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The Washington Report

for the week ended September 26, 2014

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Safety & Soundness

FDIC Chairman Gruenberg Discusses Areas of Supervisory Focus

On September 22, 2014, FDIC Chairman Martin J. Gruenberg, speaking before the American Banker Regulatory Symposium, focused his remarks on three areas of ongoing supervisory focus at the Federal Deposit Insurance Corporation (FDIC) - interest-rate risk, credit risk, and cyber security risk.

Chairman Gruenberg said the industry is "currently at a crossroads for market risk, as an upward shift in the yield curve is inevitable." He identified a number of concerns associated with a change in interest rates, such as:

- The slow loan growth and narrow interest margins have made it difficult for most institutions to restore their ratios of return on assets to pre-crisis levels, leading to concerns that institutions may take on more interest-rate risk to bolster profitability.
- Some banks have invested in long-term securities that offer attractive yields, creating maturity mismatches that have increased their exposure to interest-rate risk.
- Even though unrealized losses on assets do not always need to be recognized in capital, they can adversely affect liquidity by making it costly to sell the securities should the need arise.
- Rising interest rates could prompt large outflows of deposits, creating the risk that banks could be forced to liquidate a depreciated securities portfolio and suffer a capital loss.
- Margins could compress as deposits re-price faster than assets.
- If rates rise, some variable-rate borrowers would find it more difficult to service their debt, indirectly resulting in higher levels of loan losses.

Chairman Gruenberg did state that, "The FDIC does not intend to lower the earnings ratings of banks that are making prudent choices to limit interest rate risk."

As lending activity expands in the current environment, Chairman Gruenberg said FDIC supervisors are placing a high priority on managing credit risks, particularly in the areas of loan underwriting and concentration management. He said, "There simply is no bright line that separates prudent concentration levels from imprudent concentrations. What matters most is how well the risks are managed." He also said regulators continue to be concerned about aggressive leveraged lending activities, particularly those with high debt service loads, weak protective covenants, and a lack of amortization.

Regarding cyber security, Chairman Gruenberg said rapid innovation creates an urgent need to manage the operational risks associated with new technologies. "In an increasingly interconnected banking environment, internet cyber threats have rapidly become the most urgent category of technological challenges facing our banks. Cybersecurity is no longer just an issue for the IT department. It needs to be engaged at the very highest levels of corporate management." He said the banking agencies are in the process of implementing a number of work streams and that the FDIC has also initiated a number of programs to assist community banks in their awareness of cyber threats and to provide practical tools to help mitigate these

risks. He encouraged banks to practice responding to cyber threats as part of their regular disaster planning and business continuity exercises.

In his concluding remarks, Chairman Gruenberg said the most important lesson of the recent crisis and previous ones is that "success or failure is not determined in the current quarter or the current year. The banks that have best served their shareholders and their communities over time are those that have taken the long view, and have made risk management an essential part of their culture."

FSB and IMF Publish Fifth Progress Report of the Data Gaps Initiative

On September 23, 2014, the Financial Stability Board (FSB) and the International Monetary Fund (IMF) published the fifth progress report of the Data Gaps Initiative (DGI). The report assesses the implementation of recommendations issued in 2009 to close key information gaps for financial stability, provides benchmarks to determine when to call each recommendation complete, and outlines a future work plan.

The DGI focuses on implementation of 20 recommendations prepared by the FSB and the IMF and presented in a report, entitled "*The Financial Crisis and Information Gaps*," which was endorsed by the G20 (Group of Twenty Finance Ministers and Central Bank Governors) in November 2009.

As presented in the Executive Summary, the key messages in the fifth progress report are as follows:

- Significant progress has been made in implementing the DGI recommendations, but further work is critical to reap the full benefits of the work undertaken to date. Most of the conceptual work has been completed. Enhancements of datasets are being made by all G-20 economies but at diverse rates of progress, primarily reflecting their varying levels of sophistication of statistical systems. Implementation efforts also have been reported by several non-G-20 economies.
- DGI recommendations are broadly in line with national priorities to inform policy work. Strong policy support and peer pressure are also among the key drivers of the success of the DGI.
- Based on the agreed implementation targets, it is feasible to envisage substantive completion of the DGI by year end-2015, provided there is continued cooperation at the national and international level, and statistical activities are appropriately resourced.
- The data becoming available under the DGI are seen as enhancing policy analysis and surveillance, including financial stability and debt analysis, and in support of an understanding of domestic and international interconnectedness.
- There is a sense from the consultations with G-20 economies that further work is needed to fully achieve the potential for data provision embodied in the initiative. The development of the DGI datasets requires continuous effort to expand the number of contributors, enhance data completeness and quality, and promote data sharing among international agencies.
- A second phase of the DGI could start in 2016 to strengthen and consolidate the progress to date and promote the regular flow of comparable and high-quality data across the G-20 economies. Close cooperation among national and international agencies would be needed. The specifics of a second phase of the DGI including a revised mandate would be discussed with G-20 economies as part of the 2015 work plan.
- New data requests could also be added in the second phase, as needs arise from the user community, to ensure that the data collected are relevant for analytical and policy needs.

However these should be parsimonious in number and should go through a filtering process taking into account a broader perspective to minimize the burden and to maintain a consistent set of data for policy and analysis.

- In order to ensure the continuity of the process, each G-20 economy will be asked to identify senior level representatives to liaise with the Inter-Agency Group on Economic and Financial Statistics (IAG) on the DGI.

Federal Insurance Office Releases Second Annual Report

On September 23, 2014, the U.S. Department of the Treasury's Federal Insurance Office (FIO) released its second annual report to the President and the Congress on the state of the insurance industry. The report, which is required by the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (the Dodd-Frank Act), indicates the industry experienced strong financial performance and expanded growth in 2013. Broadly, the report covers: a financial overview of the U.S. industry; consumer protection and access to insurance; and developments in the U.S. regulatory and international markets.

The reported range of regulatory developments—at the state, federal, and international levels—include terrorism risk insurance, the National Flood Insurance Program (NFIP), the use of "captive reinsurers" by life insurance companies, acquisition of annuity companies by private equity firms, and the designation of certain firms as globally significant insurance institutions (G-SIIs).

Basel Committee Chair Discusses Reliability and Comparability of Risk-Based Capital Ratios

On September 24, 2014, Stefan Ingves, Chairman of the Bank for International Settlements' Basel Committee on Banking Supervision (BCBS or Basel Committee) discussed the reliability and comparability of risk-based capital ratios at the International Conference of Banking Supervisors in China. He said the Basel Committee is assessing bank capital ratios to ensure that they appropriately reflect banks' risks.

"Our assessments thus far have found significant variation in banks' risk-weighted assets that are not explained by underlying differences in the riskiness of banks' portfolios," he said. "Excessive variation in risk-weighted assets undermines confidence in the risk-based capital framework as a measure of bank safety." He said the Basel Committee is taking steps to reduce the variation arising from differences in how banks measure risk and that it understands that variation in risk-weighted assets can arise from differences in the rules and implementation standards set by national regulators.

He said the outcomes that the Basel Committee is seeking are:

- A regulatory framework that promotes effective supervision;
- Consistent global implementation;
- Effective bank risk measurement and management; and, ultimately,
- A strong, stable, and efficient banking system.

Chairman Ingves said there are a multitude of measures that the Basel Committee is considering to address the issue of risk-weighted assets, "but at the heart of the issue is a debate about the basic design of the regulatory framework itself."

One view is that “the outcomes we want to achieve are best promoted by maintaining internal risk models, though in in a more limited way with floors and other safeguards.” The other view is that “in some cases internal models have been used to minimize risk-weighted assets—and, therefore, regulatory capital—rather than to promote improvements in risk measurement and management.”

He said one view “dangles a carrot to induce better risk measurement and management at banks and relies on internal models to determine regulatory capital requirements.” The other “relies on supervisory-determined models for setting minimum capital requirements, but threatens a stick to penalize those banks that do not meet required risk management standards.”

Chairman Ingves said, “The simpler we make the framework, the less risk-sensitive it becomes. Conversely, the more risk-sensitive the framework is, the more complex implementation and supervision become. There are no easy answers, but the need to balance these items is becoming ingrained in the mindset of those responsible for policy development and implementation.”

He said the BCBS is undertaking a long-term strategic review of the capital framework to determine whether there are areas where the level of complexity could be reduced or where comparability could be improved to better meet the Basel Committee's objectives. He said they are considering “whether the use of banks' own risk models to calculate regulatory capital is helping or hindering the Committee's pursuit of those goals.”

OCC Bulletin Announces Revisions to the Federal Branches and Agencies Supervision Booklet of the Comptroller's Handbook

On September 26, 2014, the Office of the Comptroller of the Currency (OCC) issued OCC Bulletin 2014-46 to announce revisions to the “*Federal Branches and Agencies Supervision*” booklet of the *Comptroller's Handbook*, which was last issued in December 1999.

The OCC summarizes that the new booklet, “*Federal Branches and Agencies Supervision:*”

- Provides updated guidance and examination procedures to examiners and bankers concerning the supervision of federal branches and agencies;
- Highlights special considerations arising from legal and operational structures that differentiate federal branches and agencies from national banks;
- Explains the OCC’s supervisory process for federal branches and agencies in the context of the OCC’s participation in the interagency framework for supervising U.S. branches and agencies of foreign banks;
- Addresses OCC Bulletin 2013-29, “*Third-Party Relationships: Risk Management Guidance*” (October 30, 2013); and
- Addresses the new “*Enhanced Prudential Standards for Foreign Banking Organizations*” rule required by section 165 of the *Dodd–Frank Wall Street Reform and Consumer Protection Act*.

Enterprise & Consumer Compliance

Department of Defense Issues Proposed Rule That Would Expand Coverage of the *Military Lending Act*

On September 26, 2014, the U.S. Department of Defense (DoD) issued a proposed rule to amend the regulations that implement the *Military Lending Act* (MLA). As proposed, the revisions would extend the MLA protections to active duty servicemembers and their families by imposing a broader definition of "consumer credit" that would include open-end and closed-end credit subject to the protections of the *Truth in Lending Act* (TILA), except for credit secured by real estate or purchase-money loans, including loans to purchase a vehicle.

The MLA protections include:

- A 36 percent interest-rate limit that covers all interest and fees associated with a loan, and is referred to as the Military Annual Percentage Rate (MAPR). In the case of a credit card account, a creditor would be permitted to exclude bona fide fees that are reasonable and customary from the charges counted toward the MAPR.
- A requirement the creditor must provide the military borrower with additional disclosures, including a statement that he or she may seek legal or financial counseling advice regarding an application for credit from the Military Aid Societies.
- Prohibitions against a creditor requiring servicemembers to submit to arbitration, waive their rights under the *Servicemembers' Civil Relief Act* (SCRA), or imposing onerous legal notice requirements as a result of taking one of these loans.

The proposed rule would also permit a creditor to access the DoD's online database to assess the active-duty status of a consumer-applicant for consumer credit.

The *National Defense Authorization Act for Fiscal Year 2013* amended the MLA to state that the same regulators that enforce the TILA have administrative authority to enforce consumer credit protections for servicemembers and their dependents under the MLA.

GAO Releases Second Report on CFPB Data Collection

On September 22, 2014, the Government Accountability Office (GAO) released a report on the Consumer Financial Protection Bureau's (CFPB or Bureau) data collection activities.

The GAO report (GAO 14-758, dated September 2014) states that CFPB has taken steps to protect and secure these data collections by:

- Creating a data intake process that brings together staff with relevant expertise to consider the statutory, privacy, and information security implications of proposed consumer financial data collections.

- Taking steps to implement an information security program that is consistent with *Federal Information Security Management Act* requirements, according to the Office of Inspector General for the Federal Reserve and CFPB.
- Implementing logical access controls for the information system that maintains the consumer financial data collections and scans for problems or vulnerabilities.
- Establishing a risk-management process for the information system that maintains consumer financial data consistent with guidelines developed by the National Institute of Standards and Technology.

However, the GAO determined that additional efforts are needed to reduce the risk of improper collection, use, or release of consumer financial data. The GAO recommends the Bureau:

- Establish or enhance written procedures for:
  - Data intake, including reviews of proposed data collections for compliance with applicable legal requirements and restrictions;
  - Anonymizing data;
  - Assessing and managing privacy risks;
  - Monitoring and auditing privacy controls; and
  - Documenting results of information security risk-assessments consistently and comprehensively.
- Take or complete actions to:
  - Develop a comprehensive written privacy plan that brings together existing privacy policies and guidance;
  - Obtain periodic independent reviews of its privacy practices;
  - Develop and implement targeted privacy training for staff responsible for working with sensitive personal information;
  - Update remedial action plans to include all identified weaknesses and realistic planned remediation dates that reflect priorities and resources; and
  - Include an evaluation of compliance with contract provisions relating to information security in CFPB's review of the service provider that processes consumer financial data on its behalf.
- Consult further with the Office of Management and Budget (OMB) about its credit card collection and data-sharing agreement.

FFIEC Announces Availability of 2013 Mortgage Lending Data

On September 22, 2014, the Federal Financial Institutions Examination Council (FFIEC) announced the availability of 2013 data on mortgage lending transactions at U.S. financial institutions covered by the *Home Mortgage Disclosure Act* (HMDA), including banks, savings associations, credit unions, and mortgage companies. The HMDA data cover loan applications, originations, purchases and sales, denials, and other actions related to applications. It also includes:

- Disclosure statements for each financial institution;
- Aggregate data for each metropolitan statistical area (MSA);
- Nationwide summary statistics regarding lending patterns; and
- Loan/Application Registers (LARs) for each financial institution.

The FFIEC prepares and distributes this information on behalf of its member agencies, including the Federal Deposit Insurance Corporation, Federal Reserve Board, Office of the

Comptroller of the Currency, National Credit Union Administration, and Consumer Financial Protection Bureau, along with a representative of the State Liaison Committee.

The HMDA data show the disposition of loan applications and include information on:

- Loan amount;
- Loan type (such as conventional, Federal Housing Administration (FHA) or Veterans Administration (VA));
- Purpose (home purchase, home improvement, or refinancing);
- Property type (one- to four-family, multifamily, or manufactured housing);
- Property location (MSA, state, county, and census tract);
- Applicant characteristics (race, ethnicity, sex, and income);
- Pricing-related data;
- Whether a loan is subject to the *Home Ownership and Equity Protection Act* (HOEPA); and
- Whether a loan is secured by a first or subordinate lien, or is unsecured.

Observations from the 2013 data include, among others:

- The number of reporting institutions declined about three percent to 7,190 from 2012. The data include information on nearly 16.8 million actions including 14 million home loan applications (approximately 8.7 million of which resulted in loan originations) and 2.8 million loan purchases.
- The total number of originated loans of all types and purposes declined by approximately 11 percent (1.1 million) from 2012. Refinance originations declined by approximately 23 percent, though home purchase lending increased by approximately 13 percent.
- The FHA-insured share of first-lien home purchase loans for 1-4 family, site-built owner-occupied properties was 24 percent, down from 31 percent in 2012, and down from its peak of 42 percent in 2009. The VA-guaranteed share of such loans held steady between 2012 and 2013 at around nine percent.
- Fewer than five percent of first-lien loans originated in 2013 have annual percentage rates (APRs) that exceed the loan price reporting thresholds for "higher priced" loans, up from about three percent in 2012.
- A total of 1,873 loans covered by HOEPA were reported for the year, down from 2,194 in 2012.

OCC Report on Mortgage Performance Indicates Improvement

On September 25, 2014, the Office of the Comptroller of the Currency (OCC) released a report entitled *"OCC Mortgage Metrics Report, Second Quarter 2014"* indicating that the performance of first-lien mortgages serviced by selected large national banks and federal savings associations experienced a seasonal decline during the second quarter of 2014, but improved from a year earlier. The mortgages in this portfolio comprise 47 percent of all first-lien residential mortgages outstanding in the United States—representing a total of 24.1 million loans and $4.1 trillion in unpaid principal.

Highlights of the second quarter 2014 report findings, based on loan performance through June 30, 2014, include the following:

- Of the mortgages serviced by the reporting servicers, 92.9 percent were current and performing, compared with 93.1 percent at the end of the previous quarter and 90.6 percent a year earlier.

- The percentage of mortgages that were 30 to 59 days past due increased 15.0 percent from the previous quarter to 2.4 percent of the portfolio, but decreased 17.3 percent from a year earlier.
- The percentage of mortgages that were seriously delinquent—60 or more days past due or held by bankrupt borrowers whose payments were 30 or more days past due—increased 0.6 percent from the previous quarter, but decreased 17.0 percent from a year earlier.
- The number of mortgages in the process of foreclosure fell to 391,591, a decrease of 47.4 percent from a year earlier. The percentage of mortgages that were in the process of foreclosure at the end of the second quarter of 2014 was 1.6 percent. During the quarter, servicers initiated 79,781 new foreclosures—a decrease of 47.0 percent from a year earlier.
- Servicers implemented 208,150 home retention actions—including modifications, trial-period plans, and shorter-term payment plans—compared with 64,790 home forfeiture actions during the quarter, which include completed foreclosures, short sales, and deed-in-lieu-of-foreclosure actions.
- Mortgages serviced for Fannie Mae and Freddie Mac (government-sponsored enterprises, or GSEs) made up 58.3 percent of the mortgages in this report. The percentage of these mortgages that were current and performing was 96.6 percent

FTC Announces Court Judgment Against Debt Collector

On September 23, 2014, the Federal Trade Commission (FTC) announced that it had reached a settlement with a debt collection company that it found to have used fictitious names and threatening language to coerce consumers into paying debts they may not have owed in violation of the *Federal Trade Commission Act* (FTC Act) and *the Fair Debt Collection Practices Act* (FDCPA). Under the settlement, and a related default judgment by a federal district court, the debt collector and its principals have been barred from debt collection activities and are subject to a judgment of more than $9 million, which has been suspended for most of the defendants, due their inability to pay.

According to an FTC complaint filed in 2013, the debt collectors used fictitious business names that implied an affiliation with a law firm or a law enforcement agency. Using robocalls and voice messages that threatened legal action and arrest unless consumers responded within a few days, the defendants collected millions of dollars in payment for debts many of the consumers contacted did not owe. The complaint also charged that the defendants illegally called consumers at inconvenient times or places, including at their workplaces, despite being asked to stop; disclosed supposed debts to family members, employers, and other third parties; harassed consumers with repeated calls; failed to disclose their identity as debt collectors; and failed to provide a required written notice telling consumers how to dispute the alleged debts. Nearly 3,000 complaints to the FTC's Consumer Sentinel database were generated by the actions of the debt collector.

CFPB and OCC Assess Penalty Against a National Bank for Unfair Billing Practices

In separate but coordinated actions on September 25, 2014, the Consumer Financial Protection Bureau (CFPB or Bureau) and the Office of the Comptroller of the Currency (OCC) (collectively, the Agencies), assessed financial penalties against a national bank for engaging in violations of the *Consumer Financial Protection Act* (CFPA) and the *Federal Trade*

Commission Act, respectively, in connection with the billing and administrative practices of its third-party vendor. The Agencies found that the bank's credit card consumers were unfairly billed for identity theft protection products, referred to as "add-on" products, marketed by the bank and sold by its vendor.

The Agencies each required the bank to pay restitution of $47.9 million to more than 420,000 consumer accounts. In addition, the bank is required to pay a $5 million civil money penalty to the CFPB and a $4 million civil money penalty to the OCC. The CFPB states that restitution payments made by the bank to harmed consumers pursuant to the OCC's Order will satisfy identical obligations required by the CFPB action. The Agencies also require the bank to improve its governance of third-party vendors, especially with regard to "add-on" consumer products.

CFPB to Begin Pilot Research Program on Early Intervention Credit Counseling

On September 25, 2014, the Consumer Financial Protection Bureau (CFPB or Bureau) announced it is beginning a pilot program with a global credit card issuer and a regional credit counseling agency to ascertain the benefits of early intervention credit counseling. The program, entitled "Project Catalyst," is a research project intended to:

- Evaluate the effectiveness of early intervention credit counseling in helping consumers avoid defaulting on their credit card debt;
- Gain insight into whether notifications from card issuers can help raise cardholders' awareness of their credit performance; and
- Evaluate the analytical value of certain metrics in determining a consumer's potential to default.

The CFPB's states the pilot study will explore four questions:

- For consumers at risk of default, is having access to credit counseling and debt management services early on correlated with better financial outcomes, as compared to consumers who are offered the services and do not opt to take them up or consumers who are not offered any credit counseling services?
- Are the services more effective for particular segments of consumers (for example, those with lower levels of debt or those with longer histories of credit usage)?
- Are there differences in credit behavior among consumers who enroll in credit counseling/debt management services, those who are offered the services and do not opt to take them up, and those who are not offered any credit counseling services?
- What types of "triggers" for default – for example, transaction patterns, balances near credit limit, and changes in payment behavior – offer the most analytical value in forecasting delinquency?

The card issuer will offer this service at no cost to customers that it believes to be at risk of default and who also live in the service area of the credit counseling agency. The CFPB stated the card issuer and the counseling agency intend to share insights from this trial project with the Bureau, but the consumers' identities will not be shared and precautions will be taken to ensure that individual consumers cannot be identified through the data.

Capital Markets & Investment Management

SEC Commissioner Gallagher Discusses Future Role of Self-Regulatory Organizations at Two Conferences

Securities and Exchange Commission (SEC or Commission) member Daniel M. Gallagher discussed the future role of self-regulatory organizations (SROs) at two conferences in Washington, D.C., on September 16, 2014. At the Conference on Financial Markets Quality held by the Georgetown Center for Financial Markets and Policy, and also at the Self-Regulatory Organization Outreach Conference, Commissioner Gallagher said the SEC intends to conduct a holistic review of equity market structure that will examine the status and structure of SROs.

Commissioner Gallagher said that he had previously posed questions to industry participants "that are still pressing today, such as whether we should continue to have exchanges with statutory self-regulatory responsibilities when the vast majority of those responsibilities have been outsourced to another SRO and whether the Commission should impose limits on the ability of SROs to contract with others." Speaking for himself and not the SEC, Commissioner Gallagher told the audience at both conferences that other questions to consider regarding SROs might include:

- "What is the appropriate balance of regulatory oversight between the government and by market participants themselves?"
- "Does it still make sense to distinguish between national securities exchanges and automated trading systems (ATS)?"
- "Should we distinguish between exchanges that list securities and those that do not?"
- "What does the fact that over 35 percent of securities transactions today are effected not on SRO platforms, but rather through ATSs mean for the future of SROs?"

At the SRO Conference, he also asked:

- "Whether exchanges that outsource their regulatory responsibilities to FINRA are still SROs?"
- "Whether the benefits of rule standardization among exchanges are canceled out by the lack of a competition of ideas among exchange regulatory regimes contributing to the development of best practices?"
- "Whether FINRA inappropriately exceeded its mandate, or is it evolving with the markets?"

"And as for FINRA itself," Commissioner Gallagher said at the SRO Conference, "we need to ask whether it has inappropriately exceeded its mandate, or is simply evolving with the markets. Regardless of the answer, we need to consider what that means for both the SEC and SROs. This is especially pressing as we continue to consider the possibility of subjecting investment advisers to self regulation." He suggested that if Congress did opt to address legislation to establish an investment adviser SRO, the discussion would turn to FINRA.

However, Commission Gallagher added that an "SEC-only" approach would not work for investment advisers "any more than it did for broker-dealers." He said "the answer is not to exponentially expand the SEC staff by adding a brigade of new investment adviser examiners when there are third parties that could perform that role."

In concluding at the SRO Conference, Commissioner Gallagher said, "The fact that the investment adviser industry has operated without SRO supervision offers an opportunity for what could be considered a control experiment: two regimes alongside one another, one with SROs, one without. Even as we continue to ponder whether that situation needs to be changed, we should compare and contrast the two industries to better examine some of the strengths and weaknesses of self-regulation. We certainly must do this before even considering a fiduciary duty rulemaking for brokers."

CFTC Commissioner Giancarlo Discusses Cross-Atlantic Oversight of Derivatives at the Global Forum for Derivatives Markets

On September 24, 2014, CFTC Commissioner J. Christopher Giancarlo delivered the keynote address at the Global Forum for Derivatives Markets in Geneva, Switzerland. The event marked the fifth anniversary of the Pittsburgh G-20 Summit (conducted in September 2009), where "the global leaders agreed to work together to support economic recovery through a '*Framework for Strong, Sustainable and Balanced Growth*,'" as well as to abide by three fundamental principles for over-the-counter (OTC) derivatives markets. These principles included: 1) When possible, trading all standardized OTC derivative contracts on regulated trading platforms; 2) Moving many bilateral swaps to central counterparties (CCPs) for clearing; and 3) Reporting swap trades to trade repositories. "To achieve these common goals, the Pittsburgh participants pledged to work together to 'implement global standards' in financial markets, while rejecting 'protectionism.'"

Commissioner Giancarlo asked his audience, "Are we fully honoring the commitment to coordinate our efforts to reform the derivatives markets? Are we avoiding protectionism? Or are we, in fact, building a new 21st century protectionism around regional financial markets, especially in swaps and futures?" He suggested the answers to these questions "do not inspire confidence for the future," citing a number of current market examples, including, but not limited to:

- The fact that the European Commission (EC) has not recognized U.S. CCPs as equivalent under the European Market Infrastructure Regulation (EMIR), as it reportedly plans to do for CCPs in other countries. U.S. CCPs that are not recognized as equivalent will not qualify as "qualifying" CCPs for purposes of Basel III risk-weighting for banking institutions.
- CFTC guidance, including the July 2013 "*Interpretative Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations*" (Interpretive Guidance) and a "Staff Advisory" issued in November 2013, which, taken together, "say that CFTC trading rules apply anytime and anywhere a U.S. Person is a party to a swaps trade or the trade is assisted from U.S. shores."
- The uncoordinated approach to the regulation of swaps execution, which has fragmented global markets. "Users of swaps products are choosing to do business with global financial institutions based more on the institution's regulatory jurisdiction than traditional factors such as quality of service, product expertise and historic relationship… Rather than controlling systemic risk, the fragmentation of global swaps markets into regional ones is increasing risk by Balkanizing pools of trading liquidity and market pricing."

To avoid further protectionism, Commissioner Giancarlo called for "a reset in the EU and CFTC cross-border regulatory relationship in the spirit of the Pittsburgh G-20 accord." He expects the CFTC, which has a new Chairman and three new Commissioners, to show increasing sensitivity to global concerns, as evidenced by the recent release of an advanced notice of proposed rulemaking that considered multiple approaches to the cross-border application of CFTC rules for margin for uncleared swaps. He also said that he would encourage the CFTC to replace its cross-border Interpretative Guidance with a formal rulemaking that recognizes outcomes-based substituted compliance for competent non-U.S. regulatory regimes, seek the withdrawal of the CFTC's November 2013 Staff Advisory, and encourage exploration of ways to enhance existing cooperation in the joint supervision of dual registrants.

CFTC Global Markets Advisory Committee to Hold Public Meeting

The U.S. Commodity Futures Trading Commission (CFTC) Global Markets Advisory Committee (GMAC) will hold a public meeting on October 9, 2014, in Washington, D.C. The meeting will focus on issues related to clearing Non-Deliverable Forwards (NDFs) and the digital currency bitcoin, each of which will be addressed by panels.

The first panel will discuss whether a clearing mandate is appropriate for NDFs, with a particular focus on how such a mandate would impact foreign exchange contracts. The second panel will discuss CFTC's jurisdiction with respect to derivatives contracts that reference the digital currency bitcoin.

SEC Announces Record Whistleblower Award

The Securities and Exchange Commission (SEC) announced that it expects to award more than $30 million to a whistleblower who provided key original information that led to a successful SEC enforcement action. The award will be the largest made by the SEC's whistleblower program and the fourth award to a whistleblower living in a foreign country. The previous high for an SEC award to a whistleblower was $14 million in October 2013. The SEC stated that the whistleblower reported an ongoing fraud that would have been very difficult to detect.

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 New York-based investment advisory firm with breaching its fiduciary responsibilities when it integrated two portfolio companies owned by different private equity funds the firm advised and then managed them as one company, using a joint management team that allocated administrative expenses in a way that resulted in one company paying more than its share of expenses. Without admitting or denying the findings, the company agreed to pay $1.5 million in disgorgement plus $358,112 in prejudgment interest and a $450,000 penalty.
- The SEC charged a Missouri-based investment advisory firm with failing to maintain adequate controls to prevent one of its employees from insider trading based on a customer's nonpublic information. The SEC also charged the firm for delaying its production of documents during the SEC's investigation and providing an altered internal document related to a compliance review of the broker's trading. The firm admitted wrongdoing and agreed to pay a $5 million penalty to settle the SEC's charges, which are

the first-ever against a broker-dealer for failing to protect a customer's material nonpublic information.

- The SEC charged a New-York based investment advisory and broker/dealer firm with failing to maintain an adequate internal compliance system after its wealth management business acquired the advisory business of failed firm. Without admitting or denying the findings, the firm agreed to pay a $15 million penalty and to undertake remedial measures, including engaging an independent compliance consultant to conduct an internal review.
- The SEC charged a Florida-based penny stock company and its CEO with defrauding investors in a pump and dump scheme and the illegal issuance of over 5 billion unrestricted company shares for which no registration statement was in effect. The CEO was also charged with insider trading. The SEC is seeking a permanent injunction, disgorgement, civil money penalties, penny stock bars, and an officer and director bar for the CEO. Separately, the SEC charged a New Jersey-based registrar and transfer company, and the company's CEO with failing to supervise firm employees who enabled the penny stock company's unregistered distribution of billions of purportedly unrestricted shares of its stock. Without admitting or denying the charges, the company agreed to pay disgorgement and a $100,000 penalty, and to engage an independent consultant. The firm's CEO agreed to pay a $25,000 penalty and to be suspended for 12 months from serving in a supervisory capacity with a transfer agent.
- The SEC charged a California company and two former executives with accounting fraud, alleging that they falsified timesheets to hit quarterly financial targets. The company agreed to pay $1.75 million to settle the SEC's charges that it violated the anti-fraud, books and records, and internal control provisions of the federal securities laws. The two executives consented to the finding that they violated anti-fraud provisions, falsified books and records and circumvented the company's internal controls. They each agreed to pay disgorgement and a penalty of $50,000. Separately, the SEC issued a cease and desist order against the founder and CEO of the company. Without admitting or denying the findings, he agreed to reimburse his former company $2,570,596 in bonuses and other incentive-based or equity-based compensation he received.
- The SEC suspended trading for nine different penny stocks as part of an ongoing enforcement initiative to combat microcap fraud. The action is intended to neutralize potential threats to investors because of a lack of current and accurate information about the companies.
- The SEC sanctioned an Arizona-based company for having inadequate internal controls surrounding revenue recognition, which led it to materially misstate its revenue, net income, and other financial metrics in certain of its annual and quarterly reports filed with the SEC and in certain of its earnings releases. The company settled the SEC's charges by paying a $750,000 penalty.
- The SEC charged the operators of a California-based Internet marketing and advertising company with operating an international pyramid scheme that raised more than $129 million from investors worldwide. The SEC obtained an asset freeze and issued a temporary restraining order. The SEC is seeking disgorgement and civil penalties.
- The SEC charged four insurance agents for unlawfully selling securities to elderly investors in several states in conjunction with operating a multi-million dollar fraud and soliciting funds without registering with the SEC as a broker-dealer. The SEC is seeking disgorgement and civil money penalties.
- The CFTC charged an Ohio-based commodity pool operator (CPO) and commodity trading advisor (CTA) and his company with fraudulently soliciting more than $8.3 million from at least 40 investors for pooling and trading in futures and options. The CFTC further alleges the CPO/CTA provided participants with false account statements; embezzled and misappropriated participants' funds; and acted as a CPO and CTA while failing to register

as such with the CFTC. The CFTC seeks restitution, disgorgement, civil monetary penalties, permanent registration and trading bans, and permanent injunctions.

- The CFTC charged a telemarketer and his Florida-based company for engaging in illegal, off-exchange transactions. The CFTC alleges that the telemarketer solicited transactions for a commodity firm, but that the company neither purchased nor delivered the commodities. The other firm was previously charged with engaging in illegal off-exchange transactions and fraud. Without admitting or denying the CFTC's findings, the telemarketer and his company agreed to jointly pay restitution totaling $162,487 to their customers and accept permanent registration and trading bans.
- The CFTC charged two individuals for exceeding the spot month speculative position limit for futures contracts traded on the Chicago Mercantile Exchange (CME). Without admitting or denying the charges, the two men settled with the CFTC and agreed to pay a $525,000 civil monetary penalty.
- The CFTC charged a New York-based Retail Foreign Exchange Dealer (RFED) and Futures Commission Merchant (FCM) for failing to meet the minimum financial requirements for RFEDs and FCMs, failing to supervise its employees, and failing to comply with a prior CFTC administrative order. The company agreed to pay a $600,000 civil monetary penalty and submit to a three-year registration ban as an FCM or RFED.
- The CFTC charged a former trader at a large futures commission merchant and provisionally registered swap dealer with fraud for intentionally executing unauthorized swap transactions on behalf of a customer in order to conceal trading losses of approximately $1.2 million. The CFTC seeks restitution, civil monetary penalties, permanent registration and trading bans, and a permanent injunction.
- The CFTC charged a Florida individual, who acted as a Futures Commission Merchant without registering with the CFTC, with engaging in 17 illegal, off-exchange transactions. The individual settled the charges by agreeing to pay restitution of $55,442 to customers and a $100,000 civil monetary penalty.
- The CFTC charged a foreign financial services entity for executing prearranged, noncompetitive trades of futures contracts with another foreign financial services entity, which was previously sanctioned for its role in these trades. Without admitting or denying the charges, the financial services entity agreed to pay a $150,000 civil monetary penalty. It also agreed to institute, update, and/or strengthen policies and procedures designed to detect, deter, discipline, and correct any potential prearranged, fictitious, or noncompetitive trading.
- The CFTC charged a Delaware-based depository services company for confirming the execution of the off-exchange transactions of a physical commodity trading firm that the CFTC charged earlier this year with violations of the *Commodity Exchange Act*. The depository services company settled the charges and agreed to pay $500,000 to the court to benefit victims of the commodity trading firm it charged earlier this year.

Recent Supervisory Actions against Financial Institutions

Last Updated: September 26, 2014

Agency	Institution Type	Action	Date	Synopsis of Action
CFPB and OCC	National Bank	Individual Consent Orders	09/25	The Consumer Financial Protection Bureau and the Office of the Comptroller of the Currency assessed financial penalties on a large financial services entity for unfair billing of identity theft protection products in violation of the *Federal Trade Commission Act*.
Federal Trade Commission	Nonbank Debt Collector	Complaint	09/23	The Federal Trade Commission charged a nonbank debt collector that used fictitious names and threatened consumers into paying debts they may not have owed in violation of the *Federal Trade Commission Act* (FTC Act) and *the Fair Debt Collection Practices Act* (FDCPA).
Federal Reserve Board	State Member Bank	Written agreement	09/19	The Federal Reserve entered into a written agreement with a Massachusetts-based state member bank to address an unauthorized cash dividend to shareholders. The Federal Reserve objected to the capital plan the bank submitted in January 2014.
CFPB	Nonbank Payday Lender	Complaint	09/17	The Consumer Financial Protection Bureau charged a Missouri-based payday lender with originating online payday loans without consumers' consent and debiting fees from their checking accounts in violation of the *Consumer Financial Protection Act*, the *Truth in Lending Act*, and the *Electronic Fund Transfer Act* (EFTA).
CFPB	Nonbank For-Profit Educational Institution	Complaint	09/16	The Consumer Financial Protection Bureau charged a California-based, publicly traded, for-profit college chain with operating an illegal predatory lending scheme in violation of the *Consumer Financial Protection Act* and the *Fair Debt Collection Practices Act*. .
Federal Reserve Board	State Member Bank	Civil Money Penalty	09/11	In two separate instances, the Federal Reserve Board issued an Order of Assessment of Civil Money Penalty against an Ohio-based state member bank to address violations of the *National Flood Insurance Act*.
Federal Reserve Board	State Member Bank	Consent Cease and Desist	09/09	The Federal Reserve Board entered into a Cease and Desist Order Upon Consent of a Pennsylvania-based state member bank to address deficiencies related to the bank's firmwide compliance program for Bank Secrecy Act/anti-money laundering requirements, including board oversight, BSA/AML compliance program reviews at the firmwide and bank levels, customer due diligence, suspicious activity reporting, and transaction review.
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.

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