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The Washington Report

for the week ended November 21, 2014

In This Issue

Safety & Soundness

Agencies Issue Joint NPR to Correct and Clarify Capital Rules for Advanced Approaches Banking Organizations

On November 19, 2014, the Office of the Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation (collectively, the Agencies) issued a joint notice of proposed rulemaking (NPR) intended to clarify, correct, and update aspects of the Agencies' regulatory capital rule adopted in July 2013. The proposal would apply only to large internationally active banking organizations that currently determine their regulatory capital ratios under the advanced approaches rule or that may use the advanced approaches rule in the future, which generally includes those entities with at least $250 billion in total consolidated assets or at least $10 billion in total on-balance sheet foreign exposures.

The Agencies stated that the proposed revisions are largely driven by observations they made during the parallel run review process. The proposed revisions are also intended to enhance consistency of the U.S. regulations with international standards.

Comments must be received within 60 days of publication in the *Federal Register.*

Governor Tarullo Provides Interim Appraisal of Federal Reserve's Approach to Liquidity Regulation

In a November 20, 2014, address to the Clearing House Annual Conference, Federal Reserve Board Governor Daniel K. Tarullo provided an interim appraisal of the Federal Reserve Board's (Federal Reserve) approach to liquidity regulation.

Governor Tarullo said the Federal Reserve today has a better appreciation for the role liquidity regulation should play in tandem with capital regulation and resolution mechanisms, to both complement and limit the lender-of-last-resort (LOLR) function of central banks. He said the Federal Reserve is "well along the road" of implementing regulatory and supervisory policies to play that role and that the liquidity positions and management practices of large firms have improved. He also noted the Federal Reserve is currently working on short-term wholesale funding regulation.

Highlights of Governor Tarullo's prepared remarks included his views that:

- The financial crisis was a liquidity crisis and that regulation in this area was lagging;
- The net stable funding ratio (NSFR) is a key milestone in liquidity regulation;
- Financials are highly susceptible to runs and that central bank lending remains an important component of liquidity management;
- "Lender of last resort" relies on solvency and capital;
- Liquidity regulation should not require self-insurance against extreme market events, but should buy time for authorities to evaluate; and
- The conceptual challenge of the NSFR was greater than the LCR (liquidity coverage ratio).

The Question and Answer session following Governor Tarullo's prepared remarks highlighted the following items:

- The Federal Reserve is looking to obtain information on bank's liquidity positions in real time.
- The CLAR (Comprehensive Liquidity Assessment and Review) continues to be a supervisory review program. This approach varies from the current CCAR (Comprehensive Capital Analysis and Review) as there is currently no minimum.
- Current liquidity metrics are not readily comparable across financial institutions.
- Disclosures requirements are not likely until comparability is achieved.
- Supervisors are still thinking through how to communicate findings to the public.
- An NSFR rule will likely be proposed in the United States during 2015 and is expected to be largely congruent with the final Basel rule.

Questions on liquidity risk management may be directed to KPMG's Rob Ceske or Jeff Dykstra.

Federal Reserve Conducting Reviews of Its Examination and Supervision Processes for Large Banks

The Federal Reserve Board (Federal Reserve) announced on November 20, 2014, that it has undertaken two separate reviews to ensure that the examinations of large banking organizations are consistent, sound, and supported by all relevant information. In particular, the Federal Reserve has:

- Requested its Inspector General perform a review to determine whether:
  - "Adequate" methods exist for decision-makers at the relevant Reserve Banks and at the Federal Reserve to obtain all necessary information to make supervisory assessments and determinations; and
  - Channels exist for decision-makers to be aware of divergent views among an examination team regarding material issues.
- Begun conducting its own review to determine whether:
  - The decision-makers at the Federal Reserve receive the information needed to ensure "consistent and sound" supervisory decisions regarding the supervision of the largest, most complex banking organizations; and
  - "Adequate" methods are in place for those decision-makers to be aware of material matters that require reconciliation of divergent views related to supervision of those firms.

OCC Issues Statement on Risk Management of Banking Services Offered to Money Services Businesses

On November 19, 2014, the Office of the Comptroller of the Currency (OCC) issued Bulletin 2014-58 entitled, *Statement on Risk Management Associated with Money Services Businesses*. The statement is intended to provide clarification to national banks, federal savings associations, and federal branches and agencies of foreign banks (collectively, banks) on the agency's supervisory expectations with regard to offering banking services to money services businesses (MSBs).

The statement highlights three central points:

- The OCC does not direct banks to open, close, or maintain individual accounts, nor does the agency encourage banks to engage in the termination of entire categories of customers without regard to the risks presented by an individual customer or the bank's ability to manage the risk.

- MSBs present varying degrees of risk.
- Banks are expected to assess the risks posed by an individual MSB customer on a case-by-case basis and to implement controls to manage the relationship commensurate with the risks associated with each customer.

OCC Issues Revised Comptroller's Licensing Manual Booklet

The Office of the Comptroller of the Currency (OCC) issued Bulletin 2014-57 on November 19, 2014, announcing that it has revised the *Federal Branches and Agencies* booklet of the *Comptroller's Licensing Manual*. This is the first booklet of the manual revised since the integration of the Office of Thrift Supervision and the OCC in 2011.

The revised *Federal Branches and Agencies* booklet:

- Reflects amendments in 2003 to the *International Banking Act* and the OCC's revisions to the implementing regulation found in 12 CFR 28.
- Includes policy considerations for conversions of state-licensed branches and agencies to federal licenses, complementing the recently published *Federal Branches and Agencies Supervision* booklet of the *Comptroller's Handbook* and the OCC"s October 2014 report entitled, *The OCC's Approach to Federal Branch and Agency Supervision*.
- Incorporates applicable regulatory changes that address expedited approvals for establishments and relocations and elimination of agreements for deposit-taking by limited federal branches.
- Adds discussion of new activities and operations permitted for federal branches and agencies, including loan production offices, operating subsidiaries, and non-controlling investments.

Enterprise & Consumer Compliance

CFPB Advises Disabled Veterans to Monitor Credit Reports Following Discharge of Debt

In a blog post on November 17, 2014, the Consumer Financial Protection Bureau (CFPB or Bureau) highlighted consumer protections available to "100-percent service-disabled" veterans that have student loan debt. In particular, these individuals are permitted to seek discharge of their federal student loan debt. Private student lenders are not required to offer the benefit but may do so on a case-by-case basis. In the blog post, the CFPB advises disabled veterans whose federal or private student loans have been forgiven to review their credit reports to ensure their student loan servicer has provided correct information to the credit bureaus regarding discharge of their loan.. The Bureau states that it intends to monitor complaints submitted by veterans and other disabled student loan borrowers to make sure student loan servicers are furnishing correct information to the credit bureaus about loan discharges due to disability.

CFPB Issues Bulletin to Remind Creditors of Their Obligations under the ECOA with Regard to Public Assistance Income

On November 18, 2014, the Consumer Financial Protection Bureau (CFPB or Bureau) issued Bulletin 2014-03 to remind creditors of their obligations under the *Equal Credit Opportunity Act* (ECOA) and its implementing regulation, Regulation B, with respect to the consideration of public assistance income. The Bulletin also reminds creditors of relevant standards and guidelines regarding verification of Social Security Disability Insurance (SSDI) and Supplemental Security Income (SSI) income (collectively, Social Security disability income) received by mortgage applicants.

The Bulletin discusses standards and guidelines on verification of Social Security disability income, including under the CFPB's Ability-to-Repay rule, the Department of Housing and Urban Development's (HUD) standards for Federal Housing Administration-insured (FHA) loans, the Department of Veterans Affairs (VA) standards for VA-guaranteed loans, and guidelines from Fannie Mae and Freddie Mac.

The CFPB states that fair lending concerns may arise when a creditor requires documentation to demonstrate that Social Security disability income is likely to continue, such as information about the nature of an applicant's disability or a letter from an applicant's physician. To manage fair lending risk, the Bureau recommends that creditors:

- Articulate clearly verification requirements for Social Security disability income;
- Provide proper training of underwriters and mortgage loan originators, and others involved in mortgage-loan origination; and
- Monitor carefully for compliance with underwriting policies.

Department of Defense Prohibits Servicemembers' Use of New Allotments to Purchase, Lease, or Rent Personal Property

On November 21, 2014, the U.S. Department of Defense (DoD) announced a policy change that will prohibit servicemembers from using new allotments to purchase, lease, or rent personal property (e.g., vehicles, household goods) effective January 1, 2015. The military discretionary allotment system allows servicemembers to automatically direct a portion of their paycheck to financial institutions or people of their choosing. The change will apply only to active duty service members and not to military retirees or DoD civilians. It will not affect existing allotments or prohibit allotments made to savings accounts, support dependents, pay insurance premiums, pay mortgages, pay rents, or fund investments. The change follows an interagency review conducted in response to enforcement actions taken by the Consumer Financial Protection Bureau.

CFPB Proposes Revisions to Certain Mortgage Servicing Rules

The Consumer Financial Protection Bureau (CFPB or Bureau) released a proposed rule on November 20, 2014, that would amend certain mortgage servicing rules under Regulation X (which implements the *Real Estate Settlement Procedures Act* – RESPA) and Regulation Z (which implements the *Truth-in-Lending Act* – TILA). Broadly, the revisions would address provisions related to:

- Successors in interest;
- The definition of delinquency;
- Requests for information;

- Force-placed insurance;
- Early intervention;
- Loss mitigation;
- Payment crediting;
- Periodic statements; and
- Small servicers.

Comments on the proposed rule and related sample forms will be accepted for a period of 90 days following publication in the *Federal Register*.

CFPB Fines "Buy Here, Pay Here" Auto Dealer for Unfair Acts and Practices

On November 17, 2014, the Consumer Financial Protection Bureau (CFPB or Bureau) assessed an $8 million civil money penalty against an Arizona-based auto dealer that also acted as an auto lender (a "buy here, pay here" auto dealer) to address unfair acts and practices in violation of the unfair, deceptive, or abusive acts or practices (UDAAP) provisions of the *Consumer Financial Protection Act*. According to the CFPB Consent Order, the auto dealer failed to:

- Prevent account servicing and collection calls to consumers' workplaces after consumers asked the dealer to stop such calls;
- Prevent calls to consumers' third-party references after the references or consumers asked the auto dealer to stop calling them; and
- Prevent calls to people at wrong numbers after they have asked the auto dealer to stop calling.

The Bureau also charged the auto dealer with violations of the *Fair Credit Reporting Act* (FCRA) for: furnishing information to consumer reporting agencies that it had reasonable cause to believe was inaccurate; failing to correct or delete inaccurate information within a reasonable time after learning of the inaccuracies; and, failing to establish and/or implement reasonable written policies and procedures regarding the "accuracy" and "integrity" of the information it furnished to consumer reporting agencies.

In addition to the fine, the CFPB's Consent Order requires the auto dealer to disclose collection options to consumers, cease furnishing inaccurate repossession information, correct credit reporting information, provide credit reports to harmed consumers, and implement a program to audit the information it furnishes to the credit reporting agencies.

Capital Markets & Investment Management

FINRA and MSRB Release Proposals to Provide Pricing Reference Information for Retail Investors in Fixed Income Securities

On November 17, 2014, the Financial Industry Regulatory Authority (FINRA) and the Municipal Securities Rulemaking Board (MSRB) released companion proposals that would require

disclosure of pricing reference information on customer confirmations for transactions in fixed income securities. The proposals are substantially similar (FINRA Regulatory Notice 14-52 and MSRB Regulatory Notice 2014-20), and would require bond dealers in retail-sized fixed income transactions to disclose, on the customer's confirmation, the price of certain same-day principal trades in the same security, as well as the difference between this reference price and the customer's price.

The Securities and Exchange Commission (SEC) recommended that the MSRB consider requiring disclosure of pricing reference information to retail investors as part of a series of recommendations related to price transparency in the SEC's 2012 Report on the Municipal Securities Market. In a June 20, 2014 speech, SEC Chair Mary Jo White expressed support for additional disclosures to help investors better understand the costs of their fixed income transactions.

FINRA and the MSRB are seeking input on the likely economic implications of the proposals as well as on alternative regulatory approaches, including a potential markup disclosure requirement targeting trades that could be considered riskless principal transactions. Comments are requested no later than January 20, 2015.

SEC Adopts Rules to Governing Systems Compliance and Integrity

On November 19, 2014, the Securities and Exchange Commission (SEC) voted to adopt new rules that are intended to strengthen the technology infrastructure of the U.S. securities markets. The rules, which comprise Regulation Systems Compliance and Integrity or Regulation SCI, impose requirements on certain key market participants.

Under Regulation SCI, self-regulatory organizations, certain alternative trading systems (ATSs), plan processors, and certain exempt clearing agencies will be required to have comprehensive policies and procedures in place for their technological systems. The rules also provide a framework for these entities to, among other things:

- Take appropriate corrective action when systems issues occur;
- Provide notifications and reports to the SEC regarding systems problems and systems changes;
- Inform members and participants about systems issues;
- Conduct business continuity testing; and
- Conduct annual reviews of their automated systems.

The new rules become effective 60 days after publication in the *Federal Register*. Entities subject to Regulation SCI generally must comply with the requirements nine months after the effective date. ATSs meeting the volume thresholds in the rules for the first time, will be provided an additional six months from the time that the ATS first meets the applicable thresholds to comply. Further, entities will have 21 months from the effective date to comply with the industry- or sector-wide coordinated testing requirement.

CFTC Chairman Massad Discusses Cross-Border Regulatory Challenges

Timothy G. Massad, Chairman of the Commodity Futures Trading Commission (CFTC), discussed the challenges of harmonizing rules across borders during a November 18, 2014, speech at the CME Global Financial Leadership Conference.

He said the challenges pertain to implementing the new swaps framework and to the regulation of the futures market, including in the following areas:

- Clearing and Clearinghouse Oversight. To maintain vigilance and insure that clearinghouses themselves do not pose risk to financial stability, Chairman Massad recommends a cross-border model that is based on dual registration and cooperative oversight among regulators.
- Swaps Trading. This market is fragmented largely a result of the U.S. imposing rules on an unregulated, highly mobile trading market long before other jurisdictions. Chairman Massad said the CFTC will continue to work with other jurisdictions as they enact rules to harmonize rules where possible.
- Market Data. Much work is needed to collect and use data effectively, especially to harmonize data standards.
- Cybersecurity. The CFTC will be focused on the risks of cybersecurity as part of its examinations of clearinghouses and exchanges t.
- Enforcement and Compliance. The CFTC will be vigorous in its enforcement efforts and cooperate with foreign jurisdictions,

In closing, Chairman Massad said advancing the CFTC's goals and implementing the new regulatory framework requires more resources. "The fact is that, without additional resources, our markets cannot be as well supervised; participants cannot be as well protected; market transparency and efficiency cannot be as fully achieved."

CFTC Commissioner Bowen Seeks Public Comment on Scope and Composition of New Advisory Committee

Through a November 19, 2014 *Federal Register* release, Commissioner Sharon Y. Bowen of the Commodity Futures Trading Commission (CFTC) asked for public comment regarding the priorities and composition of CFTC's newly formed Market Risk Advisory Committee (MRAC) of which she is sponsor. The comment period ends on December 3, 2014.

The request invites members of the public to propose topics for the MRAC to consider on how to improve market structure and mitigate risk. It also requests nominations (including self-nominations) for MRAC membership, in accordance with the membership requirements outlined in the MRAC's charter.

The MRAC's mandate is to:

- Conduct public meetings and submit reports and recommendations to the CFTC on matters of public concern to clearinghouses, exchanges, intermediaries, market makers, end-users, and the CFTC regarding systemic issues that threaten the stability of the derivatives markets and other financial markets; and
- Assist the CFTC in identifying and understanding the impact and implications of an evolving market structure and movement of risk across clearinghouses, intermediaries, market makers, and end-users.

Enforcement Actions

The Securities and Exchange Commission (SEC) recently announced the following enforcement actions:

- The SEC charged the chief executive officer of a California-based penny stock company with using pump-and-dump schemes to defraud investors and realize more than $300,000

in illicit profits. The SEC seeks disgorgement with prejudgment interest, a financial penalty, a permanent injunction, and officer-and-director and penny stock bars.

- The SEC charged three penny stock promoters with conducting five separate pump-and-dump schemes that resulted in more than $10 million in ill-gotten gains. The SEC is seeking disgorgement, civil monetary penalties, and permanent injunctions.
- The SEC sanctioned two former employees in the foreign office of an Oregon-based contractor for violations of the *Foreign Corrupt Practices Act* by providing gifts to foreign government officials in order to obtain their business. Without admitting or denying the charges, the former employees agreed to pay financial penalties of $50,000 and $20,000 respectively.
- The SEC charged an unregistered broker in Florida with misappropriating investor funds as part of a fraudulent day trading scheme in which the broker and his business partner raised $500,000 from investors. In a parallel action, the U.S. Attorney's Office announced that the broker has pleaded guilty to criminal charges. The SEC is seeking a permanent injunction, disgorgement, and civil money penalties.
- The SEC suspended trading in four companies that claim to be developing products or services in response to the Ebola outbreak, citing a lack of publicly available information about the companies' operations. Coincident with the suspension, the SEC issued an investor alert warning about the potential for fraud in microcap companies purportedly involved in Ebola prevention, testing, or treatment.
- The SEC announced that a California-based broker-dealer agreed to settle a pending SEC case for market access violations by admitting wrongdoing, paying a $2.44 million penalty, and retaining an independent consultant. The violations were related to failures to establish risk management and market access controls.

Recent Supervisory Actions against Financial Institutions

Last Updated: November 21, 2014

Agency	Institution Type	Action	Date	Synopsis of Action
CFPB	Nonbank Auto Lender	Consent Order	11/17	The Consumer Financial Protection Bureau assessed civil money penalties against an auto dealer and its financing arm to address unfair practices in violation of the *Consumer Financial Protection Act* and also for violations of the *Fair Credit Reporting Act*.
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.*

Contact Us

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

John Ivanoski, Partner, National Leader, Regulatory Risk jivanoski@kpmg.com

Hugh Kelly, Principal and National Lead, Bank Regulatory Advisory hckelly@kpmg.com

Amy Matsuo, Principal and National Lead, Enterprise-wide Compliance & Consumer Regulatory amatsuo@kpmg.com

Tracy Whille, Principal and National Lead, Capital Markets and Investment Management Regulatory twhille@kpmg.com

Philip Aquilino, Principal, Bank Regulatory Safety & Soundness paquilino@kpmg.com

Pamela Martin, Managing Director and Lead, Americas FS Regulatory Center of Excellence pamelamartin@kpmg.com

Please direct subscription inquiries to the Americas FS Regulatory Center of Excellence:
regulationfs@kpmg.com

Earlier editions are available at:
www.kpmg.com/us/thewashingtonreport

Additional Contacts

Asset Management, Trust, and Fiduciary
Bill Canellis wcanellis@kpmg.com

Bank Regulatory Reporting
Brett Wright bawright@kpmg.com

Capital Markets Regulation
Stefan Cooper stefancooper@kpmg.com

Capital/Basel II and III
Paul Cardon pcardon@kpmg.com

Commodities and Futures Regulation
Dan McIsaac dmcisaac@kpmg.com

Consumer & Enterprise Compliance
Kari Greathouse cgreathouse@kpmg.com

Cross-Border Regulation & Foreign Banking Organizations
Paul Cardon pcardon@kpmg.com

Insurance Regulation
Matthew McCorry memccorry@kpmg.com

Investment Management
John Schneider jjschneider@kpmg.com

Safety & Soundness, Corporate Licensing & Governance, and ERM Regulation
Greg Matthews gmatthews1@kpmg.com