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Safety & Soundness

OCC Revises Process for Managing Matters Requiring Attention

On October 30, 2014, the Office of the Comptroller of the Currency (OCC) issued Bulletin 2014-52 to advise institutions that it has updated its policy and procedures regarding matters requiring attention (MRAs). These updates are reflected in a number of booklets in the *Comptroller's Handbook*, including "Bank Supervision Process," "Large Bank Supervision," "Community Bank Supervision," and "Federal Branches and Agencies Supervision," as well as in other internal guidance.

The OCC states the updated MRAs guidance addresses recommendations published in 2013 following an international peer review ("An International Review of OCC's Supervision of Large and Midsize Institutions") and supports the agency's mission of ensuring a safe and sound federal banking system by emphasizing timely detection and correction of deficient bank practices before they affect a bank's condition. The updated guidance also makes the MRA-related terminology, format, follow-up, analysis, and reporting consistent across the agency.

FSB Publishes Report on Cross-Border Consistencies and Global Financial Stability Implications of Structural Banking Reforms

The Financial Stability Board (FSB) published a report on October 27, 2014, entitled "*Structural Banking Reforms: Cross-border consistencies and global financial stability implications*." The report was prepared at the request of the G20 leaders to assess cross-border consistencies and global financial stability implications of structural banking reforms, taking into account country-specific circumstances. It was completed in collaboration with the International Monetary Fund (IMF) and the Organization for Economic Cooperation and Development (OECD) for use at the November 2014 Brisbane Summit.

Key findings in the report include the following:

- Jurisdictions implementing structural banking reforms emphasize that the reforms support the international reform agenda and promote global financial stability by reducing systemic risks as well as the implicit government guarantee to too-big-to-fail (TBTF) institutions. More efficient market pricing of risk and more efficient allocation of capital has resulted.
- Authorities in other jurisdictions identify a number of potential negative cross-border implications, including possible impacts on the efficiency of cross-border groups and complications to their crisis management and resolvability, decreased liquidity of financial markets, regulatory arbitrage and leakage to the shadow banking system.
- Regulatory restrictions to banking structures in order to provide greater ex ante transparency and certainty to the market and authorities in a resolution scenario can have implications for the mobility of cross-border capital flows. Some fragmentation might, however, be an intended consequence of reforms that have the objective to reduce interconnectedness between intermediaries, including across borders. The materiality of its effects for global financial stability will only became apparent as these reforms are fully implemented.

- It will be important to continue monitoring the potential implications of structural banking reforms as they are being implemented; in particular with respect to the effective functioning and operability of resolution strategies of cross-border groups, and to the liquidity of sovereign and corporate bond markets in jurisdictions where global banks have, to date, played an important role.

Basel Committee Issues Final Standard for Net Stable Funding Ratio

On October 31, 2014, the Bank for International Settlements' Basel Committee on Banking Supervision (BCBS or Basel Committee) issued the final standard for the Net Stable Funding Ratio (NSFR). A significant component of the Basel III reforms, the NSFR requires banks to maintain a stable funding profile in relation to their on- and off-balance sheet activities. The NSFR is intended to reduce the likelihood that disruptions to a bank's regular sources of funding will erode its liquidity position in a way that could increase the risk of its failure and potentially lead to broader systemic stress. It will become a minimum standard by January 1, 2018.

The final NSFR retains the structure of the January 2014 consultative proposal. The key changes introduced in the final standard cover the required stable funding for:

- Short-term exposures to banks and other financial institutions;
- Derivatives exposures; and
- Assets posted as initial margin for derivative contracts.

In addition, the final standard recognizes that, under strict conditions, certain asset and liability items are interdependent and can therefore be viewed as neutral in terms of the NSFR.

The Basel Committee is currently developing disclosure standards for the NSFR and expects to publish them for consultation around year end.

FSB Publishes Global Shadow Banking Monitoring Report

On October 30, 2014, the Financial Stability Board (FSB) published its fourth annual *Global Shadow Banking Monitoring Report*, offering a systematic account of the size, composition, and trends of nonbank financial intermediation across major global financial systems. The report presents data as of the end of 2013 from 25 jurisdictions and the euro area as a whole, covering about 80 percent of global GDP (gross domestic product) and 90 percent of global financial system assets.

The following are among the key findings:

- The broadest measure, referred to as the Monitoring Universe of Non-Bank Financial Intermediation (MUNFI), grew by $5 trillion in 2013 to reach $75 trillion. This measure is based on the financial assets of Other Financial Intermediaries (OFIs) and captures all nonbank financial intermediation where shadow banking-related risks to the financial system might potentially arise. It serves as a proxy for the global shadow banking system.
- Globally, MUNFI assets represent on average about 25 percent of total financial assets, roughly half of banking system assets, and 120 percent of GDP. These ratios have been relatively stable since 2008.
- MUNFI assets grew by 7 percent in 2013 (adjusted for foreign exchange movements), driven in part by a general increase in valuation of global financial markets. In contrast, total bank assets were relatively stable. Considerable differences in MUNFI assets exists across jurisdictions and entities.

- By absolute size, advanced economies have the largest shadow banking sectors, though emerging market jurisdictions recorded the fastest growth rates. While the nonbank financial system may contribute to financial deepening, careful monitoring is still required to detect any increases in systemic risk factors (e.g., maturity and liquidity transformation, and leverage) that could arise from the rapid expansion of credit provided by the nonbank sector.
- Trust Companies and Other Investment Funds were the fastest growing sub-sectors globally in 2013. Trust Companies have consistently grown at a fast pace, whereas the 18 percent annual growth in Other Investment Funds, the largest sub-sector, was sharply higher than in the preceding years.
- The Hedge Funds subsector remains significantly underestimated in the FSB's data collection exercise. Further refinement of the data for this sector could provide important additions to future editions of this report.

The report was accompanied by the publication of a comprehensive dataset on a jurisdiction and aggregate level, which also includes the data underlying most of the exhibits shown in the report. This is the first time such information was included in the report.

Enterprise & Consumer Compliance

FDIC Releases Results of 2013 National Survey of Unbanked and Underbanked Households

On October 29, 2014, the Federal Deposit Insurance Corporation (FDIC) released the results of the 2013 *FDIC National Survey of Unbanked and Underbanked Households*. The survey, conducted every two years in partnership with the U.S. Bureau of the Census, indicates that the proportion of unbanked households declined from 8.2 percent in 2011 to 7.7 percent in 2013, while the share of underbanked households remained essentially unchanged at 20 percent. Survey findings note that approximately one-quarter of all households were found to have used at least one alternative financial service (AFS), such as nonbank check cashing or payday loans, in the past year though four in ten unbanked and underbanked households had used an AFS in the past 30 days.

The FDIC drew three implications from the survey findings related to how financial institutions could better meet consumer needs:

- Develop strategies to help households maintain or renew banking relationships through economic transitions, such as job loss.
- Explore opportunities to deploy and market checkless checking accounts and other options to meet the transactional needs of households; and
- Integrate mobile banking initiatives with branch-based strategies in overall efforts to address consumers' needs.

CFPB Releases List of Rural or Underserved Counties

In a blog post on October 27, 2014, the Consumer Financial Protection Bureau (CFPB or Bureau) posted a link to the 2014 Rural or Underserved Counties List and the 2014 Rural Counties List. Both lists are intended for use in 2015. The blog also provides links to rules that refer to the Bureau's "rural or underserved" and "rural" counties lists, which include rules related to:

- Escrow Requirements under the *Truth in Lending Act* (TILA);
- Ability to Repay and Qualified Mortgage Standards under the TILA;
- High-Cost Mortgage and Homeownership Counseling Amendments under the TILA ; and
- Appraisals for High-Priced Mortgage Loans.

Deputy Comptroller Addresses Risks in Auto Lending, HELOCs, and Consumer Debt Sales

On October 28, 2014, Darrin Benhart, Deputy Comptroller for Supervision Risk Management at the Office of the Comptroller of the Currency (OCC), discussed auto and home equity lending risks in remarks before the Financial Services Collections and Credit Risk Conference. He also discussed the OCC's recently issued guidance on consumer debt sales.

"Product structures, loan-to-values, and pricing practices raise both credit quality and consumer compliance concerns in auto lending," said Deputy Comptroller Benhart, noting that total outstanding auto loans in national banks and federal thrifts grew 13 percent in 2013 and another 4.8 percent through the first half of 2014.

Deputy Comptroller Benhart said the OCC is seeing signs of increased risks in portfolios as some auto lenders pursue growth by lengthening terms, increasing advance rates, and originating loans to borrowers with lower credit scores. He said the average loss per vehicle has risen significantly over the past 24 months, and average charge-offs in auto lending are rising. The OCC will continue to monitor product terms and risk-layering practices to ensure that banks manage growth and exposure prudently.

Regarding home equity lines of credit (HELOCs), Deputy Comptroller Benhart said lenders need to work with borrowers who may have difficulty meeting the higher payments that result when principal volumes reach their end-of-draw periods. They should also be capturing information and preparing analyses that clarify the nature and magnitude of exposures.

He also cautioned lenders about the operational, reputation, compliance, and strategic risks that can result when banks sell debt. Referring to recent OCC guidance on loan sales, Deputy Comptroller Benhart said the OCC's expectations are for the banks to:

- Develop and implement appropriate internal policies and procedures to govern debt-sale arrangements consistently across the bank.
- Perform appropriate due diligence when selecting debt buyers and to ensure debt-sale arrangements (your contracts) with debt buyers cover all important considerations.
- Provide accurate and comprehensive information regarding each debt sold at the time of sale.
- Oversee the debt-sale arrangement appropriately.
- Ensure that they comply with applicable consumer protection laws and regulations in selling their debt.

CFPB Releases *Supervisory Highlights*

On October 28, 2014, the Consumer Financial Protection Bureau (CFPB or Bureau) issued the sixth edition of its *Supervisory Highlights*. The current issue generally covers the CFPB's supervisory activities between March and June 2014 and includes discussions of selected supervisory observations, such as regulatory violations or unfair, deceptive, or abusive acts or practices (UDAAPs) in the areas of consumer reporting, debt collection, deposits, mortgage servicing, student loan servicing and fair lending. This edition also includes updated supervisory guidance about *Home Mortgage Disclosure Act* (HMDA) reporting.

The report highlights a number of UDAAP violations identified through its supervisory examinations of larger participants in the student loan servicing market, including situations where servicers were:

- Allocating payments to maximize late fees;
- Misrepresenting minimum payments;
- Charging illegal late fees when payments were received during the grace period;
- Failing to provide accurate tax information;
- Misleading consumers about bankruptcy protections; and
- Making illegal debt collection calls to consumers at inconvenient times.

The report also identified UDAAP violations at some mortgage servicers that were found to have:

- Failed to oversee service providers;
- Delayed permanent loan modifications; and
- Deceived consumers about the status of permanent loan modifications.

Insurance

IAIS Adopts Five-Year Strategic Plan

At the conclusion of its 21st annual conference on October 27, 2014, the International Association of Insurance Supervisors (IAIS) announced that it had adopted a new strategic plan and financial outlook (SPFO) for 2015-2019. The SPFO continues multi-year projects initiated during the previous planning period, such as the work on the development of capital standards and the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame). It also continues with strategies that mark the next stage of IAIS development, such as in the area of implementation.

Pursuant to the SPFO, the IAIS committed to pursue the following high level goals over the five year term of the SPFO:

- Assessing and responding to insurance sector vulnerabilities;
- Fulfilling the role of global standard setter for the insurance industry;
- Contributing to financial stability in the insurance sector;
- Enhancing effective supervision and supervisory cooperation;
- Enhancing implementation and observance of insurance core principles;
- Engaging in effective stakeholder outreach and external interaction; and

- Maintaining and improving effective and efficient organization and operation.

With regard to the role of global standard setter, the IAIS specifically plans to:

- Develop a Higher Loss Absorbency (HLA) requirement for Global Systemically Important Insurers (GSII) by the end of 2015;
- Develop a risk-based global Insurance Capital Standard (ICS) as part of the Common Framework for Internationally Active Insurance Groups within ComFrame by the end of 2016; and
- Complete the Common Framework for Internationally Active Insurance Groups by the end of 2018.

Capital Markets & Investment Management

Federal Reserve Issues Final Rule to Amend Risk Management Standards for Designated Financial Market Utilities

On October 28, 2014, the Federal Reserve Board (Federal Reserve) issued a final rule that amends the Regulation HH risk management standards for financial market utilities (FMUs) that have been designated as systemically important by the Financial Stability Oversight Council (FSOC). The Federal Reserve also announced final revisions to part I of the *Federal Reserve Policy on Payment System Risk* (Policy), which is applicable to financial market infrastructures more generally, including those operated by the Federal Reserve Banks.

The final rule amending Regulation HH (*Designated Financial Market Utilities*) replaces the existing two sets of risk management standards for payment systems and for central securities depositories and central counterparties with a common set of risk management standards for all types of designated FMUs and also conforming changes to the definitions. Broadly, the key amendments to Regulation HH as well as the revisions to the Policy include establishing:

- Separate standards to address credit risk and liquidity risk;
- New requirements on recovery and orderly wind-down planning;
- A new standard on general business risk; and
- A new standard on tiered participation arrangements, and heightened requirements on transparency and disclosure.

The amendments and revisions are based on, and are generally consistent with, the international risk management standards in the April 2012 *Principles for Financial Market Infrastructures* developed jointly by the Committee on Payment and Settlement Systems and the International Organization of Securities Commissions (IOSCO).

The final rule becomes effective December 31, 2014 and designated FMUs must be in compliance with the rule as of that date, except for certain requirements outlined in the *Federal Register* notice. Similarly, the final revisions to the Policy become effective December 31, 2014, except for certain requirements outlined in the *Federal Register* notice that will become effective December 31, 2015.

SEC Director Addresses Disclosures of Heightened Risks of Alternative Mutual Funds

In remarks before the Securities Industry and Financial Markets Association (SIFMA) Complex Products Forum on October 29, 2014, Norm Champ, Director of the Division of Investment Management at the Securities and Exchange Commission (SEC), discussed the importance of disclosing the heightened risks of alternative mutual funds to retail investors.

Director Champ said heightened risks and the complex nature of the investment strategies employed by alternative mutual funds can make the goal of clear, concise disclosure more difficult to attain. He said funds that use or intend to use alternative investment strategies should:

- Assess the accuracy and completeness of their disclosure, making certain it is understandable to investors.
- Tailor disclosure of principal investment strategies specifically to how a fund expects to be managed and address those strategies that the fund expects to be the most important means of achieving its objectives and that it anticipates will have a significant effect on its performance.
- Consider the degree of economic exposure the alternative investment strategy creates in addition to the amount invested in that strategy.
- Provide in the prospectus a complete risk profile of the fund's investments taken as a whole, rather than a list of various investment strategies, and reflect anticipated alternative investment or asset usage.
- Assess on an ongoing basis the completeness and accuracy of alternative investments-related disclosures in the fund's registration statement in light of its actual operations.
- Review use of alternative investment strategies when the fund updates its registration statement annually and assess whether it needs to review the disclosures in its registration statement that describes its principal alternative investment strategies and risks.
- Consider the accuracy and completeness of marketing materials related to its investment objectives and performance.

In concluding, Director Champ said, "Alternative mutual funds face significant challenges when it comes to writing clear, concise prospectus disclosure. It's important to ensure that retail investors have the information they need to make informed investment decisions, especially with respect to alternative mutual funds and other complex products."

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 a Texas-based company with violating the *Foreign Corrupt Practices Act* by making improper payments to foreign officials in order to obtain beneficial treatment and reduce its tax liability. After the company self-reported its misconduct, an SEC investigation determined that the company received approximately $3.9 million in unlawful benefits. The company agreed to pay more than $5 million to settle the SEC's charges.
- The SEC charged an investment advisory firm and three top officials for being repeatedly late in providing investors with audited financial statements of its private funds in violation of the custody rule. The SEC is seeking censure, limitations on the firm's operations, suspension or revocation of its registration, and civil penalties. For the individuals, the SEC

is seeking suspension or bar from association with an investment adviser, broker, dealer, municipal securities dealer, municipal adviser, transfer agent, or nationally recognized statistical ratings organization, and civil penalties.

- The CFTC announced that a U.S. District Court imposed permanent trading and registration bans and a $210,000 civil monetary penalty against an individual from North Carolina for registration violations and failure to include certain required disclosures on his Web site. The court's Order stems from a civil enforcement action filed by the CFTC.
- FINRA censured and fined a clearing corporation $3.5 million for violating Regulation SHO, an SEC rule that established a regulatory framework to govern short sales and prevent abusive naked short selling. FINRA also censured and fined its affiliated broker-dealer $2.5 million for failing to establish, maintain, and enforce supervisory systems and procedures related to Regulation SHO and other areas.

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Agency	Institution Type	Action	Date	Synopsis of Action
CFPB	State Member Bank	Consent Order	10/09	The Consumer Financial Protection Bureau assessed financial penalties on a financial services entity for engaging in unfair, deceptive, or abusive acts or practices, related to its deceptive advertising of free checking accounts for consumers.
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 *Real Estate Settlements and Procedures Act.*
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 *Real Estate Settlement Procedures Act*. 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 *Federal Trade Commission Act.*
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*. .

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This is a publication of KPMG's Financial Services Regulatory Practice and KPMG's Americas' FS Regulatory Center of Excellence

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