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Safety & Soundness

Federal Reserve and FDIC Release Additional Guidance on Resolution Plans

On August 15, 2014, the Federal Reserve Board and the Federal Deposit Insurance Corporation (together, the Agencies) issued a joint release announcing they had completed reviews of the resolution plans filed by those U.S. bank holding companies (BHCs) and foreign entities treated as BHCs that filed their initial resolution plans in December 2013. These firms, the third group to file resolution plans based on the Agencies' staggered implementation schedule, include U.S. BHCs with less than $100 billion in nonbank assets and foreign firms with less than $100 billion in U.S. nonbank assets.

The Agencies state there are 117 firms in this group and that each of the firms has received a letter from the Agencies providing "guidance, clarification and direction for their second resolution plans based on the relative size and scope of each firm's U.S. operations." For the second round of plans, the guidance directs:

- Thirty-one "more complex" firms to file a full resolution plan that addresses the "potential obstacles to resolvability" identified by the Agencies, including global issues, financial market utility interconnections, and funding and liquidity. (These are similar to issues highlighted for the First-Wave Filers.)
- Twenty-five firms with "less complex" operations in the U.S. to file tailored plans as outlined in the Agencies' November 2011 Final Rule.
- Sixty-one firms with "limited" operations in the U.S. to focus on material changes to their initial plan and actions to strengthen their resolvability under that plan.

The group is required to submit their second round of plans by December 31, 2014. The Agencies released similar guidance on August 5, 2014, that was directed to the eleven largest firms subject to the resolution plans Final Rule, commonly referred to as the First-Wave Filers, who filed their initial plans in July 2012. Again, the guidance issued was specific to each of the filing firms.

Federal Reserve Board Vice Chairman Fischer Discusses Progress in Creating Financial Stability before an International Conference

On August 11, 2014, Federal Reserve Board Vice Chairman Stanley Fischer discussed the post-crisis regulatory and supervisory environment at a conference entitled *"The Great Recession—Moving Ahead,"* sponsored by the Swedish Ministry of Finance. He said policymakers have made much progress in creating a safer and more stable post-crisis financial environment, but more work needs to be done. As a point of reference, he acknowledged that most regulatory supervisors, acting in their own countries and in coordination with others, had enacted financial sector regulatory reforms that incorporate "some or most of the following goals:"

- To strengthen the stability and robustness of financial firms, with particular emphasis on standards for governance, risk management, capital and liquidity;
- To strengthen the quality and effectiveness of prudential regulation and supervision, with higher standards for systemically important firms;

- To build the capacity for undertaking effective macroprudential regulation and supervision;
- To develop suitable resolution regimes for financial institutions;
- To strengthen the infrastructure of financial markets, including markets for derivative transactions;
- To improve compensation practices in financial institutions;
- To strengthen international coordination of regulation and supervision, particularly with regard to the regulation and resolution of global systemically important financial institutions (G-SIFIs);
- To better monitor risks within the shadow banking system and find ways of dealing with them; and
- To improve the performance of credit rating agencies.

In particular, he identified the following efforts to strengthen the financial system and reduce the probability of future financial crises:

- Increased globally the minimum tier 1 capital ratio;
- Put in place a capital conservation buffer;
- Created a countercyclical capital buffer that enables regulators to raise risk-based capital requirements when necessary;
- Set a minimum international leverage ratio;
- Instituted a risk-based capital surcharge for G-SIFIs based on their systemic risk; and
- Developed liquidity regulations intended to improve the funding durability and overall liquidity resiliency of internationally active banks.

He made the following observations about specific efforts in the United States:

- "Capital ratios and liquidity buffers at the largest banks are up considerably, and their reliance on short-term wholesale funding has declined considerably."
- "Work on the use of the resolution mechanisms set out in *the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act), based on the principle of a single point of entry …holds the promise of making it possible to resolve banks in difficulty at no direct cost to the taxpayer. As part of this approach, the United States is preparing a proposal to require systemically important banks to issue bail-inable long-term debt that will enable insolvent banks to recapitalize themselves in resolution without calling on government funding–this cushion is known as a 'gone concern' buffer."
- "The introduction of macroeconomic supervisory stress tests has added a forward-looking approach to assessing capital adequacy, as firms are required to hold a capital buffer sufficient to withstand a several-year period of severe economic and financial stress. The stress tests are a very important addition to the toolkit of supervisors, one that is likely to add significantly to the quality and effectiveness of financial sector supervision, and one that should spread internationally as a best practice."

In concluding, Vice Chairman Fischer said with respect to the global regulators' goals (above), "Considerable progress has been made in strengthening bank capital and liquidity; in improving the quality and effectiveness of prudential regulation and supervision; in developing suitable resolution regimes for financial institutions; and in strengthening the infrastructure for the clearing and trading of derivative contracts." He suggested further progress is needed to meet the goals of "improving compensation practices; strengthening international coordination, especially with regard to the resolution and regulation of G-SIFIs; finding ways of dealing with the shadow banking system; and improving the quality of credit rating agencies."

OCC Issues Updated *"Lease Financing"* Booklet

On August 12, 2014, the Office of the Comptroller of the Currency (OCC) issued an updated "*Lease Financing*" booklet of the *Comptroller's Handbook*. It replaces a similarly titled booklet issued by the OCC in January 1998, and also replaces section 219, *"Leasing Activities,"* issued in June 1999 as part of the Office of Thrift Supervision's (OTS) *Examination Handbook* for the examination of federal savings associations.

The OCC's updated *"Lease Financing"* booklet:

- Provides an overview of the leasing business, including the legal framework for leasing, a description of various lease types, and accounting and financial reporting requirements;
- Describes the risks associated with lease financing, sound risk management processes, and regulatory risk rating guidelines;
- Discusses the commonality and differences in the laws and regulations unique to national banks and federal savings associations and among the various types of lease financing products; and
- Has an expanded examination procedures section that includes an internal control questionnaire and verification procedures.

OCC to Host Workshop for Directors of Community Banks and Federal Savings Associations

On August 13, 2014, the Office of the Comptroller of the Currency (OCC) announced that it will host a workshop for directors of national community banks and federal savings associations in Pittsburgh, Pennsylvania, on September 15, 16, and 17. The workshop is one of 35 being offered this year to enhance and expand the skills of national community bank and federal savings association directors.

Entitled *"Mastering the Basics: A Director's Challenge,"* the workshop is designed exclusively for directors of institutions supervised by the OCC and provides practical information on the roles and responsibilities of board participation. It focuses on directors' duties and core responsibilities, major laws and regulations, board reports, and bank ratings.

Enterprise & Consumer Compliance

CFPB To Accept Consumer Complaints about Virtual Products and Services and Issues Related Consumer Advisory

On August 11, 2014, the Consumer Financial Protection Bureau (CFPB or Bureau) announced that it has begun to accept consumer complaints related to virtual currency products and services, including exchange services and online digital wallets. The CFPB stated it will send the complaint to the appropriate company for response and, if the complaint is outside the jurisdiction of the CFPB, it will forward the complaint to the appropriate federal or state regulator. The CFPB indicates that it intends to use the complaints to better understand the

virtual currency market and its effect on consumers as well as to help enforce federal consumer financial laws. The Bureau will also consider consumer protection policy steps, "if appropriate."

Coincident with the announcement to accept virtual currency complaints, the CFPB issued a Consumer Advisory on the risks associated with the use of virtual currencies such as Bitcoin, XRP, and Dogecoin. These risks can include:

- Threats from hackers. The CFPB states that virtual currencies are targets for highly sophisticated hackers, who have been able to breach advanced security systems.
- Fewer consumer protections. Virtual currencies are not insured by the Federal Deposit Insurance Corporation or the National Credit Union Share Insurance Fund and failures of companies that hold consumers' virtual currencies balances may not offer the kinds of help expected from a bank or debit or credit card provider.
- Volatile exchange rates and unclear costs. The virtual currency market is in active development and the related frameworks may subject consumers to volatile pricing, excessive transaction costs, security breaches, exposures of personal information, and scam transactions.

The Advisory also states that the exchanges that handle virtual currencies are required to register with the Department of the Treasury's Financial Crimes Enforcement Network (FinCen) as money services businesses, but cautions that registration does not mean the exchange is trustworthy. Some states also require virtual exchanges to register as money transmitters or currency exchanges.

CFPB Consent Order Requires Retail Company to Repay Fees Charged to Servicemembers for "Added Protections"

The Consumer Financial Protection Bureau (CFPB or Bureau) entered into a Consent Order with a retail company to address the Bureau's allegations that it violated the unfair, deceptive, or abusive acts or practices (UDAAP) provisions of the *Consumer Financial Protection Act* (CFPA) in its credit practices. The company primarily extended credit to servicemembers, who are also entitled to consumer protections through the *Servicemember Civil Relief Act* (SCRA). The CFPB found that the company charged servicemembers a fee to obtain certain SCRA protections they were entitled to, without charge, under the law.

The Consent Order requires the company to pay $350,000 in restitution to consumers harmed by the company's SCRA fee as well as to pay a $50,000 civil money penalty.

CFPB Consent Order Penalizes Nonbank Mortgage Lender for Bait-and-Switch Mortgage Lending Scheme

On August 12, 2014, the Consumer Financial Protection Bureau (CFPB or Bureau) announced that it had entered into a Consent Order with a Georgia-based online mortgage lender, its appraisal company affiliate, and the owner of both companies that requires them to pay fines to address the CFPB's findings they engaged in a deceptive bait-and-switch mortgage-lending scheme in violation of the *Consumer Financial Protection Act* (CFPB), *the Real Estate Settlement Procedures Act* (RESPA), the *Truth in Lending Act* (TILA), and the *Omnibus Appropriations Act.*

The Bureau alleges that the company deceived tens of thousands of consumers by advertising misleading interest rates and locking them in with costly up-front fees. The

Bureau also alleges the respondents did not properly disclose the affiliate relationship and illegally overcharged borrowers for the affiliate's "third-party" services. Without admitting or denying the charges, the company and its affiliate agreed to pay $14.8 million in refunds to harmed consumers and a $4.5 million civil money penalty. The owner of the firms agreed to pay an additional $1.5 million civil money penalty. The company is required to implement a quality control program, retain an independent consultant to review its advertising practices, and be prohibited from charging fees or making referrals to affiliates without first giving consumers the proper disclosure forms.

DOJ Settles Discrimination Suit Against Large Financial Institution

On August 7, 2014, the Department of Justice (DOJ) filed a settlement with a large financial institution to resolve allegations that it engaged in a pattern or practice of discrimination on the basis of disability and receipt of public assistance in violation of the *Fair Housing Act* (FHA) and the *Equal Credit Opportunity Act* (ECOA). Under the settlement, the institution has agreed to maintain revised policies, conduct employee training, and to pay more than $1.5 million to compensate victims.

The lawsuit against the institution originated with a complaint filed by a loan applicant with the Department of Housing and Urban Development. A second defendant in the case, a mortgage broker, has revised its underwriting practices, will train its loan officers and will pay $2,000 to compensate the loan applicant who filed the Complaint through the Department of Housing and Urban Development (HUD). The DOJ does not allege that the mortgage broker discriminated against other loan applicants.

Capital Markets & Investment Management

Federal Reserve Bank of New York Workshop Addresses Risks in Wholesale Funding

On August 13, 2014, the Federal Reserve Bank of New York hosted a workshop to promote a better understanding of risks posed by wholesale funding and to explore policy options for minimizing the risks. In his opening address, William C. Dudley, President of the Federal Reserve Bank of New York, outlined the "structural vulnerabilities" of short-term wholesale funding, explaining, "The extensive use by financial firms of short-term wholesale funding was one critical factor in the crisis. Not only did this reliance on short-term funding create the potential for a firm to fail in an extraordinarily rapid manner when faced with a loss of market confidence, but it also served as a channel through which the effects of those failures were widely propagated throughout the broader financial system." He added, "Short-term funding of longer-term assets is inherently unstable, especially in the presence of information and coordination problems."

In reference to the financial crisis, President Dudley said that the "heavy reliance on short-term wholesale funding exposed the system to a series of intertwined downward spirals in asset and funding markets" adding that widespread dependence increases roll-over risk. "The

inherent fragility of short-term wholesale funding was greatly aggravated by certain institutional shortcomings in these markets, particularly in the structure of the tri-party repo system and the U.S. money market mutual fund business."

President Dudley said much has been done over the past few years to mitigate the structural flaws that make wholesale funding a point of weakness in the global financial system, including efforts by the Federal Reserve Board (Federal Reserve) to make the tri-party repo system more resilient to stress and efforts by the Securities and Exchange Commission (SEC) to address risks associated with money market mutual funds. "Important vulnerabilities remain," however, and it is "essential" to make the system more stable because provisions of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act) have made it more difficult for the Federal Reserve to exercise its emergency lending authority. This, he suggested, could cause investors "to be even more skittish in the future."

Eric Rosengren, president of the Federal Reserve Bank of Boston, also spoke at the workshop. From his perspective, "one of the most important lessons [of the financial crisis] is simply that financial institutions are susceptible to being the targets of runs by the depositors and lenders," adding that the most significant runs involved financial institutions other than banks, such as securities brokers and dealers. President Rosengren said a comprehensive re-evaluation of the regulation of broker-dealers is overdue. He suggested, "Given the lessons learned from the crisis, one might have expected less reliance by broker-dealers on repurchase agreements, and a significant increase in capital required of broker-dealers…What is striking is the lack of change – while there has been some improvement in capital, the 2013 liability structure looks surprisingly similar to the structure that prevailed before the financial crisis."

To reduce the risk of runs on broker-dealers, who do not fund their assets with insured deposits, President Rosengren suggested a number of approaches could be considered, including:

- Requiring higher capital levels;
- Utilizing a larger share of long-term subordinated debt;
- Limiting the extent to which short-term repurchase agreements held by regulated financial intermediaries could be used to finance long-term assets or high-credit-risk assets;
- Prohibiting broker-dealers from holding repurchase agreements secured by collateral that they, by rule, could not purchase;
- Implementing regulation that specifies eligible collateral for a repurchase agreement and that mandates the "haircut;" or
- Permitting the Federal Reserve's Discount Window to provide a standing liquidity facility for broker-dealers like the primary dealer facility that was established during the financial crisis.

President Rosengren acknowledged that such remedies would impact profitability, but said they may be necessary.

Enforcement Actions

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

- The SEC charged a Texas-based penny stock company and four individuals with operating a pump-and-dump scheme by misleading investors about the company's available technologies to improve production. The SEC seeks permanent injunctions, disgorgement

with prejudgment interest and financial penalties, penny stock bars, and officer-and-director bars.

- The SEC charged a New-York-based brokerage firm for adding hidden mark-ups and mark-downs to customer trades generating $18 million in illegal profits. The mark-ups and mark-downs were concealed in the purchase and sales prices of the securities. The firm has agreed to pay $14 million to settle the SEC charges. An earlier related case rendered an additional $4 million in penalties.
- The SEC has charged one individual with insider trading based on significant, nonpublic information the individual obtained from a client. Three other individuals who traded on the information were also charged. In total, the four agreed to pay more than $420,000 to settle the SEC charges.
- The SEC charged a U.S. state with securities fraud for raising $273 million through eight separate municipal bond offerings while failing to disclose that the state's pension system was significantly underfunded and the unfunded pension liability created a repayment risk to investors in those bonds. Without admitting or denying the findings, the state settled the charges by adopting new policies and procedures to help ensure that appropriate disclosures about pension liabilities are made in its offering documents.
- The CFTC entered an Order requiring a New York-based commodity pool operator to pay restitution of $244,400 to defrauded customers and a $100,000 civil monetary penalty. The commodity pool operator was charged with fraud and misappropriation in connection with a commodity pool that traded leveraged or margined off-exchange foreign currency contracts. Neither the commodity pool operator nor his company has ever been registered with the CFTC. The commodity pool operator settled the charges without admitting or denying the CFTC's findings. The CFTC also imposed permanent bans on trading, registration, and certain other CFTC-regulated activities.

Recent Supervisory Actions against Financial Institutions

Last Updated: August 15, 2014

Agency	Institution Type	Action	Date	Synopsis of Action
Federal Reserve Board	State Member Bank			The Federal Reserve Board entered into a (((with a Louisiana state member bank to address deficiencies related to the implementation of a compliance risk management program that includes strengthening board and senior management oversight, developing acceptable consumer compliance and fair lending risk assessments, and a developing a program of interim compliance reviews, risk monitoring, and training sessions.
CFPB	Nonbank Mortgage Lender	Consent Order	08/12	The Consumer Financial Protection Bureau issued a Consent Order against an online mortgage lender, its affiliate, and their owner to address violations of the *Consumer Financial Protection Act*, the *Real Estate Settlement Procedures Act*, the *Truth in Lending Act*, and the *Omnibus Appropriations Act*. The Consent Order requires the company and its servicing affiliate to pay $14.8 million in refunds to harmed consumers and a $4.5 million penalty. The owner will pay an additional $1.5 million penalty.
Department of Justice	Banking entity	Settlement	08/07	The Department of Justice settled a lawsuit against a large banking entity that it alleged had engaged in discrimination on the basis of disability and receipt of public assistance in violation of the *Fair Housing Act,* and the *Equal Credit Opportunity Act*. Under the settlement, the banking entity has agreed to maintain revised policies, conduct employee training, and pay over $1.5 million to compensate victims.
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.

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