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Recent Supervisory Actions

Safety & Soundness

Basel Committee Issues Proposal to Revise Standardized Approach for Measuring Operational Risk Capital

On October 6, 2014, the Bank for International Settlements' Basel Committee on Banking Supervision (BCBS or Basel Committee) issued a proposal to revise the standardized approach used to calculate their operational risk capital requirement. The consultative document proposes a new unitary standardized approach that would replace the current non-model-based approaches, including the Basic Indicator Approach (BIA), the Standardized Approach (TSA), and the Alternative Standardized Approach (ASA). In addition to streamlining the framework, the new approach is intended to address weaknesses identified in the existing approaches. The Basel Committee is accepting comments on the proposal until January 6, 2015.

The proposed approach would replace the current operational risk proxy of gross income with "a statistically superior measure," the Business Indicator (BI), which would be comprised of three macro-components of a bank's income statement: the "*interest component*," the "*services component*," and the "*financial component*." The proposal would also recalibrate the regulatory coefficients to incorporate a five-bucket structure with coefficients increasing in value with the rise in the value of the BI. The BCBS indicates that it will be collecting additional data to help validate the proposals.

Coincident with the release of the proposal, the Basel Committee published a paper entitled "*Review of the Principles for the Sound Management of Operational Risk*." The paper reviews banks' implementation of the "*2011 Principles for the Sound Management of Operational Risk*" (Principles), which sets out the Basel Committee's expectations for the management of operational risk.

Sixty systemically important banks in 20 jurisdictions were covered by the review and each of them answered a questionnaire assessing the extent and quality of their implementation. Results indicate that progress in implementing the Principles varies significantly across banks and that more work is needed to achieve full implementation. The four Principles (out of eleven) identified as among the least thoroughly implemented were: (1) operational risk identification and assessment; (2) change management; (3) operational risk appetite and tolerance; and (4) disclosure.

FSOC Discusses the Asset Management Industry and Proposed Changes to the Designation Processes

The Financial Stability Oversight Council (FSOC or Council) conducted closed and open session meetings on October 6, 2014. The Council announced that during the closed session the following items were considered:

- A discussion of its authority to designate nonbank systemically important financial institutions (SIFIs) under Section 113 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*.

- Certain proposed changes to the process for reviewing companies for potential designation. The Council directed staff to continue to review and evaluate these and other potential changes for further discussion.
- A vote to grant a request for an oral hearing by a nonbank financial company that is subject to a proposed SIFI designation.
- A discussion of the asset management industry, concentrating on areas of focus and potential risks, as well as processes for seeking input and evaluating information. An update on asset manager risk management policy initiatives was provided by the Securities and Exchange Commission.

The Council announced that the open session included a presentation on data gaps and data quality from the U.S. Department of the Treasury's Office of Financial Research, which addressed progress on and next steps for the Council's 2014 annual report recommendations to improve the quality of data available in the financial system.

Basel Committee Publishes Frequently Asked Questions Regarding Basel III Leverage Ratio

On October 7, 2014, the Bank for International Settlements' Basel Committee on Banking Supervision (BCBS or Basel Committee) published frequently asked questions (FAQs) on the Basel III leverage ratio.

The Basel Committee stated that it has received a number of questions since the January 2014 publication of the Basel III leverage ratio framework and the public disclosure requirements (which become applicable as of January 1, 2015). "To promote consistent global implementation of the requirements," the Basel Committee has agreed to periodically review frequently asked questions and publish answers along with any necessary technical elaboration of the standard or interpretative guidance. The FAQs on the leverage ratio framework are grouped according to the following relevant areas:

- Criteria for the recognition of cash variation margin associated with derivative exposures;
- Client-clearing of affiliated entities' trade exposures;
- Netting of securities financing transactions (SFTs);
- Netting for SFTs and derivatives in the presence of a cross-product netting agreement; and
- The exposure measure under the additional treatment for credit derivatives.

Federal Reserve Publishes Frequently Asked Questions Regarding Competitive Review for Bank Application Processes

On October 9, 2014, the Federal Reserve Board (Federal Reserve) released answers to frequently asked questions (FAQs) regarding the competitive review process for bank acquisitions, mergers, and other transactions. The FAQs, which were developed jointly with the Department of Justice, cover factors considered by both agencies in conducting competitive analysis for bank applications. They provide answers to questions raised by banking organizations considering filing applications and explain changes to the application process mandated by the *Dodd-Frank Wall Street Reform and Consumer Protection Act*.

The Federal Reserve and the Department of Justice are required to analyze bank merger applications to ensure, in part, that the proposed transactions do not raise competitive concerns. The Federal Reserve has the authority to deny applications on these or certain other grounds, while the Department of Justice can use its prosecutorial discretion to challenge specific applications that raise competitive concerns.

OCC Reports Loan Growth Accelerates Among Southern District Community Banks and Thrifts

On September 30, 2014, the Office of the Comptroller of the Currency (OCC) reported improving conditions among national banks and federal savings associations (FSAs) in the nine states that make up the OCC's Southern District.

The OCC stated the strength of institutions in the Southern District continues to improve to near pre-crisis levels, and the decline in the number of problem institutions is accelerating. The OCC also stated, however, that the search for revenue and yield in the protracted low-rate environment presents "significant strategic challenges." It cautioned banks about assuming significant interest rate risk or seeking other efficiencies and cost-cutting measures that could weaken risk management controls at the same time cybersecurity and other fraud threats are increasing. The OCC also said underwriting standards continue to be pressured by competition.

Enterprise & Consumer Compliance

CFPB Forum Focuses on Checking Account Screening Reports

The Consumer Financial Protection Bureau (CFPB or Bureau) conducted a Forum on October 8, 2014, entitled "*Access to Checking Accounts*." CFPB Director Richard Cordray provided remarks, which were focused on the screening processes banks use when opening new checking accounts. In particular, he discussed the reports provided to banks by specialty consumer reporting agencies and identified concerns with:

- The accuracy of the information contained in the reports;
- The ability of consumers to access the reports and dispute incorrect information; and
- The ways in which the reports are being used.

Director Cordray stated that reports by specialty consumer reporting agencies primarily focus on derogatory information about a consumer, such as charge-off amounts, past non-sufficient funds activity, unpaid or outstanding bounced checks, overdrafts, involuntary account closures, and fraud. He suggested the information was impaired by inconsistencies and imperfections that can influence the screening decisions for consumers.

To address these issues, Director Cordray said the Bureau intends to:

- Understand what procedures the specialty consumer reporting agencies follow and what alternatives are possible.
- Learn how improvements in the way information is furnished to specialty consumer reporting agencies, and how that information is processed and reported by those agencies, can result in greater consistency and quality in the consumer reports used for checking account screening.
- Explore whether better data might enable a financial institution to make more nuanced decisions in account screening rather than simply reaching a "yes or no" result.

- Explore how consumers are getting information about their right to obtain copies of their reports from specialty consumer reporting agencies and to what extent they are exercising those rights.
- Understand how consumers are obtaining information about their right to dispute information in those reports and how they exercise those dispute rights.
- Learn how the screening system could be used to help institutions better meet the needs of consumers, rather than excluding them from the banking system altogether.

In closing, Director Cordray said, "We need to move from screening processes designed to make banks safe from consumers to ones designed to make them safe for consumers."

CFPB Takes Enforcement Action against a State Bank for Deceptive Practices Related to Checking Accounts

The Consumer Financial Protection Bureau (CFPB or Bureau) announced on October 9, 2014, that it had taken an enforcement action against a bank for deceptive advertising, marketing, and promotion practices related to the offering of "free" checking accounts. The CFPB found the bank failed to disclose key eligibility requirements for the "free" checking accounts and automatically converted customers that failed to meet the requirements to checking accounts with fees.

The related consent order requires the bank to:

- Refund \$2.9 million to approximately 59,000 consumers charged "monthly maintenance fees" for their converted accounts;
- Update information furnished to credit reporting agencies on accounts that were closed due to negative balances; and
- Pay a \$200,000 civil money penalty.

FDIC Event to Focus on Implementation of Qualified Mortgage and Loan Originator Compensation Rules

On October 8, 2014, the Federal Deposit Insurance Corporation (FDIC) issued Financial Institution Letter 52-2014, advising FDIC-supervised institutions that it will hold a teleconference to discuss common questions and answers pertaining to implementation of the Consumer Financial Protection Bureau's (CFPB) final rules governing Ability-to-Repay/Qualified Mortgage (ATR/QM) and the Loan Originator Compensation. The teleconference is scheduled for October 22, 2014 and registration is requested by October 20, 2014.

Capital Markets & Investment Management

SEC Risk Alert and FAQs Address Broker-Dealer Obligations When Engaging in Unregistered Transactions on Behalf of Customers

On October 9, 2014, the Securities and Exchange Commission (SEC) announced publication of a Risk Alert and frequently asked questions (FAQs) to remind broker-dealers of their obligations when they engage in unregistered transactions on behalf of their customers. The guidance was accompanied by the announcement of an enforcement action against two firms for improperly selling billions of shares of penny stocks through such unregistered offerings.

The Risk Alert summarizes deficiencies that were discovered by the SEC's Office of Compliance Inspections and Examinations (OCIE) during a targeted sweep of 22 broker-dealers involved in the sale of microcap securities. Of the 22 firms examined, more than 80 percent were issued letters of deficiency for material control weaknesses and/or potential violations of law. A majority of the firms examined were also referred to the Division of Enforcement or another regulatory agency for further consideration of whether violations of law occurred.

Deficiencies uncovered during the sweep include:

- Insufficient policies and procedures to monitor for and identify potential red flags in customer-initiated sales.
- Inadequate controls to evaluate how customers acquired the securities and whether they could be lawfully resold without registration.
- Failure to file suspicious activity reports, as required by the *Bank Secrecy Act* (BSA), when encountering unusual or suspicious activity in connection with customers' sales of microcap securities.

The five FAQs remind broker-dealers of their obligation to conduct "reasonable inquiry" when selling securities in an unregistered transaction in reliance on Section 4(a)(4) of the *Securities Act*. The FAQs are not rules, regulations, or statements of the SEC.

FINRA Announces Updates of the Interpretations of Financial and Operational Rules

The Financial Industry Regulatory Authority (FINRA) issued Regulatory Notice 14-38 on October 6, 2014, announcing that it is updating the imbedded text of *Securities Exchange Act* (SEA) financial responsibility rules for broker-dealers in the *Interpretations of Financial and Operational Rules* to reflect the effectiveness of amendments the SEC adopted. The updated imbedded text relates to SEA Rules 15c3-1, 15c3-1a, 15c3-1e, 15c3-1f, 15c3-1g, 15c3-3a and 17a-4. FINRA is also making available related updates of *the Interpretations of Financial and Operational Rules* that have been communicated to FINRA by the staff of the SEC's Division of Trading and Markets. The updated interpretations relate to SEA Rule 15c3-1.

FINRA Study Highlights Vulnerability of Renters

On October 9, 2014, the Financial Industry Regulatory Authority (FINRA) Investor Education Foundation released a new study entitled *"American Renters and Financial Fragility,"* which reveals that renters:

- Tend to be less financially stable than homeowners;
- Have lower rates of financial literacy; and
- Are more likely to experience a large drop in income.

Findings of the study suggest that, given their financial fragility and low levels of financial literacy, the renter population could have a difficult time responding to income shocks and the financial consequences associated with them. The study is based on an examination of data from the Investor Education Foundation's National Financial Capability Study (State-by-State Survey), which was developed in consultation with the U.S. Department of the Treasury, other federal agencies, and the President's Advisory Council on Financial Capability.

OCC Releases Quarterly Report on Bank Trading and Derivatives Activities

The Office of the Comptroller of the Currency (OCC) released its *Quarterly Report on Bank Trading and Derivatives Activities* for the second quarter of 2014 on October 9, 2014.

Highlights of the report show:

- Trading revenue reported by insured U.S. commercial banks and savings associations increased four percent over the first quarter of 2014 though was ten percent lower than the amount of trading revenue reported in the second quarter of 2013.
- Trading revenue for the first six months of 2014 was fourteen percent less than in the first half of 2013.
- Net Current Credit Exposures (NCCE) from derivatives increased three percent during the second quarter and banks hold collateral to cover 82 percent of their NCCE. NCCE had previously fallen by 27 percent over the prior seven quarters.
- The notional amount of derivatives held by insured U.S. commercial banks increased three percent from the first quarter. Trading risk exposure, as measured by average value-at-risk (VaR), resumed a downward trend in the second quarter (average quarterly VaR at the top five dealer banking companies fell ten percent).
- Receivables from interest rate contracts increased six percent due to lower market interest rates during the second quarter.
- Derivative contracts are concentrated in a small number of institutions where the largest four banks hold 92 percent of the total notional amount of derivatives.
- Derivative contracts are concentrated in interest rate products, which represent 81 percent of total derivative notional values.
- Credit default swaps are the dominant product in the credit derivatives market, representing 96 percent of total credit derivatives.

SEC, FINRA, and MSRB to Hold Compliance Outreach Program for Municipal Advisors

The Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA), and the Municipal Securities Rulemaking Board (MSRB) on October 1, 2014, opened registration for the first Compliance Outreach Program for Municipal Advisors that will take place in Chicago, Illinois, on November 3, 2014. The SEC's Office of Compliance Inspections and Examinations, in coordination with the SEC's Office of Municipal Securities, is partnering

with FINRA and the MSRB to sponsor the program, which is intended to provide municipal advisor professionals a forum for discussions with regulators about risk management, regulatory issues, and compliance practices.

Enforcement Actions

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

- The CFTC issued an emergency Order freezing and preserving assets under the control of two individuals who operated a Florida-based commodity pool. A previous CFTC complaint alleges the individuals misappropriated more than \$1 million of customer funds. The CFTC is seeking restitution, disgorgement, civil monetary penalties, permanent registration and trading bans, and a permanent injunction.
- The CFTC charged a foreign Futures Commission Merchant (FCM) for a secured amount deficiency of approximately \$240,000. The CFTC also charged the FCM with commingling customer funds with its proprietary funds, and failure to timely notify the CFTC of the secured amount deficiency. Without admitting or denying the findings, the FCM agreed to pay a \$70,000 civil monetary penalty.
- The SEC charged current and former broker-dealer subsidiaries of a nonbank financial services entity for failing in their gatekeeper roles and improperly engaging in unregistered sales of microcap stocks on behalf of customers. Without admitting or denying the findings, the companies agreed to settle the charges by paying more than \$1.5 million in disgorgement and prejudgment interest from commissions earned on the improper sales and by paying a combined penalty of \$1 million.

Recent Supervisory Actions against Financial Institutions

Last Updated: October 10, 2014

Agency	Institution Type	Action	Date	Synopsis of Action
CFPB	State Member Bank	Consent Order	10/09	The Consumer Financial Protection Bureau entered into Consent Order with a New York-based state member bank to address its findings the bank engaged in deceptive advertising, marketing, and promotion practices related to the offering of “free” checking accounts
CFPB	Title Insurance Agency	Consent Order	09/30	The Consumer Financial Protection Bureau announced that it had assessed financial penalties on an insurance agency for entering into quid pro quo agreements with companies that referred business to its mortgage closings and title insurance businesses in violation of the <i>Real Estate Settlements and Procedures Act</i> .
CFPB	Federal Savings Bank	Consent Order	09/29	The Consumer Financial Protection Bureau assessed financial penalties on a federal savings bank and loan servicer related to its default servicing practices that violated the loss mitigation provisions of the <i>Real Estate Settlement Procedures Act</i> . Mortgage Servicing Rule.
FDIC	State Nonmember Bank	Consent Order	09/29	The Federal Deposit Insurance Corporation assessed financial penalties on a financial services entity for unfair and deceptive practices related to marketing and servicing of credit card add-on products, in violation of the <i>Federal Trade Commission Act</i> .
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 <i>Federal Trade Commission Act</i> .
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 <i>Federal Trade Commission Act</i> (FTC Act) and the <i>Fair Debt Collection Practices Act</i> (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 <i>Consumer Financial Protection Act</i> , the <i>Truth in Lending Act</i> , and the <i>Electronic Fund Transfer Act</i> (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 <i>Consumer Financial Protection Act</i> and the <i>Fair Debt Collection Practices Act</i> .

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