KPMG cutting through complexity

The Washington Report

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In This Issue

Safety & Soundness

Federal Reserve and FDIC Provide Feedback on Second Round Resolution Plans of First-Wave Filers

On August 5, 2014, the Federal Reserve Board (Federal Reserve) and the Federal Deposit Insurance Corporation (FDIC), collectively "the agencies," jointly announced the completion of reviews for the second round of resolution plans submitted by 11 large, complex banking organizations in 2013 (the First-Wave Filers). Based on their reviews, the agencies identified what they termed to be "shortcomings" in the individual 2013 resolution plans, adding they will need to be addressed in the firms' 2015 submissions.

Each of the firms received a letter from the agencies that addressed the "shortcomings" specific to their resolution plan. The agencies stated that while the shortcomings varied across the firms, there were common features, including:

- Assumptions that the agencies regard as unrealistic or inadequately supported, such as assumptions about the likely behavior of customers, counterparties, investors, central clearing facilities, and regulators; and
- The failure to make, or even to identify, the kinds of changes in firm structure and practices that would be necessary to enhance the prospects for orderly resolution.

The 2015 submissions, due on or before July 1, 2015, must demonstrate that the firms are making significant progress to address all the shortcomings identified in the letters, and that they are taking actions to improve their resolvability under the U.S. Bankruptcy Code. These actions include:

- Establishing a rational and less complex legal structure that would take into account the best alignment of legal entities and business lines to improve the firm's resolvability;
- Developing a holding company structure that supports resolvability;
- Amending, on an industry-wide and firm-specific basis, financial contracts to provide for a stay of certain early termination rights of external counterparties triggered by insolvency proceedings;
- Ensuring the continuity of shared services that support critical operations and core business lines throughout the resolution process; and
- Demonstrating operational capabilities for resolution preparedness, such as the ability to produce reliable information in a timely manner.

The agencies expect an appropriate balance between transparency and confidentiality of proprietary and supervisory information in the resolution plans, and they will work with these 11 firms to explore ways to enhance public transparency of future plan submissions.

Federal Reserve Releases Results of July 2014 Senior Loan Officer Opinion Survey on Bank Lending Practices

On August 4, 2014, the Federal Reserve Board (Federal Reserve) released the results of its July 2014 *Senior Loan Officer Opinion Survey on Bank Lending Practices*, which found a continued easing of lending standards and terms for many types of loan categories as well as a broad-based pickup in loan demand over the past three months. The survey results are based on responses from 75 domestic banks and 23 U.S. branches and agencies of foreign banks.

Key findings from the July 2014 survey include:

- The majority of banks reported that the *Ability-to-Repay* and *Qualified Mortgage Standards* under the *Truth in Lending Act* (the ATR/QM rule) that went into effect in January 2014 had no effect on the approval rate of prime conforming mortgages, in part because those loans qualify for a safe harbor under the exemption provided for loans that meet the underwriting criteria of the government-sponsored housing enterprises (GSEs). In contrast, about half of the respondents indicated that the ATR/QM rule has reduced approval rates on applications for prime jumbo home-purchase loans and nontraditional mortgages.
- Lending conditions eased, on net, for many loan categories. Domestic and foreign banks generally reported that standards for most categories of C&I loans (i.e., commercial and industrial) were either easier than or near the midpoints of their ranges over the past decade.
- "Moderate to large" fractions of banks continued to report that the levels of standards for all types of residential real estate and credit card loans were at least somewhat tighter than the midpoints of their bank's longer-term ranges.
- A "modest net fraction" of domestic respondents indicated that they were more willing to make consumer installment loans relative to three months ago. Most banks, however, reported that standards and the surveyed terms on various types of consumer loans were little changed. "Moderate fractions" of banks reported having experienced stronger demand for each of the three types of consumer loans in the survey: credit card loans, auto loans, and other consumer loans.

Basel Committee Extends Comment Period for Proposed Revisions to Pillar 3 Disclosure Framework

On August 5, 2014, the Bank for International Settlements' Basel Committee on Banking Supervision (Basel Committee) announced it would extend by two weeks the comment period on proposed revisions to the Pillar 3 disclosure framework that were published previously on June 24, 2014. Comments are now due by October 10, 2014.

The proposed revisions are intended to enhance comparability across banks by ensuring greater consistency in the way they disclose information about risk exposures. The review was prompted by concerns that the Basel framework's existing Pillar 3 disclosure regime failed to promote the early identification of a bank's material risks and did not provide sufficient information to enable market participants to assess a bank's overall capital adequacy.

The Basel Committee is seeking feedback from investors, analysts, rating agencies, and other users of Pillar 3 data, as well as from the audit community. It has stated that a goal of the proposed revisions is to improve the transparency of the internal model-based approaches that banks use to calculate minimum regulatory capital requirements.

The present consultative document, which focuses on overhauling the existing disclosure requirements related to risk-weighted assets, is the first phase of a two phase review of disclosure requirements. Once finalized, it will replace the existing Pillar 3 framework. The second phase will expand the scope of the review to include standards that are currently under development or being revised, together with additional disclosure requirements to further improve the comparability of banks' risk profiles.

Enterprise & Consumer Compliance

OCC Guidance Focuses on Consumer Debt Sale Arrangements with Third Parties

On August 4, 2014, the Office of the Comptroller of the Currency (OCC) issued Bulletin 2014-37 to provide guidance to national banks and federal savings associations (together, Banks) about the OCC's expectations regarding the structuring of consumer debt-sale arrangements with third parties. The guidance is intended to ensure that debt sales to third parties are consistent with safe and sound banking practices and promote fair treatment of customers. The OCC expects Banks to:

- Ensure that appropriate internal policies and procedures have been developed and implemented to govern debt-sale arrangements consistently across the Bank;
- Perform appropriate due diligence when selecting debt buyers;
- Ensure that debt-sale arrangements with debt buyers cover all important considerations, such as provisions for confidentiality and information security, responsibility for compliance with applicable consumer protection laws, minimum-service-level agreements, ability to resell debt, and reasons for litigation;
- Provide accurate and comprehensive information regarding each debt sold, at the time of sale;
- Ensure Bank compliance with applicable consumer protection laws and regulations; and
- Implement appropriate oversight of debt-sale arrangements.

FDIC Launches Financial Education Pilot Program for Youth Savings

On August 4, 2014, the Federal Deposit Insurance Corporation (FDIC) announced the launch of a financial education program, the *Youth Savings Pilot Program*, for institutions that work with or intend to work with schools and/or non-profit organizations. The program is intended to identify promising approaches to offering financial education tied to the opening of safe, low-cost savings accounts for school-aged children. Pilot participants will share best practices and provide technical assistance in addressing challenges related to the operation of the programs.

The first phase of the pilot is open to institutions currently working with schools or nonprofit organizations that help students open savings accounts in conjunction with financial education programs. Applications will be accepted through August 22, 2014. The second phase is expected to target new programs that begin during the 2015–16 school year. The FDIC will begin soliciting interested participants for this phase in April 2015.

FTC Announces Separate Actions Against Two Debt Collectors for Unfair and Deceptive Practices

On August 7, 2014, the Federal Trade Commission (FTC) announced that it had reached an agreement with a Tennessee-based debt collector for engaging in unfair and deceptive practices in violation of the *Federal Trade Commission Act* (FTC Act) and the *Fair Debt Collection Practices Act* (FDCPA). In addition to paying a $1.5 million civil money penalty, the FTC order requires the company to take certain measures when a consumer disputes the validity of a debt—it must either close the account and end its collection efforts, or suspend collection, until it has conducted "a reasonable investigation" and verified that the information about the debt is accurate and complete.

On the same day, the FTC announced that it had reached an agreement with a New York-based debt collector for violations of the FTC Act and the FDCPA related to unfair and deceptive practices. The order requires the company to pay $1.2 million in civil money penalties though all but $490,000 is suspended due to the inability of the company to pay. In addition, the company is required to, among other things, provide consumers with a disclosure that explains consumers' rights regarding the collection of time-barred debt, and another explaining how to file a complaint with the FTC if they feel they are being treated unfairly.

FTC Settlement Results in Refunds for Consumers Harmed by Fraudulent Tax Relief Company and Mortgage Relief Scams

On August 5, 2014, the Federal Trade Commission (FTC) announced that it is mailing refund checks totaling more than $16 million to 18,571 consumers nationwide who paid more than $100 million to a California-based company that falsely claimed it could reduce their tax debts. Affected consumers will receive, on average, 16 percent of the amount they lost.

The refunds are the result of a 2013 settlement agreement that the defendants reached with the FTC. Under the settlement order, the company and its leader were banned from telemarketing and selling debt relief services and required to surrender more than $15 million in cash and assets to settle charges that they violated federal law. It is the FTC's first action against a tax relief company.

On August 8, 2014, the FTC separately announced the issuance of refund checks totaling more than $800,000 to 1,305 consumers harmed by one of two unrelated mortgage relief scams.

Federal Reserve Releases Report on Economic Well-Being of U.S. Households

On August 7, 2014, the Federal Reserve Board (Federal Reserve) released a report conducted by its Division of Consumer and Community Affairs entitled, *"Report on the Economic Well-Being of U.S. Households."* Based on responses to the 2013 online *Survey of Household Economics and Decision Making*, the report provides insight into topics of current relevance to household finances, including housing and living arrangements, credit access and behavior, education and student loan debt, savings, retirement, and health expenses. All responses were as of September 2013.

The survey generally found that many households were "faring well" but portions of the population were simultaneously displaying signs of distress. For example:

- Approximately 25 percent of households said that they were "just getting by" financially and another 13 percent said they were struggling to do so.
- Homeowners generally appeared positive about the outlook for the housing market, with many homeowners expecting house prices in their neighborhoods to increase over the 12 months following the survey. Less than 10 percent of homeowners expected house prices in their neighborhoods to decline over the 12 months following the survey.
- Thirty-one percent of survey respondents had applied for some type of credit in the prior 12 months, and one-third of those who applied for credit were turned down or given less credit than they applied for. Another 19 percent said they had put off applying for credit because they thought they would be turned down.
- Education debt of some kind was held by 24 percent of the population. The average total of all education debt was $27,840, with a median of $15,000. Some households report struggling to service this debt, with 18 percent indicating that they were behind on payments in some way for their education debt.
- Of those respondents that had savings in 2008, 57 percent reported using some or all of that savings in the economic recession that followed the financial crisis.
- Thirty-one percent of non-retired respondents reported having no retirement savings or pension, including 19 percent of those ages 55 to 64.

CFPB Focuses on the Disclosure of Agreements Between Universities and Financial Institutions to Sell Financial Products to Students

On August 6, 2014, the Consumer Financial Protection Bureau (CFPB or Bureau) published a blog post advising college students to understand the agreement their university has with a financial institution to market financial products and services directly to the university's students. Financial institutions are required to disclose these agreements when marketing credit cards and private student loans to students, but other financial products and services, such as deposit accounts, prepaid cards, and debit cards, are not subject to the disclosure requirement. In December 2013, the CFPB asked financial institutions to voluntarily post such agreements on their Web sites, stating that "making these agreements available for all financial products shows schools' and companies' commitment to transparency."

According to the CFPB blog, the Bureau has now reviewed the Web sites of the financial institutions "partnered" with the 14 schools that make up the Big Ten Conference. The Bureau found that at least 11 of those schools have established banking partners to market financial products to their students, though only four of the agreements were readily available on the Web sites of the financial institution partners, and three of those four agreements did not contain "important information," such as how much the institution pays the school to gain access to students for marketing purposes.

The CFPB cites a report from the General Accountability Office (GAO) that states "increased transparency for college card agreements could help ensure that the terms are fair and reasonable for students and the agreements are free from conflicts of interest." The CFPB adds that it will be sending alerts to universities "to make sure they know that their bank partner has not yet committed to transparency for student financial products."

Capital Markets & Investment Management

SEC Commissioner Piwowar Outlines Steps for Improvements to Municipal Bond Market

On August 1, 2014, SEC Commissioner Michael S. Piwowar discussed his views on steps to improve the municipal bond market in a speech before the 2014 Municipal Finance Conference. He indicated these steps were developed by staff at the Securities and Exchange Commission (SEC) and "most" have recently received the support of the SEC Chair, Mary Jo White. He also said that he thought there was enough momentum behind them "to be enacted in the near-term for the benefit of retail investors and the market as a whole." The steps, or "reforms," included improvements in the areas of:

- Riskless Principal Transactions. Commissioner Piwowar said dealers should be required to disclose markups and markdowns on all riskless principal bond transactions on customer confirmations. "Retail customers should have the information necessary to fully understand the costs associated with their transactions and to make informed decisions about how they trade municipal securities." He said the issue of riskless principal markups is common to both the municipal and corporate securities markets, and encouraged the Municipal Securities Rulemaking Board (MSRB) and the Financial Industry Regulatory Authority (FINRA) to work together to publish proposed rules for public comment.
- Best Execution. "The inherent complexity of the municipal securities market—combined with its highly retail customer base" creates the need for the high standard of best execution. Municipal securities dealers must be subject to a standard of best execution so that retail customers will have confidence that they are receiving the best execution available for each transaction into which they enter, said Commissioner Piwowar. He said the MSRB is in the process of developing a final rule for submission to the SEC regarding best execution standards. He also said that the MSRB and FINRA intend to publish practical guidance on how to apply a best execution standard in the context of illiquid securities such as certain municipal and corporate bonds.
- Pre-Trade Transparency. The lack of price transparency in the municipal securities market is particularly acute for retail investors, said Commissioner Piwowar. "While the MSRB's Electronic Municipal Market Access (EMMA) system provides a wealth of historical pricing information in the municipal securities market in an easy-to-access format, there is still a significant need for publicly available information regarding pre-trade pricing for these financial products." He supports efforts to incrementally increase pre-trade price transparency in the municipal securities market by amending Regulation ATS to mandate the public dissemination of pricing information for certain transactions on significant alternative trading systems.

IOSCO Launches Public Information Repository for Central Clearing Requirements

On August 5, 2014, the International Organization of Securities Commissions (IOSCO) launched a public information repository for central clearing requirements for over-the-counter (OTC) derivatives that is intended to provide regulators and market participants with consolidated information on the clearing requirements of different jurisdictions. The repository was established in February 2014, but until now had only been available to IOSCO members. IOSCO wanted to gain sufficient experience, and gather enough information on central clearing requirements before opening the repository to the public.

By providing this information, IOSCO seeks to assist authorities in their rule making and help participants comply with the relevant regulations in the OTC derivatives market. The repository sets out central clearing requirements on a product-by-product level, along with relevant exemptions. The information will be updated quarterly and is for reference only. IOSCO recommends that interested parties refer to the original version of the relevant laws and regulations.

FINRA Amends FINRA Rule 9120 and the Definition of "Hearing Officer"

On August 6, 2014, the Financial Industry Regulatory Authority (FINRA) announced that it had amended FINRA Rule 9120 to modify the definition of "Hearing Officer" to include any former FINRA employee who previously acted as a hearing officer and who is a licensed attorney. The implementation date of the amended definition is August 12, 2014. Based on the amended definition, the Chief Hearing Officer may appoint a former employee of FINRA who previously acted as a hearing officer to act in an adjudicative role and fulfill the various adjudicative responsibilities and duties of a hearing officer described in the Code of Procedure. The Rule previously limited this role to a current FINRA employee. The new rule text is available in the online FINRA Manual.

Enforcement Actions

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

- The SEC obtained a final judgment in federal court requiring a Virginia-based financial services holding company, a subsidiary brokerage firm, and their chief executive officer to pay nearly $70 million as the outcome of a trial that found them liable for fraud. The SEC's complaint alleged that the three engaged in a Ponzi scheme devised by the founder and president and operated through the sale of millions of dollars of the firm's promissory notes and stock through misleading and false representations and disclosures that masked the underlying financial hardship of the firm and its inability to pay promised returns without using new investor money.
- The SEC charged a Texas-based company and its chief executive officer with making fraudulent claims about the company's assets. The SEC also charged a stock promoter and his firm for disseminating the fraudulent claims. The SEC is seeking a cease and desist order while its charges are investigated.
- The SEC charged a New York-based brokerage firm and its founder for allegedly violating net capital requirements and falsifying books and records to conceal the capital deficiencies. The U.S. Attorney's office has also filed charges against the founder for obstructing the SEC's examination.

- The CFTC obtained a $500,000 civil monetary penalty pursuant to a federal court Consent Order against a former director in the commodities business of a large financial services entity who was charged with fraud. The CFTC alleged that the former director mismarked and inflated the value of his position in the entity's proprietary account, resulting in a $42.4 million loss for the institution. The former director is permanently banned from registering with the CFTC and banned for seven years from trading any CFTC-regulated products for or on behalf of others.
- The CFTC obtained a $13 million civil monetary penalty pursuant to a federal court Consent Order against companies based in California, the United Kingdom, and Switzerland, and two traders based in Australia and the United Kingdom. The CFTC charged the defendants with manipulation and attempted manipulation of the New York Mercantile Exchange (NYMEX). In addition to the penalty payments, the Consent Order also limits the physical market trading of the California-based company for three years, and requires all of the companies to maintain records and audio recordings for three years, and to engage an independent consultant to evaluate compliance, internal control, and risk management policies, procedures, and practices.
- The SEC charged four individuals with fraud for manipulating the securities of several microcap companies in a pump and dump scheme and reaping more than $2.5 million in illegal profits. The SEC seeks temporary, preliminary, and permanent injunctions, an emergency asset freeze, disgorgement, prejudgment interest, financial penalties, and penny stock bars.
- The SEC charged a former chief executive officer (CEO) of a New York-based broker-dealer subsidiary with fraud for deceiving brokerage customers with hidden fees to buy and sell securities. The SEC is seeking disgorgement, a financial penalty, and a permanent injunction. In a parallel action, the U.S. Department of Justice announced criminal charges against the CEO.
- The CFTC obtained a Consent Order for permanent injunction against a Florida resident and his company for engaging in illegal, off-exchange precious metals transactions. The Order requires the defendants to pay restitution of $526,960; imposes permanent trading, solicitation and registration bans against them; and prohibits them from engaging in illegal, off-exchange retail commodity transactions.
- The CFTC obtained a Supplemental Consent Order requiring three individuals and their Florida-based company to pay more than $25 million in restitution and a $10 million civil monetary penalty in connection with operating a fraudulent precious metals scheme. They had previously been found liable for illegal, off-exchange precious metals transactions and fraud, and received a permanent injunction. The Consent Order also imposes permanent trading and registration bans.
- The CFTC charged an individual and his North Carolina-based company with misappropriation, solicitation fraud, and issuing false statements in connection with the operation of an unregistered commodity trading pool. The CFTC alleges that the company lost $65,374 in trading commodity futures, returned $186,561 to pool participants as purported profits in the manner of a Ponzi scheme, and misappropriated $331,556. The CFTC seeks a civil monetary penalty, restitution, disgorgement, trading and registration bans, and preliminary and permanent injunctions.

Recent Supervisory Actions against Financial Institutions

Last Updated: August 8, 2014

Agency	Institution Type	Action	Date	Synopsis of Action
Federal Reserve Board	State Member Bank	Civil Money Penalty	08/05	The Federal Reserve Board issued an Order to Assess Civil Money Penalties against an Iowa-state member bank to address violations of the National Flood Insurance Act.
CFPB, State Attorneys General	Nonbank Consumer Lender	Consent Order	07/29	The Consumer Financial Protection Bureau and 13 state attorneys general issued a Consent Order against a nonbank consumer lender to address violations of the unfair, deceptive, or abusive acts or practices provisions of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* and the *Truth in Lending Act*. The Consent Order requires the company to provide approximately $92 million in debt relief to harmed consumers, which included approximately 17,000 U.S. servicemembers and other consumers.
Federal Reserve Board	State Member Bank	Civil Money Penalty		The Federal Reserve Board issued an Order to Assess Civil Money Penalties against an Iowa-state member bank to address violations of the National Flood Insurance Act.
CFPB, FTC	Law Firms	Complaint	07/23	The Consumer Financial Protection Bureau initiated complaints against three companies and individuals for violations of Regulation O and the *Dodd-Frank Wall Street Reform and Consumer Protection Act*. Related to their collection of more than $25 million in illegal advance fees for services that falsely promised to prevent foreclosures or renegotiate troubled mortgages. The CFPB is seeking compensation for victims, civil fines, and injunctions. Separately, the Federal Trade Commission filed six lawsuits, and states are taking 32 actions against foreclosure relief scammers in a nation-wide sweep.
FDIC	Banking Entities	Settlement	07/14	The Federal Deposit Insurance Corporation, as receiver for three failed banks, announced a $208,250,000.00 settlement with five entities of a large bank related to misrepresentations in the offering documents for 24 residential mortgage-backed securities (RMBS) purchased by the failed banks.
CFPB	Law Firm	Complaint	07/14	The Consumer Financial Protection Bureau initiated a complaint against a law firm for violations of the Fair Debt Collection Practices Act (FDCPA) and the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) related to its use of use of deceptive court filings and faulty evidence. The CFPB is seeking compensation for victims, a civil fine, and an injunction against the firm and its partners
CFPB	Payday Lender	Consent Order	07/11	The Consumer Financial Protection Bureau initiated an enforcement action against a payday lender to address findings of unfair, deceptive, and abusive practices related to debt collection by the company and its third-party debt collectors. The company is required to pay a total of $10 million in refunds to harmed borrowers and civil money penalties. .

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