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Safety & Soundness

OCC Finalizes Guidance on Heightened Standards for a Risk Governance Framework at Large Financial Institutions

On September 2, 2014, the Office of the Comptroller of the Currency (OCC) announced that it has adopted final rules and guidelines to establish minimum standards for the design and implementation of a risk governance framework at large financial institutions and minimum standards for a boards of directors in overseeing the design and implementation of the framework. The guidelines are issued as an appendix to, and are enforceable under, the OCC's regulations governing safety and soundness standards (Part 30).

The guidelines are applicable to "Covered Banks," which are defined to include:

- Insured national banks, insured federal savings associations, and insured federal branches of a foreign bank (collectively, Banks) that have an average of total consolidated assets equal to or greater than $50 billion;
- Any Bank with average total consolidated assets of less than $50 billion, if that Bank's parent company controls at least one Covered Bank; and
- Any Bank with average total consolidated assets of less than $50 billion, if the OCC determines that the Bank's operations are highly complex or otherwise present a heightened risk so as to warrant the application of the guidelines.

In final form, the guidelines are generally the same as those proposed in January 2014, but include revisions intended to "provide clarity and avoid imposing managerial responsibilities on board members." The guidelines consist of three sections: 1) an introduction, which explains the scope and defines key terms; 2) an outline of the minimum standards for the design and implementation of a Covered Bank's risk governance framework; and, 3) an outline of the minimum standards for the board of directors' oversight of the Covered Bank's risk governance framework.

Compliance dates vary for different Covered Banks such that:

- Covered Banks with $750 billion or more in average total consolidated assets "should" comply immediately upon the effective date (60 days after publication in the *Federal Register)*.
- Covered Banks with average total consolidated assets of $100 billion or more but less than $750 billion "should" comply within six months of the effective date.
- Covered Banks with average total consolidated assets equal to or greater than $50 billion but less than $100 billion "should" comply within 18 months of the effective date.
- Covered Banks with less than $50 billion in average total consolidated assets that are a Covered Bank because their parent company controls at least one other Covered Bank "should" comply on the same date that the other Covered Bank should comply.
- Covered Banks that reach the $50 billion average total consolidated assets threshold after the effective date of the guidelines "should" comply within 18 months from the date of the most recent Call Report (Consolidated Reports of Condition and Income) used in the calculation of the average.

Agencies Adopt Final Rule for Supplementary Leverage Ratio

On September 3, 2014, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (collectively, the Agencies) adopted a joint final rule that modifies the definition of "total leverage exposure," which serves as the denominator of the supplementary leverage ratio adopted by the Agencies as part of their July 2013 final rule to implement the Basel III capital framework in the United States (revised capital rule). The final rule will become effective January 1, 2015.

Revisions to the definition of "total leverage exposure" (as defined in the revised capital rule):

- Include the effective notional principal amount of credit derivatives and other similar instruments through which a banking organization provides credit protection (sold credit protection);
- Modify the calculation of total leverage exposure for derivative and repo-style transactions; and
- Revise the credit conversion factors applied to certain off-balance sheet exposures.

The revisions also change the frequency with which certain components of the supplementary leverage ratio are calculated and establish the public disclosure requirements of certain items associated with the supplementary leverage ratio. The Agencies state the changes "strengthen the ratio by more appropriately capturing a banking organization's on- and off-balance sheet exposures, and, based on estimates, would increase the aggregate measure of exposure across firms."

The final rule applies to all banks, savings associations, bank holding companies, and savings and loan holding companies (banking organizations) that are subject to the Agencies' advanced approaches risk-based capital rules (AA Banks), as defined in the revised capital rule, including AA Banks that are subject to the enhanced supplementary leverage ratio standards finalized by the Agencies in May 2014. These entities (AA Banks) will be required to disclose their supplementary leverage ratios beginning January 1, 2015. They will also be required to comply with a minimum supplementary leverage ratio capital requirement of 3 percent and, as applicable, the enhanced supplementary leverage ratio standards beginning January 1, 2018.

Agencies Adopt Final Rule for a Liquidity Coverage Ratio

On September 3, 2014, the Federal Reserve Board (Federal Reserve), the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (collectively, the Agencies) adopted a final rule to implement a quantitative liquidity requirement, a "liquidity coverage ratio," in the United States consistent with the liquidity standards established by the Basel Committee on Banking Supervision (Basel Committee).

In final form, the quantitative liquidity requirement imposes the expectation that, on a consolidated basis, a company's "unencumbered high-quality liquid assets" (HQLAs) are at least equal to 100 percent of its "total net cash outflows" over a prospective 30-calendar-day period. The ratio of the company's liquid assets to its projected net cash outflows is referred to as its "liquidity coverage ratio" or LCR.

It is largely identical to the proposed rule published by the Agencies in November 2013, however, it contains a few adjustments in response to comments from the public, including:

- Changes to the range of corporate debt and equity securities included in HQLA;
- A phasing-in of daily calculation requirements;
- A revised approach to address maturity mismatch during a 30-day period; and

- Changes in the stress period, calculation frequency, and implementation timeline for the bank holding companies and savings and loan companies subject to the modified LCR.

Banking organizations covered by the final rule generally include bank holding companies (BHCs), certain savings and loan holding companies (SLHCs), and depository institutions with $250 billion or more in total consolidated assets or $10 billion or more in on-balance sheet foreign exposure, and their consolidated subsidiary depository institutions that have assets of $10 billion or more in total consolidated assets (Covered Companies). BHCs and SLHCs without significant insurance or commercial operations that have $50 billion or more in total consolidated assets and are not otherwise companies covered by the LCR final rule, will be subject to a modified LCR requirement by the Federal Reserve (Modified LCR HCs) as part of the enhanced prudential standards required by Section 165 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act.*

The final rule becomes effective January 1, 2015 though transition schedules have been introduced to phase-in compliance and reporting frequency requirements:

- Covered Companies with $700 billion or more in total consolidated assets or $10 trillion or more in assets under custody, and their consolidated depository institution subsidiaries with $10 billion or more in total consolidated assets must calculate the LCR on a monthly basis between January 1, 2015 and June 30, 2015, and on a daily basis thereafter.
- All other Covered Companies must calculate the LCR on a monthly basis between January 1, 2015 and June 30, 2016, and on a daily basis thereafter.
- All Covered Companies must achieve at least: 80 percent of the minimum LCR in 2015, 90 percent of the minimum LCR in 2016, and 100 percent of the minimum LCR in 2017 and thereafter.
- Modified LCR HCs must calculate the modified LCR on a monthly basis beginning January 1, 2016.
- Modified LCR HCs must achieve at least 90 percent of the minimum Modified LCR in 2016, and 100 percent of the minimum Modified LCR in 2017 and thereafter.

The final rule does not apply to nonbank financial services companies designated by the Financial Stability Oversight Council for supervision by the Federal Reserve though they had been included under the proposed rule. The Federal Reserve states that it intends to apply enhanced prudential liquidity standards to these companies through a subsequently issued order or rule following evaluation of the business model, capital structure, and risk profile of each designated nonbank financial company.

Joint Forum Releases Report on Supervisory Colleges for Financial Conglomerates

On September 3, 2014, the Joint Forum released its *Report on Supervisory Colleges for Financial Conglomerates*. The report, the result of a recent self-assessment survey of Joint Forum members, presents findings on how far cross-sectoral issues and specific questions related to financial conglomerates (FCs) are effectively addressed within supervisory colleges. The report is available on the Web site of the Bank for International Settlements (BIS).

Fourteen jurisdictions participated in the survey, which also provides information on the implementation of the 29 Principles included in the Joint Forum's *Principles for the Supervision of Financial Conglomerates,* released in 2012. Particular emphasis was placed on *Principle 6: Supervisory cooperation, coordination, and information-sharing*. While the Joint Forum reports that general progress has been made in implementing the *Principles* since the previous study in 2011, it has identified several gaps and issues in relation to the implementation of *Principle 6.* The Joint Forum states

- Not all jurisdictions have in place a specific supervision framework for financial conglomerates or coordination agreements with other supervisors of financial conglomerates on a cross-sectoral level. Gaps exist in the coordination of on-site and off-site supervision with other domestic or international supervisors, and in arrangements or processes for taking enforcement actions with other domestic or international authorities; and
- There appear to be insufficient specific mechanisms for supervisory cooperation and coordination in periods of crisis/stress, thereby possibly hindering effective intervention in times of crisis.

The Joint Forum was established in 1996 by the Basel Committee on Banking Supervision (Basel Committee), the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS) to deal with issues common to the banking, securities, and insurance sectors, including the regulation of FCs.

Enterprise & Consumer Compliance

CFPB Bulletin Addresses UDAAP Concerns Related to Solicitations for Credit Card Promotional Offers

On September 3, 2014, the Consumer Financial Protection Bureau (CFPB or Bureau) issued Bulletin 2014-02 to address regulatory concerns associated with credit card solicitations that offer a promotional annual percentage rate (APR) over a defined period of time (i.e., a grace period). The Bulletin is specifically directed toward credit card issuers and relates to transactions such as convenience checks, deferred interest/promotional interest rate purchases, and balance transfers.

The Bureau indicates that the Bulletin was prompted by concerns that some solicitations for these types of offers do not clearly or prominently convey that a consumer who accepts such an offer and continues to use the credit card to make purchases will lose the grace period on the new purchases if the consumer does not pay the entire statement balance, including the amount subject to the promotional APR, by the payment due date. The Bureau indicates that such marketing materials risk being deceptive and that, depending on all of the facts and circumstances, a credit card issuer may risk engaging in abusive conduct if it fails to adequately alert consumers to this relationship.

The CFPB Bulletin stresses that credit card issuers are legally required to clearly communicate costs, conditions, and limitations associated with promotional offers. Further, the Bulletin states the Bureau expects credit card issuers to:

- Incorporate into their compliance management systems adequate measures to prevent violations of federal consumer financial laws, including provisions prohibiting unfair, deceptive, or abusive acts or practices (UDAAP); and

- Implement internal controls sufficient to ensure that they market promotional APR offers in a manner that limits the risk of statutory or regulatory violations and related consumer harm, including, but not limited to, ensuring that:
  - All solicitations, applications, account-opening materials, and convenience checks comply with the requirements in Regulation Z (which implements the *Truth-in-Lending Act*);
  - All marketing materials clearly, prominently, and accurately describe the material costs, conditions, and limitations associated with the offers; and
  - All marketing materials clearly, prominently, and accurately describe the effect of promotional APR offers on the grace period for new purchases.

Coincident with the release of the Bulletin, the CFPB published a blog post with tips for consumers about credit card interest-rate promotions, an explanation of how grace periods work, and various things to consider after deciding to accept a promotional offer.

Capital Markets & Investment Management

Agencies Seek Comment on Proposed Rule for Swap Margin Requirements

On September 3, 2014, five federal agencies (Agencies) announced the release of a proposed rule that would establish minimum margin requirements for swap dealers, major swap participants, security-based swap dealers, and major security-based swap participants. The proposed rule implements Sections 731 and 764 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act), which require the Agencies to jointly adopt rules to establish capital requirements and initial and variation margin requirements for such entities and their counterparties on all non-cleared swaps and non-cleared security based swaps. In particular, Sections 731 and 764 require the Agencies to adopt rules for those entities under their prudential supervision (Covered Swap Entities). The provisions also require the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) to separately adopt rules imposing capital and margin requirements for swap entities for which there is no prudential regulator. Comments are requested by each of the Agencies no later than 60 days after publication in the *Federal Register*.

The five Agencies participating in the proposed rule include the Federal Reserve Board, the Farm Credit Administration, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, and the Office of the Comptroller of the Currency.

The proposed rule builds on a previously proposed rule released by the Agencies in April 2011 and includes modifications to reflect some of the comments received on that proposal as well as modifications to reflect key principles of an international framework agreed to in September 2013 by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions and outlined in their joint document entitled, *Margin requirements for non-centrally cleared derivatives*.

In the currently proposed rule, the Agencies are proposing to adopt a risk-based approach that would establish minimum initial and variation margin requirements for Covered Swap Entities. The risk posed by the Covered Swap Entity's counterparties would be considered in establishing the minimum amount of initial and variation margin that the entity must exchange with its counterparties. The margin requirements would generally apply to the posting as well as the collection of minimum initial and variation margin amounts by a Covered Swap Entity from and to its counterparties. Covered Swap Entities would not be required to collect specific or minimum amounts of initial margin or variation margin from "other counterparties" that are not swap entities or financial end users as a matter of course, but rather each Covered Swap Entity would be able to determine the necessary margins consistent with its overall credit risk management of the swap entity's exposure to the customer.

With regard to capital requirements, the proposed rule would require a Covered Swap Entity to comply with the regulatory capital rules applicable to that entity as part of its prudential regulatory regime. The Agencies suggest that existing regulatory capital rules across the Agencies specifically take into account and address the unique risks arising from swap transactions and activities.

As required by the Dodd-Frank Act, staff of the five Agencies consulted with staff of the CFTC and the SEC in developing the proposed rule.

Federal Reserve Board Governor Powell Discusses Reforming U.S. Dollar LIBOR

On September 4, 2014, Federal Reserve Board Governor Jerome H. Powell discussed ongoing efforts to reform the current structure and uses of the London Interbank Offered Rate (LIBOR) in a speech entitled, *Reforming U.S. Dollar LIBOR: The Path Forward*, at New York University.

Governor Powell noted that a number of global efforts to reform reference rates have been undertaken since the 2012 LIBOR scandal. These efforts include the introduction of a broad set of 19 principles developed by the International Organization of Securities Commissions (IOSCO) that reference rates and other financial benchmarks are now expected to meet. For purposes of his remarks, Governor Powell focused on U.S. dollar LIBOR, suggesting reasons why further reforms are necessary and how those reforms should proceed.

Governor Powell said the U.S. dollar LIBOR needs to be updated to reflect current practices in unsecured funding markets and to be better anchored in actual transactions. He said regulators need to work with market participants to encourage them to develop and adopt alternative reference rates that better reflect the current structure of U.S. financial markets in which borrowing and derivatives transactions are much more likely to be secured with collateral.

The Federal Reserve Board (Federal Reserve), in cooperation with the LIBOR administrator and authorities in the United Kingdom (U.K.), is considering ways to update the mechanics of U.S. dollar LIBOR to make LIBOR more robust and more representative of current bank funding costs. Their efforts are focused on two attributes of LIBOR—its definition and the data used to produce it. Governor Powell explained:

- U.S. dollar LIBOR needs to be redefined to include a broader range of transaction types. Doing so, he said, will make it more robust and will allow it to reflect actual bank funding costs, which is what the rate was intended to do.

- Broadening the definition to include the unsecured borrowing from nonbanks would make the rate more representative of current funding practices. Changing the definition of LIBOR, as has been done in the past, would acknowledge the fact that a reference rate must adapt to continue to represent what it is meant to measure.
- Updating the definition of U.S. dollar LIBOR could also allow other sources of transactions data to be incorporated into it. The current panel-based method of calculating U.S. dollar LIBOR could possibly change to a rate that is fully transactions based. The Federal Reserve began collecting data from banks on a variety of unsecured transaction in April 2014.
- Basing U.S. dollar LIBOR more on transactions could modestly increase the volatility of the rate, but it would more accurately reflect the volatility of the market it represents.

Governor Powell said robust alternatives to U.S. dollar LIBOR also are needed to better reflect the secured nature of many of the current financial market transactions:

- Encouraging alternatives that better reflect current funding markets would allow for greater choice, increase the resilience of the system, and would potentially make hedging of some risks less costly. In addition, the incentive to manipulate LIBOR would be substantially reduced if a smaller share of the multi-hundred-trillion-dollar derivatives market was referencing it.
- Some possible alternatives to LIBOR include rates based on the U.S. Treasury market or rates based on the secured funding markets that have replaced much of the borrowing banks used to do in the unsecured interbank market.

In promoting alternatives to LIBOR, Governor Powell said the Federal Reserve:

- Will encourage key market participants to narrow down the list of alternatives and develop them into robust reference rates that meet agreed-upon international standards and best practices;
- Is strongly committed to at least one such rate being developed and actively used as soon as practicable;
- Intends to meet with a wide range of market participants, including end users, to hear their views about how change can be effected and to begin the work of developing alternatives to LIBOR;
- Will convene a group of the largest global dealers later this year to discuss these issues; and
- Will work toward the goal of ensuring that any changes to LIBOR will not require borrowers or lenders to amend their existing contracts.

In concluding, Governor Powell said, "My hope is that governments, market participants, and end users can work together to build a stronger foundation for the reference interest rates that are so critical to our financial system. Implementation of these measures is clearly in the interest of U.S. financial stability."

Enforcement Actions

The Securities and Exchange Commission (SEC) recently announced the following enforcement actions:

- A Texas-based investment advisory firm was charged with fraud for failing to disclose a conflict of interest. The advisory firm recommended its clients invest in certain mutual funds for which the advisory firm had an undisclosed compensation agreement with the offering brokerage firm. The SEC is seeking a cease and desist order, disgorgement, and civil money penalties.

- A California-based attorney and two other individuals were charged with violations of the *Securities Act* and the *Securities and Exchange Act* for defrauding foreign investors trying to come to the United States through an immigrant investor program. The SEC alleges that the three raised nearly $11.5 million from two dozen investors seeking to participate in the program. The SEC is seeking disgorgement, prejudgment interest, penalties, and permanent injunctions. In a parallel action, the U.S. Attorney's Office announced criminal charges against the attorney.

Agency	Institution Type	Action	Date	Synopsis of Action
CFPB	Nonbank Debt Settlement Payment Processor	Consent Order	08/25	The Consumer Financial Protection Bureau issued a Consent Order against a debt settlement payment processor for allegedly helping other companies to collect illegal upfront fees from consumers in violation of the *Consumer Financial Protection Act* and the *Telemarketing and Consumer Fraud and Abuse Prevention Act*. The Bureau is seeking $6 million in relief to consumers as well as a $1 million civil penalty.
FTC	Nonbank Debt Relief and Credit Repair entity	Complaint	08/22	The Federal Trade Commission asked a federal court to shut down a an illegitimate debt relief and credit repair program that made false claims it was provided and funded by the federal government. The FTC charged the operators with two counts of violating the FTC Act's prohibition on deceptive acts or practices, as well as two counts of violating the *Credit Repair Organizations Act's* prohibitions on collecting advance fees before providing credit repair services.
FDIC	Banking Entities	Settlement	08/21	The Federal Deposit Insurance Corporation, as receiver for twenty-six failed banks, announced a settlement of more than $1 billion with eighteen related entities of a large bank related to misrepresentations in the offering documents for 155 residential mortgage-backed securities (RMBS) purchased by the failed banks.
Federal Reserve Board	State Member Bank	Written Agreement	08/12	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.

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