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In This Issue

Bank & Thrift

Comptroller Curry Speaks About Risks from Cybersecurity and Third-Party Relationships

Thomas Curry, Comptroller of the Currency, highlighted the importance of cybersecurity and its relationship to third-party management during remarks before the CES Government meeting on April 16, 2014. Comptroller Curry noted that he was spending "more and more time" on IT issues in general and cybersecurity in particular.

Comptroller Curry suggested that as larger banks improve their defenses against cyberattacks it is "very likely" perpetrators of cybercrime will turn their attention to community banks. He said, "These smaller institutions can provide a point of entry into larger networks, and they may have less sophisticated defenses than large banks. Many depend upon third-party providers for their IT services, including security. That's understandable, but they still have to be able to assure themselves that these service providers have adequate controls and solid processes in place to protect them and their customers. This can be particularly problematic for community banks and thrifts that may not have the resources or specialized expertise needed to identify and mitigate these vulnerabilities." Comptroller Curry noted that the OCC is particularly focused on controls and risk management practices employed by vendors that provide services to banks and thrifts.

With regard to third-party providers, Comptroller Curry identified the following trends that the OCC sees as key areas of risk:

- Service providers are consolidating and leaving financial institutions more dependent on a single vendor.
- Financial institutions are increasingly relying on outside vendors, including foreign-based vendors, for critical activities.
- Third-party vendors have access to vast amounts of sensitive bank and customer data.

He also said the OCC expects board and management to ensure that appropriate risk management practices are in place, such as established, clear accountability for day-to-day management of third-party relationships and periodic independent reviews of these relationships. The agency also expects banks to consider the vendor's risk management practices and controls, such as the soundness of its security program, the adequacy of its physical security controls, the quality of its business continuity plan, and its process for reporting security incidents.

Comptroller Curry stated that banks have been asking the OCC to do more in the area of supervising critical service providers. And he said, "While we won't go into every provider, we will examine service providers that support a large number of banks and that could, therefore, pose a systemic risk to the financial sector. However, even if we do supervise a service provider, that does not alleviate a bank of its responsibility to understand and manage risks involved in their third-party relationships. Our supervision does not take the place of due diligence or ongoing monitoring commensurate with the level of risk and complexity of the arrangement."

Basel Committee Issues Frequently Asked Questions Related to Basel III Liquidity Coverage Ratio

The Bank for International Settlements' Basel Committee on Banking Supervision (Basel Committee) issued a set of Frequently Asked Questions (FAQs) on April 16, 2014 related to the Basel III Liquidity Coverage Ratio framework finalized in January 2013. The FAQs address multiple questions spread over 19 separate topics. Under the Basel Committee's Basel III capital framework, the liquidity coverage ratio will be introduced beginning January 1, 2015. The Federal Reserve Board, Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation released a joint proposed rule in the fall of 2013 covering implementation of the liquidity coverage ratio in the US. That proposed rule would also require introduction of the ratio beginning January 1, 2015 for certain large financial institutions.

Basel Committee Publishes Final Supervisory Framework for Measuring and Controlling Large Exposures

On April 15, 2014, the Bank for International Settlements' Basel Committee on Banking Supervision (Basel Committee) published a final standard that sets out a supervisory framework for measuring and controlling large exposures. The new standard will take effect beginning January 1, 2019.

The large exposure standard includes a general limit applied to all of a bank's exposures to a single counterparty, which is set at 25 percent of a bank's Tier 1 capital. This limit also applies to a bank's exposure to identified groups of connected counterparties (i.e., counterparties that are interdependent and likely to fail simultaneously). A tighter limit of 15 percent of Tier 1 capital will apply to exposures between banks that have been designated as global systemically important banks (G-SIBs).

Based on comments received on the Basel Committee's March 2013 proposal, the final standard reflects the following revisions:

- The definition and the reporting thresholds are now 10 percent of the eligible capital base (instead of the 5 percent proposed);
- The treatment of a limited range of credit default swaps (CDS) used as hedges in the trading book has been modified so that it is more closely aligned with the risk-based capital framework;
- The proposed granularity threshold for exposures to securitization vehicles has been replaced with a materiality threshold related to the capital base of the bank (calibrated at 0.25 percent of the capital base); and
- A treatment that recognizes particular features of some covered bonds.

The Basel Committee adds that it will review, by 2016, the appropriateness of setting a large exposure limit for exposures to qualifying central counterparties (QCCPs) related to clearing activities, which are currently exempted. It will also review the impact of the large exposures framework on monetary policy implementation.

FDIC to Conduct Seminars on Deposit Insurance Coverage

The Federal Deposit Insurance Corporation (FDIC) announced on April 18, 2014 that it will be conducting seminars for bank officers and employees between May and December 2014 on the topic of deposit insurance coverage. In particular, the FDIC will hold four sessions each on "Fundamentals of Deposit Insurance Coverage;" "Deposit Insurance Coverage for Revocable

Trust Accounts;" and "Advanced Topics in Deposit Insurance Coverage." The seminars are free of charge but advanced registration is required. Additional information is available on the FDIC Web site.

Agencies Update Large Institution CRA Examination Procedures

The Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation approved, on an interagency basis, *Large Institution Community Reinvestment Act Examination Procedures*. The new examination procedures reflect revisions to the *Interagency Questions and Answers Regarding Community Reinvestment* issued in November 2013, including additional guidance for 1) evaluating community development activities in the broader statewide or regional area that includes an institution's assessment area, and 2) considering investments in nationwide funds. The examination procedures are posted on the Federal Financial Institutions Examination Council's (FFIEC) Web site.

Federal Reserve Guidance Addresses Loan Sampling Expectations for Bank and Nonbank Subsidiaries of Entities with $10-$50 Billion in Total Consolidated Assets

The Federal Reserve Board's (Federal Reserve) Division of Supervision and Regulation released guidance (SR 14-4) on April 18, 2014 to outline the agency's loan sampling expectations for its examination of state member bank (SMB) and credit-extending nonbank subsidiaries of banking organizations with $10-$50 billion in total consolidated assets. The guidance states that examiners will have the flexibility, depending upon the structure and size of subsidiary SMBs, to utilize the guidance applicable to smaller SMBs when the SMB subsidiary's total assets are below $10 billion. SR 14-4 supersedes the examiner loan sampling expectations described in SR 94-13, "Loan Review Requirements for On-site Examinations," and clarifies expectations for the assessment of material retail credit portfolios for these institutions. This guidance should be implemented upon issuance for SMBs and credit extending nonbank subsidiaries of banking organizations with $10-50 billion in total consolidated assets.

Enterprise & Consumer Compliance

CFPB Proposes Five-Year Extension of International Money Transfer Rule Disclosure Exception

The Consumer Financial Protection Bureau (CFPB) proposed revisions to its international money transfer rule on April 15, 2014. As proposed, the revisions are intended to preserve the rule's new consumer protections while providing federally insured institutions, such as banks and credit unions, with additional time to provide exact disclosures in certain cases.

Under the international money transfer rule (which took effect in October 2013), remittance transfer providers are required to disclose certain third-party fees, as well as any exchange rate that will apply to the transfer. The *Dodd-Frank Wall Street Reform and Consumer Protection Act* contains an exception that explicitly allows federally insured financial institutions to estimate, until July 21, 2015, third-party fees and exchange rates when providing remittance transfers to their accountholders for which they cannot determine exact amounts for reasons beyond their control. The proposed rule would extend that exception for five years, until July 21, 2020. Comments will be accepted for 30 days following publication in the *Federal Register*.

Capital Markets & Investment Management

SEC Proposes Rules for Security-Based Swap Dealers and Major Security-Based Swap Market Participants

On April 17, 2014, the Securities and Exchange Commission (SEC) proposed new rules for security-based swap dealers (SBSDs) and major security-based swap participants (MSBSPs). The proposed rules would cover:

- Recordkeeping, reporting, and notification requirements applicable to SBSDs and MSBSPs;
- Securities count requirements applicable to certain SBSDs;
- Additional recordkeeping requirements applicable to broker-dealers to account for their security-based swap and swap activities;
- An additional capital charge provision that would be added to the proposed capital rule for certain SBSDs; and
- Technical amendments to the broker-dealer recordkeeping, reporting, and notification requirements.

The rulemaking is required by the *Dodd-Frank Wall Street Reform and Consumer Protection Act*, which authorizes the SEC and other regulators to put in place a comprehensive framework to regulate the over-the-counter swaps and security-based swaps markets.

The SEC will seek public comment on the proposed rules for 60 days following their publication in the *Federal Register*.

CFTC Issues Notice of Temporary Registration as a Swap Execution Facility to GTX SEF, LLC

On April 17, 2014, the Commodity Futures Trading Commission (CFTC) approved the application of GTX SEF, LLC (GTX) for temporary registration as a swap execution facility (SEF). GTX is the 20th SEF temporarily registered by the CFTC to date.

All future temporarily and fully registered SEFs are required to demonstrate continued compliance with all applicable provisions of the Commodity Exchange Act and CFTC regulations, including regulations in Part 37 relating to Core Principles and Other Requirements for Swap Execution Facilities, as well as any future regulations, amendments, guidance, and interpretations issued by the CFTC. As a next step, the CFTC will undertake a substantive review of GTX's application for full registration.

Enforcement Actions

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

- The SEC announced a second round of charges in its ongoing case against two executives at a New York City-based brokerage firm that the SEC alleges were involved in a massive kickback scheme to secure the bond trading business of a state-owned foreign bank. The SEC seeks disgorgement of ill-gotten gains plus interest and financial penalties against the two executives, as well as five previously named defendants. In a parallel action, the U.S. Attorney's Office for the Southern District of New York and the U.S. Department of Justice's Criminal Division announced criminal charges against the two executives.
- The SEC announced charges against a San Diego-based investment advisory firm, its chief executive officer, chief compliance officer, and another employee for misleading investors and breaching their fiduciary duties to clients. The SEC's order seeks return of allegedly ill-gotten gains plus interest, financial penalties, an accounting, and remedial relief.
- The SEC charged a former employee of a London-headquartered multinational oil and gas company with insider trading in the company's securities, based on confidential information obtained by the employee about the magnitude of a 2010 oil spill. Without admitting or denying the allegations, the employee consented to the entry of a final judgment permanently enjoining him from future violations of federal antifraud laws and SEC antifraud rules and agreed to return $105,409 of allegedly ill-gotten gains, plus $13,300 of prejudgment interest, and to pay a civil penalty of $105,409.
- The SEC announced charges against the Massachusetts-based operators of a large pyramid scheme that mainly targeted Dominican and Brazilian immigrants in the U.S. The SEC alleges that the defendants claimed to be running a multilevel marketing company that sells telephone service based on "voice over Internet" technology that was actually an elaborate pyramid scheme operation.
- The CFTC issued an Order filing and simultaneously settling charges against a Florida-based resident and his two companies for engaging in illegal, off-exchange precious metals transactions. The CFTC Order requires the defendant and one of his companies to jointly pay restitution totaling $243,456.61 and the defendant and his other company to jointly pay restitution totaling $14,854.41 to their customers. The Order also imposes permanent registration and trading bans on the individual and his two companies.
- The CFTC filed an enforcement action against a New York-based resident and his two companies, charging them with solicitation fraud, making false statements, and registration violations in connection with a commodity pool that he formed. The CFTC seeks civil monetary penalties, trading and registration bans, and a permanent injunction against further violations of the federal commodities laws.

Recent Supervisory Actions against Financial Institutions

Last Updated: April 18, 2014

Agency	Institution Type	Action	Date	Synopsis of Action
Federal Reserve Board	State member bank	Civil Money Penalty	04/15	The Federal Reserve Board issued an Order of Assessment of Civil Money Penalty against a Wyoming-based state member bank to address violations of the National Flood Insurance Act.
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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