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The Washington Report

for the week ended February 6, 2015

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Safety & Soundness

Financial Stability Oversight Council Announces Changes to Nonbank Designations Process

At its meeting on February 4, 2015, the Financial Stability Oversight Council (FSOC) voted to adopt certain changes and to formalize certain practices related to its processes for reviewing nonbank financial companies for potential designation as systemically important. Nonbank financial companies designated by the FSOC as systemically important are subject to consolidated supervision by the Federal Reserve Board and enhanced prudential standards.

Under the changes, which are effective immediately, the FSOC will:

- Inform companies "earlier" (i.e., when they come under active review during Stage 2 of the designation process) and provide additional opportunities for companies and their regulators to engage with FSOC and staff.
- Make "more information" available to the public about its designations work, while continuing to protect sensitive, nonpublic information. The FSOC states that it intends to publish additional information on how the Stage 1 thresholds are calculated, which may include: how various accounting standards are evaluated, components of the six Stage 1 thresholds, and practices for calculating the thresholds when incomplete data are available.
- Provide a "clearer and more robust" process for the FSOC's annual review of its designations, including more engagement between designated companies and the FSOC along with "ample opportunity" for companies to present information.

The FSOC stated that in the future it may consider other proposals for changes to the designations process that strengthen its ability to identify and address potential risks to financial stability.

Separately, FSOC voted to extend by 30 days the deadline on its notice seeking public comment regarding potential risks to U.S. financial stability from asset management products and activities. The deadline is now March 25, 2015.

FFIEC Updates Business Continuity Planning Booklet to Include Guidance on Third-Party Service Providers

On February 6, 2015, the Federal Financial Institutions Examination Council (FFIEC) issued a revised Business Continuity Planning Booklet (BCP Booklet) that contains a new appendix entitled *Strengthening the Resilience of Outsourced Technology Services.* The BCP Booklet is part of the FFIEC's *Information Technology Examination Handbook* (IT Handbook).

The appendix highlights that a financial institution's reliance on third-party service providers to perform or support critical operations does not relieve a financial institution of its responsibility to ensure that outsourced activities are conducted in a safe and sound manner. It states that an effective third-party management program should provide the framework for financial institution management to identify, measure, monitor, and mitigate the risks associated with outsourcing. It highlights and strengthens the BCP Booklet in four specific areas:

- Third-Party Management;
- Third-Party Capacity;
- Testing with Third-Party Technology Service Providers; and
- Cyber Resilience.

The BCP Booklet contains guidance to assist examiners in evaluating financial institution and service provider risk management processes to ensure the availability of critical financial services. The booklet also was designed to provide guidance to financial institutions about the implementation of their business continuity planning processes.

Office of Financial Research Launches New Web Site

On February 3, 2015, the U.S. Department of the Treasury's (Treasury Department) Office of Financial Research (OFR) launched a stand-alone Web site where it intends to make public its work on assessing and monitoring threats to financial stability and to serve as a vehicle for OFR's emerging research-and-data virtual community.

OFR Director Richard Berner stated that by having a Web site that is separate from the Treasury Department Web site, the OFR will be easier to find online and therefore increase the transparency of its work. The new Web site features a "Director's Blog" and blogs by other members of OFR's management team. It also contains expanded information about OFR's initiatives to fill gaps in financial data and improve data quality. OFR intends to add interactive graphics and downloadable data that Director Berner said "will be thought-provoking and useful for our broad spectrum of stakeholders, from academics and researchers, to members of Congressional staffs, the news media, and the public."

The OFR was established by the *Dodd-Frank Wall Street Reform and Consumer Protection Act* to provide research, data, and analysis for the benefit of the Financial Stability Oversight Council (FSOC), Council member agencies, Congress, and the public.

Basel Committee Seeks Comment on Guidance for Sound Credit Risk Practices Associated with Implementing and Applying an Expected Credit Loss Accounting Framework

On February 2, 2015, the Bank for International Settlements' Basel Committee on Banking Supervision (Basel Committee) issued a consultative document that outlines supervisory expectations regarding sound credit risk practices associated with implementing and applying an expected credit loss (ECL) accounting framework. The document is intended to replace the June 2006 supervisory guidance entitled, *Sound Credit Risk Assessment and Valuation for Loans*, which was based on the incurred-loss model of accounting.

As proposed, the revised guidance is structured around 11 principles and is intended to promote high-quality, robust and consistent implementation of ECL accounting frameworks across all jurisdictions. In particular, it:

- Sets forth supervisory expectations for ECL accounting that are consistent with the applicable accounting standards established by the IASB and other standard setters; and
- Presents the Basel Committee's view of the robust application of those standards, including circumstances in which the Basel Committee expects internationally active banks to limit their use of particular simplifications and/or practical expedients included in the relevant accounting standards.

The Basel Committee will accept comments on the consultative document through April 30, 2015.

Joint Forum Seeks Comment on Credit Risk Management Report and Recommendations

On February 5, 2015, the Joint Forum released a consultative paper entitled *Developments in credit risk management across sectors: current practices and recommendations*. The paper summarizes the results of a survey conducted by the Joint Forum to better understand the current state of credit risk management in the banking, securities, and insurance sectors given the significant market and regulatory changes since the 2008 financial crisis. The survey is also intended to provide insight into the current supervisory framework around credit risk, the state of credit risk management at firms, and implications for the supervisory and regulatory treatments of credit risk. Fifteen supervisors and 23 firms from Europe, North America, and Asia responded to the survey.

Based on its analysis of the survey responses and subsequent discussions with firms, the Joint Forum made four recommendations for consideration by supervisors, highlighting issues associated with:

- Overreliance on internal models for credit risk management and regulatory capital;
- The growth of risk-taking behaviors and the resulting need for firms to have appropriate risk management processes;
- A growing need for high-quality liquid collateral to meet margin requirements for over-the-counter derivatives sectors; and
- The accuracy of firms in capturing central counterparty exposures as part of their credit risk management process.

Comments on the consultative paper and recommendations of the Joint Forum as requested by March 4, 2015. The Joint Forum was established in 1996 under the aegis of 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 financial conglomerates.

Enterprise & Consumer Compliance

CFPB and U.S. Department of Education Announce Student Loan Forgiveness Agreement with New Owner of For-Profit Colleges

On February 3, 2015, the Consumer Financial Protection Bureau (CFPB or Bureau) and the U.S. Department of Education announced that it had reached a settlement that will provide more than $480 million in debt relief for private student loans obtained by current and former students of a group of privately operated for-profit colleges. The CFPB estimates the debt relief will result in an immediate 40 percent reduction in the students' principal balances.

The CFPB had charged the former owner of those colleges with, among other things, false advertising regarding its career services and using illegal tactics to collect student debts. Many of those colleges are now under the ownership of a new company that, in addition to the debt relief, has agreed to provide a series of new consumer protections including:

- Ensuring that the third-party holder of these student loans follows certain guidelines in collecting on the loans, for example, implementing a ban on suing or threatening to sue any borrower;
- Directing the deletion of any negative reporting information that currently exists on credit reports related to these loans; and
- Providing flexible withdrawal policies and clear information on job prospects.

The new company also agreed that it will not operate a private student loan program for seven years.

In conjunction with the agreement, the CFPB published a Consumer Bulletin with information for current and former students of the colleges impacted by the agreement.

CFPB Charges Company with UDAAP Violations

On February 3, 2015, the Consumer Financial Protection Bureau (CFPB or Bureau) announced that it has asked a federal district court to enter a Consent Order permanently banning a Texas-based company from offering any consumer financial products or services. In December 2014, the Bureau had charged the company with using unfair, deceptive, or abusive acts or practices (UDAAP), in violation of the *Consumer Financial Protection Act* and the *Fair Credit Reporting Act* in connection with its offering of credit. Without admitting or denying the CFPB's allegations, the company agreed to pay a $70,000 penalty.

The CFPB alleged that the company sold a buying-club membership card that it falsely advertised as a general-purpose credit card when, in fact, the card could only be used to buy products from the company. The Bureau also alleged that most consumers never used the membership card, but were not able to recoup their membership fees. The CFPB further alleged that the company deceptively implied an affiliation with unions by, among other things, using pictures of nurses, firefighters, and other public servants in its advertising.

Separately, the company has been sued by multiple government authorities, including the New York State Attorney General and the U.S. Postal Service.

CFPB Orders Subprime Credit Card Company to Refund Illegal Credit Card Fees

The CFPB charged a subprime credit card originator, marketer, and servicer with engaging in deceptive acts or practices in violation of the *Consumer Financial Protection Act* for: misrepresenting certain fees paid in connection with its credit cards, and misrepresenting that certain security deposits would be "FDIC-insured." The CFPB also charged that the company violated the *Truth in Lending Act* (TILA) by requiring certain consumers to pay fees exceeding the required limits set for the first year after account opening. Without admitting or denying the CFPB's findings, the company agreed to settle the charges and refund an estimated $2.7 million to approximately 98,000 individuals who were charged illegal credit card fees. The company also was ordered to pay a $250,000 civil penalty.

The terms of the agreement require the company to be subject to the CFPB's supervisory authority for the first time and for the duration of the Consent Order. This authority can include examinations of the company as well as monitoring by the Bureau for compliance with consumer financial protection laws.

Insurance

NAIC Forms Cybersecurity Task Force

Officers and the leadership of the National Association of Insurance Commissioners (NAIC) identified cybersecurity in the insurance sector as a key initiative for 2015, and have announced the creation of a new Cybersecurity (EX) Task Force to monitor emerging cyber risks, their impact on the industry, and the potential for regulatory action. The task force will coordinate NAIC efforts regarding the protection of information housed in insurance departments and the NAIC; the protection of consumer information collected by insurers; and monitoring the cyber-liability market. The group will report and make recommendations to the NAIC Executive Committee.

IAIS Launches Thematic Self-Assessment and Peer Review on Market Conduct

On February 5, 2015, the International Association of Insurance Supervisors (IAIS) launched a self-assessment and peer review survey on Market Conduct that addresses Insurance Core Principles 18 (Intermediaries) and 19 (Conduct of Business – insurers and intermediaries). The IAIS has requested that responses to the online survey be submitted by March 2, 2015.

Capital Markets and Investment Management

FINRA Issues Proposal to Require ATS to Submit Quotation Information Relating to Fixed Income Securities

On February 6, 2015, the Financial Industry Regulatory Authority (FINRA) issued Regulatory Notice 15-03 to propose that alternative trading systems (ATS) be required to submit quotation information for corporate and agency debt securities. The fixed income quotation information reported to FINRA would not be publicly disseminated and would be used solely for regulatory and surveillance purposes. As proposed, the rule would apply only to ATS that display quotations in fixed-income securities and would require them, on a weekly basis, to provide FINRA with quotation information for TRACE-eligible corporate and agency debt securities. Quotation information for other fixed income products, such as securitized products, would not be required. FINRA requests that comments on the proposal be submitted by April 7, 2015.

FINRA Publishes Report on Cybersecurity

On February 3, 2015, the Financial Industry Regulatory Authority (FINRA) published a report entitled, *Report on Cybersecurity Practices*. It draws, in part, from the results of FINRA's 2014 targeted examination (sweep) of a cross-section of firms. The sweep focused on the types of threats that firms face, areas of vulnerabilities in their systems, and firms' approaches to managing these threats.

The report indicates that the frequency and sophistication of cyber-attacks is increasing, and it recommends that individual broker-dealers, and the industry make responding to these threats a high priority as breaches at a broker-dealer could result in "adverse implications for investors, firms, capital markets and even broader swaths of the financial system." The report is intended to assist firms in that effort by detailing practices that firms can tailor to their business model to strengthen their cybersecurity efforts.

According to both FINRA's 2014 sweep and its earlier survey of firms conducted in 2011, broker-dealers identified the top three threats as:

- Hackers penetrating firm systems;
- Insiders compromising firm or client data; and
- Operational risks.

Coincident with the report, FINRA issued a new Investor Alert entitled *Cybersecurity and Your Brokerage Firm*, which encourages investors to understand their firm's cybersecurity policies. It includes a series of questions investors can ask to help them better understand their firm's cybersecurity activities and policies, as well as practical advice to help investors safeguard their brokerage accounts and personal financial information.

SEC Addresses Cybersecurity in Two Publications

The Securities and Exchange Commission (SEC) on February 3, 2015, released two publications—a Risk Alert and an Investor Bulletin – that address cybersecurity at brokerage and advisory firms and provide suggestions to investors on ways to protect their online investment accounts.

The Risk Alert from the SEC's Office of Compliance Inspections and Examinations (OCIE) contains observations based on examinations of more than 100 broker-dealers and investment advisers. The examinations focused on how these firms:

- Identify cybersecurity risks;
- Establish cybersecurity policies, procedures, and oversight processes;
- Protect their networks and information;
- Identify and address risks associated with remote access to client information, funds transfer requests, and third-party vendors; and
- Detect unauthorized activity.

The Investor Bulletin, issued by the SEC's Office of Investor Education and Advocacy (OIEA), provides basic tips to help investors safeguard their online investment accounts.

CFTC Extends Public Comment Deadline for Registration Applications of a Derivatives Clearing Organization and Swap Execution Facility

On February 4, 2015, the U.S. Commodity Futures Trading Commission (CFTC) announced it is extending the deadline for public comment on related applications submitted by LedgerX, LLC (LedgerX), for registration as a derivatives clearing organization and registration as a swap execution facility. The original comment period ended on January 30, 2015, but due to commenters' requests for additional time, the CFTC is extending the deadline to February 20, 2015. LedgerX plans to list and clear fully collateralized, physically settled options on bitcoins.

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 stock research analyst, a corporate insider, and two other individuals involved in a California-based insider trading ring that generated nearly $750,000 in illegal profits by trading in advance of four corporate news announcements. Without admitting or denying the allegations, all four individuals agreed to settle the SEC's charges by paying more than $1.6 million combined in disgorgement, prejudgment interest, and penalties. The stock research analyst was barred from the securities industry and from participating in penny stock offerings. The corporate insider agreed to be barred from serving as an officer or director of a public company for 10 years.
- The SEC charged an Illinois-based company, its former CEO, and its CFO for accounting and disclosure violations as a result of their failure to record and disclose a $58 million impairment charge prior to a public offering. Without admitting or denying the SEC's allegations, they settled the charges. The company agreed to pay a $1 million penalty, and the former CEO and CFO agreed to pay nearly $700,000 in combined disgorgement and penalties.
- The SEC imposed sanctions against four foreign-based accounting firms that had refused to turn over documents related to investigations of potential fraud. The firms are members of large international networks of accounting firms and registered with the Public Company Accounting Oversight Board. The firms each agreed to pay $500,000 and admit that they did not produce documents before the proceedings were instituted. In agreeing to settle the charges, the firms did not admit or deny other findings in the SEC's order but did agree to submit to additional remedial measures if future document productions fail to meet specified criteria.
- The CFTC announced that a U.S. District Court entered an emergency restraining Order freezing assets and prohibiting the destruction or concealment of books and records of two individuals and their California-based companies. The Order follows a CFTC complaint charging them with precious metals and futures fraud, misappropriation, engaging in illegal off-exchange precious metals transactions, and registration violations. The CFTC is seeking restitution, disgorgement, civil monetary penalties, trading and registration bans, and a permanent injunction.
- The CFTC charged an Ohio-based financial institution with mishandling the customer segregated funds accounts of a futures commission merchant (FCM) customer. The CFTC alleged the institution improperly held and used the segregated funds account by treating the account like a regular business checking account, thereby allowing the FCM

to withdraw customer money for non-customer purposes. To settle the CFTC charges the institution agreed to a permanent injunction and to pay $18 million in restitution to the customers of the FCM.

- The CFTC charged a Florida-based company and its owner with engaging in illegal off-exchange transactions. They agreed to settle the CFTC charges by jointly paying restitution totaling more than $320,000 and a $200,000 civil monetary penalty and accepting permanent trading and registration bans.
- The CFTC charged two individuals and their companies, both based in Florida, with engaging in illegal, off-exchange transactions. Without admitting or denying the CFTC's findings, they settled the CFTC charges and agreed to jointly pay restitution of approximately $1,596,000 to their customers and a $1 million civil monetary penalty. They also agreed to permanent registration and trading bans.

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