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The Washington Report
for the week ended November 28, 2014

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Safety & Soundness

FDIC Adopts Assessments Final Rule

The Federal Deposit Insurance Corporation (FDIC) released Financial Institution Letter (FIL-57-2014) on November 24, 2014, to announce that it has adopted a final rule amending its regulations governing risk-based deposit insurance assessments to reflect changes in the regulatory capital rules that go into effect in 2015 and 2018.

In particular, the Final Rule:

- Revises the ratios and ratio thresholds for capital evaluations used in the FDIC's risk-based deposit insurance assessment system to conform to the prompt corrective action (PCA) capital ratios and ratio thresholds adopted by the FDIC, the Federal Reserve Board and the Office of the Comptroller of the Currency (collectively, the Agencies);
- Revises the assessment base calculation for custodial banks to conform to the asset risk weights adopted by the Agencies; and
- Requires all highly complex institutions to measure counterparty exposure for deposit insurance assessment purposes using the Basel III standardized approach credit equivalent amount for derivatives (with modifications for certain cash collateral) and the Basel III standardized approach exposure amount for securities financing transactions—such as repo-style transactions, margin loans, and similar transactions—as adopted by the Agencies.

The final rule will become effective January 1, 2015, except for incorporation of the supplementary leverage ratio and corresponding ratio thresholds into the definition of capital evaluations, which will become effective January 1, 2018.

Federal Reserve Proposes Order to Apply Enhanced Prudential Standards and Reporting Requirements to a Designated Nonbank Company

On November 25, 2014, the Federal Reserve Board (Federal Reserve) released a proposed order for public comment that would apply enhanced prudential standards to a nonbank financial services company that has been designated by the Financial Stability Oversight Council (FSOC) for supervision by the Federal Reserve. As proposed, the enhanced prudential standards would be generally similar to those that apply to similarly-sized bank holding companies, and would include requirements for risk-based and leverage capital, capital planning, stress testing, liquidity, and risk management. The Federal Reserve states that, based on an assessment of the company's business model, capital structure, risk profile, and systemic footprint, the nonbank company's activities and risk profile are substantially similar to those of a large bank holding company.

The Federal Reserve is also proposing to apply additional enhanced prudential standards to the nonbank company, including independence requirements for the nonbank's board of directors, restrictions on intercompany transactions, and leverage capital requirements comparable to the largest, most systemic U.S. banking organizations. Under the proposed order, the nonbank

company would be required to file certain reports with the Federal Reserve that are similar to the reports required of large bank holding companies.

The Federal Reserve requests comments on the proposed order to be submitted no later than 60 days after its publication in the *Federal Register*.

Agencies Provide Feedback on Institution's Second Resolution Plan and Move Resolution Plan Submission Date for Three Companies

On November 25, 2014, the Federal Reserve Board and the Federal Deposit Insurance Corporation (the Agencies) announced they had completed their review of a large financial institution's 2014 resolution plan and issued a joint letter to the firm. The letter notes improvements from the firm's original plan submitted in 2013, including the narrative describing the firm's preferred resolution strategy and its progress in addressing the five obstacles identified in guidance issued by the Agencies.

Despite the improvements, the Agencies also identified specific shortcomings in the firm's 2014 resolution plan, which the firm must address in its 2015 plan. That plan must also demonstrate the firm is making significant progress to address those identified shortcomings in order to ensure the Agencies determine the firm's resolution plan meets the requirements of the *Dodd-Frank Wall Street Reform and Consumer Protection Act.*

The Agencies also announced that, beginning in 2015, three foreign-based banks that operate in the U.S. will be required to submit their annual resolution plans by December 31 of each year instead of by July 1. Companies with U.S. nonbank assets of $100 billion or more are generally required to submit their resolution plans by July 1 of each year. Other companies subject to the Agencies rule must submit their annual resolution plans by December 31.

Enterprise & Consumer Compliance

CFPB Requests Research Papers for 2015 Conference on Consumer Finance Research

The Consumer Financial Protection Bureau (CFPB or Bureau) has announced that it will hold its first Research on Consumer Finance conference in Washington, D.C., on May 7 and 8, 2015. The conference is intended to connect consumer finance researchers and policymakers with research across a wide range of disciplines and approaches, including economics, the behavioral sciences, cognitive sciences, and psychology.

The Bureau has requested that research papers be submitted by January 16, 2015. The papers should focus on:

- Ways consumers and households make decisions about borrowing, saving, and financial risk-taking;

- How various forms of credit (mortgage, student loans, credit cards, installment loans etc.) affect household well-being;
- The structure and functioning of consumer financial markets;
- Distinct and underserved populations; and
- Relevant innovations in modeling or data.

CFPB Ombudsman Delivers 2014 Annual Report

On November 24, 2014, the Consumer Financial Protection Bureau (CFPB or Bureau) announced that the CFPB Ombudsman had delivered the 2014 Ombudsman Annual Report to CFPB Director Richard Cordray. The report outlines the efforts of the Ombudsman to serve as an "independent, impartial, and confidential resource that assists consumers and companies in informally resolving issues with the CFPB."

Among other things, the report indicates the Ombudsman received fewer individual inquiries during fiscal year (FY) 2014 than in FY2013. It attributes nearly all of the decline to fewer consumers "reaching the office" than in the past year. In contrast, the report indicates the number of inquiries from other parties increased by approximately 9 percent, including inquiries from attorneys, third parties, financial entities, businesspersons, consumer and trade groups, and officials of local, state, and federal governments.

Looking ahead to 2015, the report announces the Ombudsman intends to:

- Launch a focus group program to provide another forum for consumer, trade, and other groups to share feedback with the Ombudsman office;
- Further use facilitation to assist in the resolution of systemic issues;
- Continue to be available for visits to financial entities' operations to increase its understanding of various industries; and
- Provide new deliverables to inform stakeholders, both internally and externally, about the work of the Ombudsman.

House Subcommittee Holds Hearing on the Private Flood Insurance Market

The U.S. House Committee on Financial Services' Subcommittee on Housing and Insurance held a hearing on November 19, 2014, entitled *Opportunities for a Private and Competitive Sustainable Flood Insurance Market*. The hearing focused on proposed legislation, the *Flood Insurance Market Parity and Modernization Act of 2014* (H.R. 4558), which would amend *the Flood Disaster Protection Act of 1973* to clarify that flood insurance offered by a private carrier outside of the National Flood Insurance Program (NFIP) can satisfy the mandatory purchase requirement. If enacted, the legislation would:

- Define acceptable private flood insurance as a policy that provides flood insurance coverage issued by an insurance company that is licensed, admitted, or otherwise approved to engage in the business of insurance in the state or jurisdiction in which the insured property is located.
- Treat as acceptable a private flood insurance policy issued by an insurance company that is eligible as a non-admitted insurer to provide insurance in the state or jurisdiction where the property to be insured is located.
- Provide consumers with private sector alternatives to the NFIP and possibly reduce flood insurance premiums through greater competition.

Representatives of a consumer group and the insurance industry stated they supported the legislation in part because, it would shift some of the post-disaster recovery and rebuilding burden from taxpayers and government programs to the private sector and those who choose to live in high risk areas. It would also encourage greater private market participation in the business of flood insurance, and provide new options for consumers purchasing flood insurance.

Insurance

House Subcommittee Considers the Impact of International Regulatory Standards the on Competitiveness of U.S. Insurers

The Housing and Insurance Subcommittee of the U.S. House Committee on Financial Services conducted a hearing on November 18, 2014 entitled, *The Impact of International Regulatory Standards on the Competitiveness of U.S. Insurers, Part II*. The hearing focused on various international regulatory standards proposed by the G-20, the Financial Stability Board (FSB), the International Association of Insurance Supervisors (IAIS), and other international supervisory authorities. Witnesses offering testimony at the hearing represented the Federal Reserve Board (Federal Reserve), Federal Insurance Office (FIO) of the U.S. Treasury, the National Association of Insurance Commissioners (NAIC), and the National Conference of Insurance Legislators (NCOIL).

The Federal Reserve representative said the Federal Reserve, the FIO and the NAIC engage with U.S. insurance companies on the development of global regulatory standards for insurance firms that are consistent across countries and appropriate for internationally active U.S. insurers. He said the Federal Reserve supports group-wide consolidated capital standards that are "well tailored to insurance risks for the largest and most active global insurers" and that are "deliberately developed through transparent processes and properly calibrated."

Like the FIO and NAIC, the Federal Reserve joined the International Association of Insurance Supervisors (IAIS), where it has focused on the IAIS' work on financial stability and consolidated supervision. The IAIS' strategic priorities include:

- Continuing to refine its designation methodology for global systemically important insurers (G-SIIs) and to design loss absorbency requirements for G-SIIs;
- Supplementing the recently released Basic Capital Requirement (BCR) for G-SIIs with a Higher Loss Absorbency (HLA) capital requirement for G-SIIs that present the greatest risk to financial stability; and
- Eventually replacing the BCR with the Insurance Capital Standard (ICS) currently under development.

The other witnesses said they also support international prudential standards that promote consistent oversight. Several expressed concern that the standards reflect the needs of U.S. insurance consumers and companies, and do not undermine or compromise the U.S. state-based insurance regulatory system. The representative of the NCOIL said his organization

would like “a more official role” for state lawmakers in global discussions because international officials “may not understand or appreciate what state regulation does so well.”

Capital Markets & Investment Management

CFTC Division of Market Oversight Issues Rule Enforcement Reviews of Exchanges

On November 24, 2014, the U.S. Commodity Futures Trading Commission’s (CFTC) Division of Market Oversight (Division) issued three separate rule enforcement reviews of certain Designated Contract Markets (DCMs or Exchanges).

The Division’s reviews assessed compliance with the *Commodity Exchange Act Core Principles for DCMs* and related regulations with respect to their audit trail program, trade practice surveillance program, and disciplinary program.

Overall, the Division found the Exchanges’ respective programs to be generally in compliance with the assessed DCM core principles and CFTC regulations. However, the Division’s reviews identified certain deficiencies – areas where an Exchange is not in compliance with a CFTC regulation and must take corrective action. The Division also recommended areas where an Exchange should improve its compliance program.

The audit trail program of two exchanges were found to be deficient in:

- Ensuring that their program for reviewing front-end audit trail data is effective and the reviews are conducted in a timely manner, as required by CFTC regulation §38.553(a)(1);
- Developing a program to at least annually review and enforce the assignment process of user IDs to automated trading models, algorithms, programs, and system in order to enforce the Exchanges user ID (Tag 50) policy, as required by CFTC regulation §38.553(a)(1).
- Ensuring that the minimum summary fine amount for electronic trading audit trail deficiencies on each exchange is “meaningful” and “sufficient to deter recidivist behavior,” as required by CFTC regulation §38.553(b). This minimum summary fine amount should be published in the Exchanges’ rules.

In the Trade Practice Surveillance Program of two Exchanges, the Division found the Exchanges to be deficient in completing investigations in one year or less, absent mitigating circumstances, as required by CFTC regulation §38.158(b). The Division recommended that the Exchanges:

- Implement a system that would enable Market Regulation staff to efficiently track connections between related trade practice matters (complaints, research files, and cases) and thereby identify the source of time delays;
- Continue to develop strategies to detect spoofing; and
- Reduce the time they take to complete pre-investigative trade practice matters (research files and complaints).

The disciplinary program of all four Exchanges were found to be deficient in maintaining sufficient enforcement staff to promptly prosecute possible rule violations, as required by CFTC regulation §38.701. The Division recommended that the Exchanges take appropriate measures to ensure that internal deliberations do not interfere with the prompt resolution of disciplinary matters.

Senate Permanent Subcommittee on Investigations Releases Report on Physical Commodities; Governor Tarullo Testifies Regarding Supervision of Physical Commodities Activities

The U.S. Senate Permanent Subcommittee on Investigations (Subcommittee) conducted a two-day hearing on November 20 and 21, entitled *Wall Street Bank Involvement with Physical Commodities*. The purpose of the hearing was to examine "the extent to which banks and their holding companies own physical commodities like oil, natural gas, aluminum, and other industrial metals, as well as own or control businesses like power plants, oil and gas pipelines, and commodity warehouses." Eleven witnesses provided testimony, including Federal Reserve Board Governor Daniel K. Tarullo. Federal Reserve Governor Tarullo stated the Federal Reserve's review of commodity-related activities of the firms it supervises is ongoing and encompasses:

- Assessing the potential risk of physical commodities activities to the safety and soundness of the financial holding companies engaged in these activities. In doing so, it is focusing on the risk to safety and soundness presented by specific activities and on whether those risks can be appropriately and adequately mitigated.
- Conducting "a careful and thorough" assessment of the costs and benefits of financial holding company engagement in these activities. The effort includes a complete assessment of the comments the Federal Reserve received in response to its Advance Notice of Proposed Rulemaking (NPR) issued in January 2014.

Governor Tarullo said the Federal Reserve expects to issue a formal NPR regarding these matters in the first quarter of 2015.

In advance of the hearings, the Subcommittee released a report, *The Wall Street Bank Involvement with Physical Commodities*, which summarizes the findings of its two-year investigation. The findings generally address:

- Engaging in risky activities;
- Mixing banking and commerce;
- Affecting prices;
- Gaining trading advances;
- Incurring new bank risks;
- Incurring new systemic risks;
- Using ineffective size limits; and
- Lacking key information.

Broadly, the Subcommittee's recommendations address:

- Reaffirming the separation of banking activities and commerce with regard to physical commodities;
- Clarifying size limits;
- Strengthening disclosures;
- Narrowing the scope of complementary activity;
- Clarifying the scope of the grandfathering clause;
- Narrowing the scope of the merchant banking authority;

- Establishing capital and insurance minimums;
- Preventing unfair trading;
- Utilizing the "Section 620" study;
- Reclassifying commodity-backed exchange traded funds; and
- Studying the misuse of physical commodities to manipulate prices.

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 foreign bank's private banking arm with violating federal securities laws for failing to register with the SEC before providing cross-border brokerage and investment advisory services to U.S. clients. The entity agreed to admit wrongdoing and pay $12.5 million to settle the SEC's charges.
- The CFTC charged an individual in California with fraud for misappropriating nearly $130,000 in customer funds and for acting as a Futures Commission Merchant (FCM) without being registered as such with the CFTC. A U.S. District Judge issued an emergency Order freezing and preserving assets of the individual and prohibiting him from destroying documents or denying CFTC staff access to his books and records. The CFTC seeks restitution, disgorgement, civil monetary penalties, trading and registration bans.
- The CFTC filed a Notice of Intent to revoke the registrations of a Florida-based registered commodity pool operator and its registered associated person, alleging they are subject to statutory disqualification from CFTC registration based on an Order for entry of default judgment and an amended Order of permanent injunction entered by U.S. District Court.
- The CFTC ordered a registered COMEX floor broker to pay a $140,000 civil penalty for failing to comply with a CFTC subpoena and to cease and desist from further violations of CFTC recordkeeping requirements. The CFTC also announced that it has separately revoked the floor broker's registration for demonstrated inability to abide by rules and regulations associated with the individual and his floor broker registration, including CFTC recordkeeping requirements.
- FINRA fined the wholly owned subsidiary of a U.S.-based global financial institution $15 million for failing to adequately supervise communications between its equity research analysts and its clients and the broker-dealer's sales and trading staff, and for permitting one of its analysts to participate indirectly in two road shows promoting initial public offerings to investors. In settling the matter, the institution neither admitted nor denied the charges, but consented to the entry of FINRA's findings.

Recent Supervisory Actions against Financial Institutions

Last Updated: November 28, 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 of The Washington Report 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

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