These changes include:

- Existing items 1 through 33 of Schedule RC-R have been designated Part I.A, Regulatory Capital Components and Ratios. All institutions except advanced approaches institutions will complete Part I.A in their Call Reports for March 31 through December 31, 2014. No changes will be made to Part I.A in 2014.
- A new Part I.B, Regulatory Capital Components and Ratios, has been added to Schedule RC-R. Advanced approaches institutions will complete Part I.B in their Call Reports for March 31 through December 31, 2014.
- Effective March 31, 2015, Part I.A will be removed from Schedule RC-R, and Part I.B will be designated Part I, Regulatory Capital Components and Ratios. All institutions will then complete Part I of the schedule.
- Existing items 34 through 62 and Memorandum items 1 and 2 of Schedule RC-R have been designated Part II, Risk-Weighted Assets. No changes will be made in 2014 to Part II, which all institutions will complete in their Call Reports for March 31 through December 31, 2014. A revised version of Part II of Schedule RC-R is expected to take effect in March 2015. The revised Part II would incorporate the standardized approach for calculating risk-weighted assets under the revised regulatory capital rules and would be completed by all institutions.

The announcement highlights that the reporting of the amount and number of noninterest-bearing transaction accounts of more than $250,000 in Schedule RC-O, Memorandum item 5, has been eliminated effective this quarter.

Enterprise & Consumer Compliance

CFPB and OCC Enter into Enforcement Action Against a National Bank for Findings of Illegal Credit Card Practices with Add-On Products

On April 9 2014, the Office of the Comptroller of the Currency (OCC) assessed a $25 million civil money penalty against a national bank and its credit card subsidiary (collectively, the bank), and ordered restitution totaling approximately $459.5 million to 1.9 million consumer accounts. The Consumer Financial Protection Bureau (CFPB) similarly assessed the bank a $20 million civil money penalty and approximately $727 million in restitution and other relief. Restitution payments made by the bank to these consumers pursuant to the OCC's order satisfy identical obligations required by the CFPB action.

The agencies found that the bank's billing practices violated Section 5 of the *Federal Trade Commission Act* and the CFPB's unfair, deceptive, or abusive acts or practices provisions. Consumers eligible for restitution include those who were unfairly billed for identity theft protection products marketed and sold by the bank and its vendors. The restitution ordered by the OCC will benefit consumers who enrolled in and paid for identity theft protection products but did not receive the full benefit of the products. The restitution will include the full amount paid for these products, plus any associated over-limit fees and finance charges.

The OCC order also requires the bank to improve governance of third-party vendors associated with "add-on" consumer products and submit a risk management program for "add-on" consumer products marketed or sold by the bank or its vendors.

Capital Markets & Investment Management

FINRA Launches Retrospective Rule Review

The Financial Industry Regulatory Authority (FINRA) issued two new Regulatory Notices on April 8, 2014, as part of an initiative to conduct retrospective rule reviews on an ongoing basis. *Regulatory Notice 14-14* requests comment on the effectiveness and efficiency of FINRA's communications with the public rules, while *Regulatory Notice 14-15* requests comment on gifts, gratuities, and non-cash compensation rules. FINRA states that its retrospective rule reviews are designed to ensure that FINRA's rules remain relevant and appropriately designed to achieve their objectives of protecting the interests of the investing public.

FINRA requests that comments be submitted by May 8, 2014.

CFTC Issues an Extension of Time-Limited No-Action Relief to FCMs

On April 7, 2014, the Commodity Futures Trading Commission's (CFTC) Division of Swap Dealer and Intermediary Oversight (DSIO) issued an extension of time-limited, no-action relief to Futures Commission Merchant (FCMs). The extension of no-action relief will expire on June 30, 2014.

On November 14, 2013, the CFTC adopted amendments to Commission Regulations 1.20, 22.2, and 30.7 (Customer Protection Final Rule). In the Customer Protection Final Rule, the CFTC listed certain conditions under which an FCM can accept a single payment from a customer for deposit to the customer's section 4d(a)(2) segregation account and Part 30 secured account and cleared swaps account.

In extending the initial relief in CFTC Letter No. 14-02, DSIO states that it will not recommend that the CFTC take enforcement action against an FCM that does not comply with certain conditions set forth in the Customer Protection Final Rule in respect of such single payments. The no-action position is conditioned upon the FCM maintaining compliance with its obligation to hold sufficient funds in section 4d(a)(2) segregation accounts, Part 30 secured accounts, and cleared swaps accounts to meet the net liquidating equities of all of the FCM's customers in each respective account origin at all times.

CFTC Seeks Public Comment on ICE Clear Europe Request

On April 7, 2014, the Commodity Futures Trading Commission (CFTC) announced a request for public comment on a petition submitted by ICE Clear Europe Limited (ICE Clear Europe) for an order pursuant to Section 4d(a) of the *Commodity Exchange Act* (Act). The petition requests that the CFTC amend an earlier order dated October 15, 2012, which permitted ICE Clear Europe and its clearing members that are registered futures commission merchants to (1) commingle in an account subject to Section 4d(a) (a futures customer account) positions in futures and options, and foreign futures and foreign options, and related customer money, securities, and property; and (2) portfolio margin these futures and options, and foreign futures and foreign options, in the futures customer account. The October 15, 2012 order related to certain energy contracts, and ICE Clear Europe now requests that the CFTC amend that order to apply to additional products including certain interest rate, energy, and financial contracts.

Comments regarding the request should be submitted on or before April 21, 2014.

CFTC Provides Conditional No-Action Relief for MTFs

On April 9, 2014, the Commodity Futures Trading Commission's (CFTC) Divisions of Market Oversight (DMO) and Swap Dealer and Intermediary Oversight (DSIO) announced the joint issuance of CFTC No-Action Letter No. 14-46 (No-Action Letter 14-46), which replaces CFTC No-Action Letter No. 14-16 (No-Action Letter 14-16) issued on February 12, 2014.

No-Action Letter 14-16 provided no-action relief for (1) qualifying multilateral trading facilities (MTFs) from the swap execution facility (SEF) registration requirement; (2) parties executing swap transactions on qualifying MTFs from the trade execution mandate; and (3) swap dealers and major swap participants executing swap transactions on qualifying MTFs from certain business conduct requirements. Subsequent to the issuance of No-Action Letter 14-16, the CFTC continued to engage in dialogue with the staffs of the European Commission and the Financial Conduct Authority of the United Kingdom, as well as with facility operators and market participants, concerning certain terms and conditions in No-Action Letter 14-16.

As a result of these conversations, and seeking to build upon the significant progress achieved to date towards harmonizing a regulatory framework for CFTC-regulated SEFs and EU-regulated MTFs, the CFTC issued No-Action Letter 14-46, which generally tracks the conditional relief provided in No-Action Letter 14-16. However, No-Action Letter 14-46 features several notable clarifications, as well as new and amended conditions including the following items:

- An MTF must report all swap transactions to a CFTC-registered or provisionally-registered swap data repository as if it were a SEF, in compliance with parts 43 and 45 of the CFTC's regulations, as a condition subsequent to qualifying for relief;
- An MTF must certify that it is subject to and compliant with regulations that require all MTF participants to consent to the MTF's jurisdiction, thereby enabling the MTF to effectively enforce its rules;
- Qualifying MTFs must submit monthly reports to CFTC staff summarizing levels of participation and volume by U.S. persons; and
- Clarifications regarding the reporting obligations for counterparties to swap transactions executed on or pursuant to the rules of a qualifying MTF.

The CFTC states that the revisions included in No-Action Letter 14-46 are consistent with the commitments made by the CFTC in the CFTC-EC Path Forward statement and the spirit of international cooperation evidenced by that document.

The issuance of No-Action Letter 14-46 was preceded by the issuance of CFTC No-Action Letter No. 14-31, which provides additional time for MTFs to comply with the conditions for obtaining relief under No-Action Letter 14-46, and for DMO to consider certifications made by MTFs pursuant to No-Action Letter 14-46. The short-term no-action relief provided by CFTC No-Action Letter No. 14-31 will expire on May 14, 2014.

Enforcement Actions

The Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) recently announced the following enforcement actions:

- The SEC announced that it charged a national drugstore chain with misleading investors about significant financial setbacks and using improper accounting that artificially boosted its financial performance. The drugstore has agreed to pay $20 million to settle the charges.
- The SEC announced fraud charges and an asset freeze against the operators of a $40 million South Florida-based Ponzi scheme that targeted investors through YouTube videos. In a parallel action, the U.S. Attorney's Office for the Southern District of Florida announced criminal charges in a parallel action.
- The SEC announced enforcement actions against two leaders of a Las Vegas-based transfer agent firm who were responsible for disclosure failures in registration forms filed with the SEC. The transfer firm and the two individuals agreed to pay a total of $75,000 in penalties to settle the SEC's charges.
- The SEC announced fraud charges against a Hawaii-based individual posing as an investment banker and soliciting investors through Twitter, Facebook, and other social

media. An administrative hearing will be conducted to determine any remedial action or financial penalties.

- The SEC charged a California-based technology company with violating the *Foreign Corrupt Practices Act* (FCPA) when its subsidiaries in three different countries made improper payments to government officials to obtain or retain lucrative public contracts. The company has agreed to pay more than $108 million to settle the SEC's charges and a parallel criminal case announced by the U.S. Department of Justice.
- The CFTC released a rule enforcement review of a Chicago-based securities futures exchange. The CFTC found specific areas where the exchange will need to improve its trade practice program, including ensuring that its compliance surveillance department is adequately staffed to meet the exchange's self-regulatory responsibilities and significantly increasing the frequency and number of spot checks on the transactions that it conducts annually.
- The CFTC issued an Order filing and simultaneously settling charges that, between March 2009 and October 2012, a New York-based CFTC-registered Futures Commission Merchant (FCM) and former Retail Foreign Exchange Dealer (RFED) failed to comply with minimum financial requirements for FCMs and RFEDs. The CFTC Order requires the FCM to pay a $275,000 civil monetary penalty and to cease and desist from violating the Commodity Exchange Act and CFTC Regulations.
- The CFTC filed and settled charges against three companies and their owners for engaging in illegal, off-exchange precious metals transactions. The respondents are required to jointly pay more than $940,000 in restitution to their defrauded precious metals customers.

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Recent Supervisory Actions against Financial Institutions

Last Updated: April 11, 2014

Agency	Institution Type	Action	Date	Synopsis of Action
Federal Reserve Board	State member bank	Prompt Corrective Action Directive	04/10	The Federal Reserve Board issued a Prompt Corrective Action Directive against a Maryland-based state member bank to address its failure to maintain adequate capital reserves. The state member bank was found to be significantly undercapitalized.
CFPB	Mortgage lender	Notice of Charges	01/29	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	01/16	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	01/07	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.

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