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Safety & Soundness

Federal Reserve Adopts Final Rule Amending Reserve Requirements

On November 13, 2014, the Federal Reserve Board (Federal Reserve) adopted a final rule amending Regulation D, *Reserve Requirements of Depository Institutions*, to reflect the annual indexing of the reserve requirement exemption amount and the low reserve tranche for 2015.

The Regulation D amendments set the amount of total reservable liabilities of each depository institution that is subject to a zero percent reserve requirement in 2015 at $14.5 million (from $13.3 million in 2014). This amount is known as the reserve requirement exemption amount. The amount of net transaction accounts at each depository institution (over the reserve requirement exemption amount) that is subject to a three percent reserve requirement in 2015 has been set at $103.6 million (from $89.0 million in 2014). This amount is known as the low reserve tranche. The adjustments to both of these amounts are derived using statutory formulas specified in the *Federal Reserve Act.*

The Federal Reserve also announced changes in two other amounts, the nonexempt deposit cutoff level and the reduced reporting limit, that, in combination with the reserve requirement exemption, are used to determine the frequency with which depository institutions must submit deposit reports later in 2015.

The final rule will become effective 30 days after publication in the *Federal Register*. The new low reserve tranche and reserve requirement exemption amount will apply to the fourteen-day reserve maintenance period that begins January 22, 2015. For depository institutions that report deposit data weekly, this maintenance period corresponds to the fourteen-day computation period that begins December 23, 2014. For depository institutions that report deposit data quarterly, this maintenance period corresponds to the seven-day computation period that begins December 16, 2014.

Agencies Issue Frequently Asked Questions on Leveraged Lending

The Federal Deposit Insurance Corporation (FDIC) released Financial Institution Letter (FIL) 53-2014 on November 13, 2014 to highlight the Frequently Asked Questions (FAQs) guidance on leveraged lending released last week by the FDIC in conjunction with the Federal Reserve Board and the Office of the Comptroller of the Currency (collectively, the Agencies) as part of the Shared National Credit Review results. The FAQs respond to commonly asked questions about the *Interagency Guidance on Leveraged Lending* (Guidance) issued by the Agencies in March 22, 2013, which is intended to help institutions strengthen risk management frameworks to ensure that leveraged lending activities do not heighten risk in the banking system through the origination and distribution of poorly underwritten and low-quality loans. The responses to these FAQs are intended to foster industry and examiner understanding and promote consistent application and implementation of the interagency Guidance. The questions cover:

- Definition of a leveraged loan;
- Loans with non-pass risk ratings;

- Trading desk activities;
- Underwriting standards;
- Institution applicability;
- Examiner assessment; and
- Differences between the Guidance and the FDIC's deposit insurance assessment rule.

Governor Tarullo Favors Raising Size of Banks Covered by Small Bank Holding Company Policy Statement

In remarks before the Community Bankers Symposium on November 10, 2014, Federal Reserve Board Governor Daniel K. Tarullo said he would like to see a statutory amendment that would permit the Federal Reserve Board (Federal Reserve) to raise the size of banks covered by the Federal Reserve's *Small Bank Holding Company Policy Statement* to a threshold of $1 billion in total consolidated assets from the $500 million threshold set in 2006. He explained, "The policy statement allows small, noncomplex bank holding companies to operate with higher levels of debt than would normally be permitted, subject to restrictions to ensure that higher debt does not pose an undue risk to subsidiary banks and that leverage is reduced over time. Bank holding companies that are subject to the policy statement are exempt from the [Federal Reserve] Board's risk-based and leverage capital guidelines, and are subject to reduced regulatory reporting requirements."

"The intervening eight years have obviously brought dramatic changes in the financial, business, and regulatory environments," said Governor Tarullo. "Approximately 85 percent of all bank holding companies qualified after the threshold was raised in 2006, a figure that has dropped to about 75 percent today. Raising the threshold to $1 billion would recoup that lost coverage and go a bit further, covering 89 percent of holding companies."

He said legislative action is needed to bring about the change because the *Collins Amendment* to *Dodd-Frank Wall Street Reform and Consumer Protection Act* eliminated the Federal Reserve's authority to extend the capital treatment in the policy statement to holding companies with assets greater than the threshold in effect on May 19, 2010, or to savings and loan holding companies of any size.

Governor Tarullo also offered remarks on tiered regulation and tiered supervision in the context of community bank oversight. He closed by saying, "Post-crisis attention has understandably been focused on too-big-to-fail issues and other sources of systemic risk. But now is a good time to look at the other end of the banking industry, where the contrast is substantial. Smaller banks present a very different set of business models. Their risks and vulnerabilities tend to grow from different sources. An explicit and sustained tailoring of regulation and supervision for community banks not only seems reasonable, it seems an important and logical next step in financial regulatory reform."

FSB Issues Proposals on Adequacy of Total Loss-Absorbing and Recapitalization Capacity of G-SIBs

On November 10, 2014, the Financial Stability Board (FSB) issued a set of principles and a detailed term sheet on the adequacy of loss-absorbing and recapitalization capacity of global systemically important banks (G-SIBs). These policy proposals were developed by the FSB in consultation with the Bank for International Settlements' (BIS) Basel Committee on Banking Supervision (BCBS) at the request of the G20 leaders.

The FSB indicates that, when finalized, these policies will form a new minimum standard for total loss-absorbing capacity (TLAC) that is intended to:

- Provide home and host authorities with confidence that G-SIBs have sufficient capacity to absorb losses, both before and during resolution; and
- Enable resolution authorities to implement a resolution strategy that minimizes any impact on financial stability and ensures the continuity of critical economic functions.

The FSB suggests that by strengthening the credibility of authorities' commitments to resolve G-SIBs without exposing taxpayers to loss, the TLAC, in conjunction with other measures, should:

- Remove the implicit public subsidy from which G-SIBs currently benefit when they issue debt and incentivize creditors to better monitor G-SIBs' risk-taking.
- Achieve a level playing field internationally, reducing G-SIBs' funding cost advantage and ensuring they compete on a more equal footing within their home and foreign markets.

TLAC adequacy will need to take account of individual G-SIBs' recovery and resolution plans, their systemic footprints, business models, risk profiles, and organizational structures. The principles and term sheet provide guidance for home and host authorities on how to determine a firm-specific Pillar 2 TLAC requirement in addition to the common Pillar 1 TLAC minimum. Calibration and composition of firm-specific TLAC requirements should be determined in consultation with Crisis Management Groups and subject to review in the FSB's Resolvability Assessment Process (RAP).

In early 2015, the FSB intends to undertake comprehensive impact assessment studies to inform the calibration of the Pillar 1 element of the TLAC requirement for all G-SIBs. Comments are requested no later than February 2, 2015. The TLAC proposals are expected to be finalized by the time of the G20 Leaders' Summit in 2015 and conformance will not be expected until at least January 1, 2019.

BCBS Publishes Reports Related to Implementation of the Capital Framework

In advance of the G20 Leaders Summit, the Bank for International Settlements' Basel Committee on Banking Supervision (BCBS) published two reports on November 12, 2014.

- The first report outlines the measures the BCBS is taking to reduce excessive variability in bank capital ratios as well as to improve their consistency and comparability. The measures include:
  - Policy proposals to revise the standardized (non-modeled) approaches for calculating regulatory capital ratios that will also provide the basis for a capital floor; and
  - Reducing the modeling choices in the capital framework when determining internal-model based estimates of credit, market, and operational risk-weighted assets.

  The report also discusses the role of disclosure, implementation monitoring, and additional analytical and policy work in progress.
- The second report is intended to update the G20 Leaders on the implementation of Basel III standards since the BCBS' August 2013 progress report to G20 Leaders. It discusses steps taken by BCBS member jurisdictions to adopt the Basel III standards and banks' progress in bolstering their capital and liquidity positions. Specific implementation-related challenges are also highlighted.

On November 14, 2014, the BCBS published the findings of a review of its members' implementation of national discretions that are contained within the Basel capital framework. The national discretions allow certain flexibilities in implementing the standards to accommodate differences in the structure and development of financial systems. The BCBS states they can also impair the comparability of implementation across jurisdictions. The report provides a list of each national discretion in use for the purpose of bringing greater transparency to the use of national discretions and so improve comparability. The BCBS states that it is also reviewing some of the discretionary items for possible removal from the framework.

FSB Publishes Resolution Planning Progress Report for G-SIFIs

On November 12, 2014, the Financial Stability Board (FSB) published its report for G20 leaders on progress in reforming resolution regimes and resolution planning for global systemically important financial institutions (G-SIFIs). The report reviews progress to date and sets its 2015 priorities to implement the *Key Attributes of Effective Resolution Regimes for Financial Institutions* (Key Attributes) to ensure that the G-SIFIs are resolvable.

The FSB has identified the following priorities for 2015 to advance progress in effective resolution regimes and resolution planning:

- Finalize the common international standard on total loss absorbing capacity (TLAC) that global systemically important banks must have;
- Achieve the broad adoption of contractual recognition of temporary stays on early termination and cross-default rights in financial contracts and finalize FSB guidance on effective cross-border recognition;
- Develop further guidance to support resolution planning by home and host authorities, particularly regarding funding arrangements and operational continuity of core critical services; and
- Promote the full implementation of the FSB's requirements for resolution regimes and resolution planning beyond the banking sector.

According to the report, FSB jurisdictions have made continued progress in adopting the powers and tools needed to resolve failing banks. Few jurisdictions have in place resolution regimes that are fully compliant with the Key Attributes and that also provide adequate powers for resolving failures in the nonbank financial sectors. The FSB said it intends to continue monitoring implementation of the Key Attributes to support implementation across all financial sectors, including for financial market infrastructures, insurers, and firms that hold client assets.

The FSB also reports the initial results from the launch of the Resolvability Assessment Process (RAP). The RAP assesses the resolvability of each G-SIFI at the level of senior officials of the firm's home and key host authorities. The initial assessments, which reflects results based on a subset of ten G-SIFIs, show that good progress has been made in resolution planning, but that material legal, operational, and financial barriers to the feasibility and credibility of the resolution plans remain to be addressed. A number of those barriers relate to issues that are covered by the FSB work priorities for 2015 and may be mitigated as that work is finalized and implemented.

Enterprise & Consumer Compliance

CFPB Issues Proposed Rule to Provide Consumer Protections for Prepaid Cards

The Consumer Financial Protection Bureau (CFPB or Bureau) issued a proposal on November 13, 2014, that would amend Regulation E, which implements the *Electronic Fund Transfer Act* (EFTA), and Regulation Z, which implements the *Truth in Lending Act* (TILA), as well as the official interpretations to those regulations in order to create comprehensive consumer protections for prepaid financial products. In particular, the proposed rule would require companies to:

- Limit consumers' losses when funds are stolen or cards are lost;
- Investigate and resolve errors;
- Provide easy and free access to account information; and
- Adhere to credit card protections if a credit product is offered in connection with a prepaid account.

The Bureau also proposed new "Know Before You Owe" prepaid disclosures that would provide consumers with information about the costs and risks of prepaid products. The proposal would require prepaid account issuers to provide the Bureau with terms and conditions for prepaid accounts, which it would post on a Web site maintained by the Bureau. Issuers would also be required to post the terms and conditions on their own Web sites or make them available upon request.

The proposed rule covers prepaid cards as well as mobile and electronic prepaid accounts that can store funds. In addition to general purpose reloadable prepaid cards, the rule would also apply to prepaid cards that are used to distribute payroll wages, certain government payments, child support payments, and government benefits that are not needs-tested such as unemployment insurance and public pensions. The rule would not apply to gift cards or certain other related types of cards.

The proposed rule and disclosures will be open for public comment for 90 days following publication in the *Federal Register*.

CFPB Fines Mortgage Lender for Steering Consumers into Costlier Mortgages

The Consumer Financial Protection Bureau (CFPB or Bureau) asked a federal district court to approve a Consent Order requiring a California-based residential mortgage lender to pay $730,000 in refunds to more than 1,400 borrowers that the Bureau alleges were steered into loans with higher interest rates. According to the CFPB complaint, the lender violated the Federal Reserve Board's (Federal Reserve's) *Loan Originator Compensation Rule* (which the CFPB has enforced since July 21, 2011) by tying its loan officers' quarterly bonuses to the interest rates on the loans they offered to borrowers. The CFPB did not seek a civil penalty based on the lender's financial condition and the Bureau's desire to maximize relief directly from the lender to affected consumers.

Capital Markets & Investment Management

CFTC Further Implements Trade Execution Requirement

On November 10, 2014, the Commodity Futures Trading Commission's (CFTC) Division of Market Oversight (Division) announced further implementation of the trade execution requirement for certain interest rate and credit default swaps. CFTC No-Action Letter No. 14-137 provides a phased compliance timeline.

The Division previously provided no-action relief for certain swaps required to be traded on a swap execution facility (SEF) or designated contract market (DCM) to the extent that those swaps were part of a package transaction. The Division has determined that further relief is appropriate to enable market participants the necessary time to fully comply with the trade execution requirement with respect to swap components of certain categories of package transactions.

Market participants will also have the opportunity to transition their trading of these swap components onto SEFs and DCMs.

The Division has tailored the relief by category—for example, SEFs and DCMs are provided with flexibility in offering methods of execution for swap components of certain package transactions via their trading systems, facilities, or platforms. Finally, with respect to certain categories of package transactions, the time-limited relief will enable the Division to gather data not previously available to the agency to further assess whether SEFs and DCMs can appropriately offer the capability to transact swap components of such package transactions via competitive means of execution.

FSB Proposes Standards and Processes for Global Securities Financing Data Collection and Aggregation

On November 13, 2014, the Financial Stability Board (FSB) requested comment on its report, *Standards and Processes for Global Securities Financing Data Collection and Aggregation*. The proposed standards and processes are based on the policy recommendations in the FSB report *Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos* that was published in August 2013.

The proposed standards and processes in the consultative document:

- Define the data elements for repurchase agreements (repos), securities lending and margin lending that national/regional authorities will be asked to report as aggregates to the FSB for financial stability purposes.

- Describe data architecture issues related to the data collection and transmission from the reporting entity to the national/regional authority and then from the national/regional to the global level.
- Propose six recommendations to national/regional authorities to ensure the consistency among national/regional data collections, the quality of global aggregates and the efficiency of the reporting framework.
- Discuss potential uses of the aggregated data and the next steps for the completion of the initiative.

The FSB intends to complete its work on developing standards and processes by the end of 2015, based on the public consultation findings and further discussion with market participants. By then, the FSB also intends to develop an implementation timeline for the global data collection and aggregation. After that, the publication of relevant aggregates on the global securities financing markets to improve market transparency will be considered.

The FSB requests interested parties to submit comments on the proposed standards and processes for global securities financing data collection and aggregation along with responses to the questions no later than February 12, 2015.

FINRA Requests Comment on Various Proposals

During the week ended November 14, 2014, the Financial Industry Regulatory Authority (FINRA) announced that it is seeking comment on a variety of proposals, including proposals to:

- Identify over-the-counter (OTC) trades in NMS stocks reported more than two seconds following trade execution as "out of sequence" and not last sale eligible for public dissemination purposes. (Regulatory Notice 14-46; comments due January 9, 2015.)
- Reduce the synchronization tolerance for computer clocks. The current clock synchronization requirements allow for a tolerance of one second from the National Institute of Standards and Technology (NIST) atomic clock. Under the proposal, the tolerance for computer clocks would be reduced to 50 milliseconds. The tolerance for mechanical time stamping devices would remain at one second. (Regulatory Notice 14-47; comments due January 9, 2015.)
- Expand FINRA's alternative trading system (ATS) transparency initiative to publish the remaining equity volume executed over-the-counter (OTC), including non-ATS electronic trading systems and internalized trades. FINRA stated that it believes the public will be able to better understand a firm's trading of equities off exchanges by reviewing the firm's new OTC equity trading volume information together with its existing ATS volume reports. (Regulatory Notice 14-48; comments due January 9, 2015.)
- Establish "pay-to-play" and related rules that would regulate the activities of member firms that engage in distribution or solicitation activities for compensation with government entities on behalf of investment advisers that provide or are seeking to provide investment advisory services to such government entities within two years after a contribution to an official of the government entity is made by the member firm or a covered associate. (Regulatory Notice 14-50; comments due December 15, 2014.)
- Require member firms to report additional information to the Order Audit Trail System (OATS), including identifying non-member broker-dealers when reporting orders received from such entities. FINRA is also proposing to require ATSs to provide FINRA with additional order book information using existing OATS interfaces. (Regulatory Notice 14-51; comments due January 13, 2015.)

OCC Fines Three Banks for FX Trading Improprieties

On November 12, 2014, the Office of the Comptroller of the Currency (OCC) assessed a total of $950 million in civil money penalties against three national banks for unsafe or unsound practices related to their wholesale foreign exchange (FX) trading businesses. In addition to assessing civil money penalties, the OCC issued cease-and-desist orders requiring the banks to correct deficiencies and enhance oversight of their FX trading activity. The fines follow multiagency examinations and investigations of the banks' activities in the global FX market.

The OCC's examinations found that the banks had deficiencies in their internal controls and had engaged in unsafe or unsound banking practices with respect to the oversight and governance of FX trading, resulting in the banks' failure to identify the risks related to sales, trading, and supervision of employee conduct in FX trading. As a result of these control deficiencies and unsafe or unsound practices, the employee misconduct went undetected for several years.

Concurrent with the OCC's enforcement action, the U.S. Commodity Futures Trading Commission (CFTC) and the United Kingdom Financial Conduct Authority (FCA) took action against some of the financial institutions for "improprieties related to their FX trading activities." The CFTC issued Orders filing and settling charges against financial institutions for attempted manipulation of, and for aiding and abetting other banks' attempts to manipulate, global FX benchmark rates to benefit the positions of certain traders. The CFTC's Orders collectively impose more than $1.4 billion in civil monetary penalties. The FCA's actions resulted in penalties of approximately $1.7 billion.

Enforcement Actions

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

- The SEC charged two foreign-based operators of an online high-yield securities offering with fraud. The investment scheme sought to exploit investors through pervasive social media pitches in which the operators purported that the investment would yield guaranteed profits. The SEC is seeking civil money penalties and disgorgement.
- The SEC charged the owner of a Maryland-based real estate company with conducting an offering fraud and diverting investor funds to personal uses. The SEC also charged a former stockbroker for participating in the scheme. In a parallel case, the U.S. Attorney's Office announced criminal charges against the owner. The SEC is seeking permanent injunctions, disgorgement, civil money penalties, and officer and director bars.
- The CFTC issued five Orders filing and settling charges against financial institutions for attempted manipulation of, and for aiding and abetting, other banks' attempts to manipulate, global foreign exchange (FX) benchmark rates to benefit the positions of certain traders. The Orders collectively impose over $1.4 billion in civil monetary penalties.
- The CFTC charged a registered Futures Commission Merchant (FCM) based in Illinois for failing to diligently supervise an associated person and for failing to provide and maintain an adequate program of supervision. Without admitting or denying the CFTC findings, the FCM settled the charges and agreed to pay a $700,000 civil monetary penalty and disgorge $104,279 in commissions earned from the trading activity related to the supervisory failures.

Recent Supervisory Actions against Financial Institutions

Last Updated: November 14, 2014

Agency	Institution Type	Action	Date	Synopsis of Action
CFPB	Nonbank Mortgage Lender	Complaint	11/13	The Consumer Financial Protection Bureau charged a residential mortgage lender with violating the *Loan Originator Compensation Rule* by paying its loan officers quarterly bonuses in amounts based on terms or conditions of the loans they closed. The CFPB is seeking financial penalties in a Consent Order that is not yet approved in U.S. District Court.
OCC	National Banks	Consent Orders	11/11	The Office of the Comptroller of the Currency assessed fines against three financial services entities for unsafe or unsound practices related to their wholesale foreign exchange (FX) trading businesses.
Federal Reserve Board	State Member Bank	Consent Order	11/06	The Federal Reserve Board issued an Order of Assessment of Civil Money Penalties against a Texas-based state member bank to address violations of the National Flood Insurance Act,
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*.

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