The Washington Report

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Safety & Soundness

Federal Reserve Chair Yellen Discusses State of Financial Regulation

In a May 6, 2015, address at a conference sponsored by the Institute for New Economic Thinking, Federal Reserve Board Chair Janet L. Yellen broadly discussed the incentives in the financial sector that contributed to the build-up of risk in advance of the financial crisis and the supervisory and regulatory actions being taken to realign those incentives. In discussing "where we stand" today, Chair Yellen stated:

- "We and other supervisory agencies have made significant progress in addressing incentive problems within the financial sector, especially within the banking sector."
- "Policymakers, including those of us at Federal Reserve, remain watchful for areas in need of further action or in which the steps taken to date need to be adjusted."
- "Engagement with the broader public is crucial to ensuring that any future steps move our financial system closer to where it should be. Active debate and discussion of these issues is important to improve our understanding of the challenges that remain."

Comptroller Discusses OCC Proposals to Ease Regulatory Burden on Community Banks

In a May 4, 2015, address at the Interagency Outreach Meeting on *The Economic Growth and Regulatory Paperwork Reduction Act,* Comptroller of the Currency Thomas J. Curry said he is hopeful that Congress, in its current legislative session, will advance three Office of the Comptroller of the Currency (OCC) proposals to ease the regulatory burden on community banks:

- Raise the asset threshold from $500 million to $750 million for banks to qualify for the 18-month examination cycle.
- Exempt banks and thrifts with less than $10 billion in assets from compliance with the Volcker Rule.
- Authorize a basic set of powers that both federal savings associations and national banks can exercise, regardless of their charter, so that savings associations can change business strategies without moving to a different charter.

Comptroller Curry also encouraged community banks to trim costs through collaborative efforts on loan participations and community bank development activities as well as on accounting, clerical support, employee benefit planning and other expenses. He recommended the OCC's paper on the subject, which is entitled, "An Opportunity for Community Banks: Working Together Collaboratively."

U.S. House Committee on Financial Services Subcommittees to Hold Hearings

On May 13, 2105, the U.S. House Committee on Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing entitled "Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens, Part II." Also on May 13, 2015, the U.S. House Committee on Financial Services Subcommittee on Oversight and Investigations will hold a hearing entitled, "The Dodd-Frank Act and Regulatory Overreach."

Enterprise & Consumer Compliance

CFPB Publishes Data Point Report on Consumers with Limited or No Credit Histories

On May 5, 2015, the Consumer Financial Protection Bureau (CFPB or Bureau) Office of Research published a report entitled "Data Point: Credit Invisibles," which documents the results of a research project undertaken to better understand how many consumers are "credit invisible" (that is, do not have credit records with the three nationwide credit reporting agencies (NCRAs)) or have unscored credit records (records that contain insufficient credit histories to generate a credit score), as well as the demographic characteristics of such consumers. Key findings highlighted in the report, which was based on December 2010 data, include:

- Twenty-six million consumers, or approximately one in every 10 adults, do not have any credit history with an NCRA. An additional 19 million consumers have credit records that are unscored.
- African American and Hispanic consumers, as well as consumers in low-income neighborhoods are more likely to have no credit history with an NCRA or not enough current credit history to produce a credit score.

Capital Markets and Investment Management

IOSCO Consults on Sound Practices at Large Intermediaries for Assessing Credit Risk

On May 7, 2015, the International Organization of Securities Commissions (IOSCO) published on its Web site the consultation report "Sound Practices at Large Intermediaries: Alternatives to the Use of Credit Ratings to Assess Creditworthiness." The report proposes 13 sound practices for large market intermediary firms to consider in the implementation of their internal credit assessment policies and procedures.

IOSCO stated that identifying sound practices regarding the suitable alternatives to credit ratings for assessing credit risk is expected to reduce the potential overreliance of large intermediaries on credit rating agencies (CRAs). In turn, this reduction would help increase investor protection, while contributing to market integrity and financial stability.

IOSCO also stated that regulators could consider these sound practices as part of their oversight of market intermediaries and that large market intermediary firms may find these sound practices useful in the development and implementation of effective alternative methods for the assessment of creditworthiness.

The sound practices are based on a study of the current practices used by large market intermediary firms for assessing credit risk without mechanistically relying on CRAs. Comments are requested on or before July 8, 2015.

SEC Approves Pilot to Assess Tick Size Impact for Smaller Companies

On May 6, 2015, the Securities and Exchange Commission SEC) approved a proposal by the national securities exchanges and the Financial Industry Regulatory Authority (FINRA) to initiate a two-year pilot program that would widen the minimum quoting and trading increments–or tick sizes–for stocks of some smaller companies. The SEC intends to use the pilot program, which will begin on May 6, 2016, to assess whether wider tick sizes enhance the market quality of these stocks for the benefit of issuers and investors.

The SEC modified several provisions of the proposal submitted by the exchanges and FINRA to take into account input from commenters. These changes included:

- Extending the pilot to two years rather than one;
- Removing the venue limitation from the trade-at prohibition that would have required price matching executions to occur where the person's quotation was displayed;
- Reducing the size of block transactions eligible for the exception to better reflect trading in smaller-cap stocks;
- Modifying the market capitalization threshold for securities included in the tick size pilot; and
- Revising certain data elements concerning market maker profitability to make the collection less burdensome and assure the protection of confidential business information.

The tick size pilot will include stocks of companies with $3 billion or less in market capitalization, an average daily trading volume of one million shares or less, and a volume weighted average price of at least $2.00 for every trading day. The pilot will consist of a control group of approximately 1,400 securities and three test groups with 400 securities in each selected by a stratified sampling. Initial assessments on the tick size pilot's impact will be prepared by the exchanges and FINRA 18 months after the pilot begins based on data generated during the first 12 months of its operation.

OFR Publishes Paper Examining High-Frequency Trading and Large Datasets

On May 5, 2015, the Office of Financial Research (OFR) published a paper that it funded through its joint grant program with the National Science Foundation (NSF). The paper, entitled "Tick Size Constraints, High-Frequency Trading, and Liquidity," discusses the impact on the financial system of trading activity at the nanosecond level. The paper is intended to contribute to developing technologies for working with large datasets and foster a better understanding of market liquidity.

IOSCO Publishes Results of Its Anti-Fraud Messaging Survey

On May 6, 2015, the International Organization of Securities Commissions (IOSCO) published the results of its Survey on Anti-fraud Messaging. The survey, based on a fact-finding survey of the members of IOSCO´s Committee on Retail Investors, describes strategies used by some securities market regulators to educate individual investors about how to protect themselves against investment fraud. The report is intended to provide information and examples of strategies that may help other IOSCO members identify effective methods of educating investors about investment fraud. The survey is available on the IOSCO Web site.

CFTC Issues Staff Letter Regarding Captive Finance Companies Eligibility for End-User Exception

The U.S. Commodity Futures Trading Commission's (CFTC) Division of Clearing and Risk (Division) published CFTC Staff letter 27-2015 on May 4, 2015, interpreting Section 2(h)(7)(C)(iii) of the *Commodity Exchange Act* (CEA) to clarify that a securitization special purpose vehicle that is wholly-owned by, and consolidated with, an entity described in Section 2(h)(7)(C)(iii) of the CEA qualifies as a captive finance company and, therefore, is eligible to elect the end-user exception from a clearing requirement determination issued by the Commission under Section 2(h) of the CEA. This letter responds to letters that the Division received from finance divisions of several automobile manufacturers.

SEC Offers Program to Help Firms Comply with Regulation SCI

The Securities and Exchange Commission (SEC) announced on May 5, 2015, that it has opened registration for outreach programs to help firms comply with an SEC rule that aims to protect investors by strengthening the technology underpinning U.S. securities markets. Registration is available on the SEC Web site.

The SEC adopted Regulation Systems Compliance and Integrity, or Regulation SCI, in November 2014 and compliance with many of its requirements begins this fall. Those subject to Regulation SCI are required to have comprehensive policies and procedures for their technological systems, conduct business continuity testing, annually review their automated systems and take appropriate corrective action when system issues occur.

CFTC Chair Discusses Margin Methodologies Before European Parliament Committee on Economics

On May 6, 2015 Timothy Massad, Chairman of the Commodities Future Trading Commission (CFTC), addressed the European Parliament Committee on Economics regarding regulatory treatment of central counterparties (CCPs) and the harmonization of rules between the U.S. and the European Commission (EC). He focused the balance of his remarks specifically on margin methodology.

Enforcement Actions

The Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission (CFTC) and the Financial Industry Regulatory Authority (FINRA) recently announced the following enforcement actions:

- The SEC charged four former officers of a former Delaware-based bank holding company with fraud for intentionally understating past due bank loans during the financial crisis. The bank holding company was acquired by another institution, which paid $18.5 million to settle related SEC charges of improper accounting and disclosure fraud. The SEC is seeking disgorgement with interest, civil monetary penalties, and corporate officer and director bars for two of the former officers. In a related action, the U.S. Attorney's office brought criminal charges against the other two officers.
- The CFTC filed of a civil enforcement action in U.S. District Court against two foreign nationals for engaging in unlawful disruptive trading practices (spoofing) in futures markets. The CFTC alleges the individuals placed bids and offers with the intent to cancel them before execution. The CFTC is seeking preliminary and permanent injunctions, civil monetary penalties, disgorgement and trading and registration bans.
- FINRA censured a firm and fined it $10 million for "broad supervisory failures in a number of key areas, including the sales of non-traditional exchange-traded funds (ETFs), certain variable annuity contracts, non-traded real estate investment trusts (REITs) and other complex products, as well as for its failure to monitor and report trades and deliver to customers more than 14 million trade confirmations. In addition to the fine, the firm was ordered to pay approximately $1.7 million in restitution to certain customers who purchased non-traditional ETFs.

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