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Safety & Soundness

Basel Committee Report Assesses Implementation of Basel Capital Framework in U.S. and E.U. Member States

On December 5, 2014, the Bank for International Settlements' Basel Committee on Banking Supervision (BCBS or Basel Committee) published reports assessing the implementation of the Basel capital framework in the United States (U.S.) and in nine European Union (E.U.) states that are members of the Basel Committee.

Conducted under the BCBS's Regulatory Consistency Assessment Program (RCAP), the U.S. assessment was based on the set of U.S. regulations published in July 2013 to implement the Basel III regulatory capital reforms. The assessment evaluated 13 of the 14 components of the risk-based capital standards as the U.S. has implemented the Advanced Measurement Approaches for operational risk and opted to not implement the simpler approaches. Overall, the U.S. was found to be "largely compliant" because only minor provisions of the relevant Basel standards have not been satisfied. The assessment was based on the RCAP conclusions:

- Seven of the 13 components meet all minimum provisions of the relevant Basel standards and were graded as "compliant."
- Four of the components were assessed as "largely compliant" because most, but not all, provisions of the global standard were satisfied.
- Two components - the securitization framework and the standardized approach for market risk - were assessed as "materially non-compliant."

The EU assessment was based on the EU's Capital Requirements Regulation and Fourth Capital Requirements Directive and took account of relevant rules in place at the member-state level. Overall, the E.U. member states were found to be "materially noncompliant" because key provisions of relevant Basel standards have not been satisfied. The assessment was based on the RCAP conclusions as follows:

- Eight of the 14 components meet all minimum provisions of the relevant Basel standards and were graded as "compliant."
- Four of the components were assessed as "largely compliant" because most, but not all, provisions of the global standard were satisfied.
- One component - the Internal Ratings-based (IRB) approach for credit risk - was assessed as "materially non-compliant" and pertained primarily to the treatment of exposures to small and medium-size enterprises (SMEs), corporates, and sovereigns.
- Another component that relates to the E.U.'s counterparty credit risk framework, which provides an exemption from the Basel framework's credit valuation adjustment (CVA) capital charge for certain derivatives exposures, was found to be "non-compliant."

Comptroller Says OCC Will Not Wait until the End of the ECRPRA Process to Eliminate Some Outdated or Unnecessary Regulations

On December 2, 2014, Comptroller of the Currency Thomas J. Curry addressed the first in a series of Interagency Outreach Meetings designed to review outdated, unnecessary, or unduly

burdensome regulations as required by the *Economic Growth and Regulatory Paperwork Reduction Act* (EGRPRA). The review is undertaken every ten years under the auspices of the Federal Financial Institutions Examination Council (FFIEC), whose members include the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation, the Federal Reserve Board, the Consumer Financial Protection Bureau, the National Credit Union Administration, and representatives of the state supervisory authorities. The Interagency Outreach Meetings are being conducted publicly and industry participation is encouraged.

In his remarks, Comptroller Curry said that the OCC "will not wait until the end of the EGRPRA process to make changes when a solid case has been made for reform." However, he noted that regulations rooted in Congressional laws require legislative action to change. The OCC has proposed that Congress consider reducing regulatory burden by:

- Allowing healthy, well-managed community institutions to qualify for the 18-month examination cycle. He added that by raising the asset threshold from $500 million to $750 million, 300 additional banks and thrifts would qualify for the 18-month examination cycle.
- Providing a community bank exemption from the Volcker Rule for banks and thrifts with less than $10 billion in assets.
- Allowing federal savings associations and national banks to expand their business models without changing their governance structures so they can adapt to changing economic and business environments and meet the needs of their communities.

Comptroller Discusses Supervisory Approach for Federal Branches and Agencies of Foreign Banks

On December 3, 2014, Comptroller of the Currency Thomas J. Curry discussed the Office of the Comptroller of the Currency's (OCC's) approach to supervising federal branches and agencies of foreign banks during an event hosted by the International Bankers Association of California and the National Association of Chinese American Bankers.

Comptroller Curry said that in supervising federal branches and agencies of foreign banks, the OCC:

- Applies a supervision-by-risk approach to all entities that "requires an in-depth understanding of the operations of each branch or agency, and specifically addresses the institution's unique size, scope of operations, complexity, and the risks presented by its business."
- Develops a consolidated risk profile and supervisory strategy for the U.S.-based organization of foreign banks with multiple federal branches and agencies.
- Collaborates with the Federal Reserve to complete an annual Strength of Support Assessment that "provides a framework for evaluating the financial and managerial support available from the home office, as well as the potential impact of environmental factors."
- Maintains ongoing communication with home country regulators to gather information to aid in its supervision of the federal branch or agency.
- Emphasizes the elimination of complexity in the branch or agency's organizational structure because the federal branches and agencies of foreign institutions do not participate in the U.S. deposit insurance program. The OCC would be responsible for their resolution should the need arise.
- Works collaboratively with the home jurisdictions and parent organization to understand strategy, structure, and resources and maintains "an ongoing dialogue with home country supervisors so that both sides have a clear understanding of what to expect should the need for a resolution arise."

Comptroller Curry also encouraged the federal branches and agencies of foreign banks to:

- Join the Financial Services Information Security and Analysis Center (FS-ISAC) in order to take advantage of the intelligence provided by the public-private sector partnership to combat cyber security threats;
- Conduct their own due diligence of third-party service providers;
- Be cautious about underwriting standards, particularly in the areas of indirect auto and leveraged lending as well as in commercial credit; and
- Make compliance with the *Bank Secrecy Act* and Anti-Money Laundering laws a priority.

Federal Reserve Board Governor Brainard Discusses the Agency's Financial Stability Agenda

On December 3, 2014, Federal Reserve Board Governor Lael Brainard discussed the Federal Reserve Board's (Federal Reserve) financial stability agenda at an event hosted by The Brookings Institution. She stated that although the Federal Reserve has "an inherent responsibility for financial stability, it has an incomplete set of authorities and a limited regulatory perimeter in a financial system that has large capital markets and a fragmented regulatory structure."

Governor Brainard said the Federal Reserve, therefore, utilizes the tools under its authority to:

- Build structural resilience at the largest, most complicated institutions through tougher through-the-cycle standards;
- Use broad countercyclical measures to limit the buildup and potential consequences of risks to financial stability; and
- Explore the design of time-varying, sector-specific tools, and, at times, to "look to the unique capacity of monetary policy to act across the financial system."

Governor Brainard said the Federal Reserve's financial stability agenda, overseen by the Federal Reserve's newly created Committee on Financial Stability, is proceeding in the following four pillars, which she said are in varying stages of advancement:

- *Surveillance.* Federal Reserve staff:
  - Perform a quarterly systematic assessment of a standard set of financial vulnerabilities, including asset valuations and risk appetite, leverage, maturity and risk transformation, and interconnectedness in the broad financial system, and borrowing by households and businesses;
  - Use the detailed information gathered through bank examinations and loan reviews to assess emerging risky practices;
  - Undertake periodic analyses of potential system-wide consequences of possible shocks, such as a sharp rise in the level or volatility of interest rates; and
  - Study the behavior of markets and institutions following close brushes with specific risk events for insights into possible structural vulnerabilities and assess possible policy actions.
- *Macroprudential policy.* The Federal Reserve is:
  - Promulgating a new system of through-the-cycle safeguards to deliver "much greater structural resilience and make excessive risk-taking costly for the large, complex institutions;"
  - Assessing broad, time-varying regulatory tools that might further buttress resilience during periods in which risks associated with rapid credit expansion are building; and
  - Exploring tools that can be varied over the cycle to target specific activities.
- *Working across the regulatory perimeter.* The Federal Reserve cooperates with other regulators to develop well-rehearsed working protocols and a joint sense of responsibility

for financial stability. "The network of independent financial agencies is enhancing cooperation through the formal structure and responsibilities of the Financial Stability Oversight Council as well as through joint rulemakings and joint supervisory efforts."

- *Monetary policy.* A "second line of defense," monetary policy is a complement to macroprudential tools. While it is important to recognize that necessary adjustments in monetary policy could have broader consequences, it is "equally important to acknowledge the potential utility of monetary policy" in addressing risks to financial stability and the broader economy.

Enterprise & Consumer Compliance

CFPB Fines Debt Settlement Company for Charging Illegal Upfront Fees

On December 4, 2014, the Consumer Financial Protection Bureau (CFPB or Bureau) announced that it has asked a federal district court to enter a consent order requiring a New Jersey-based debt settlement services company to pay a $69,075 civil money penalty for charging consumers illegal upfront fees for services they did not receive in violation of the Federal Trade Commission's Telemarketing Sales Rule. Without admitting or denying the charges, the company agreed to pay the fine and take steps to prevent future violations.

Department of Treasury and HUD Announce Enhancements to HAMP

The U.S. Department of the Treasury (Treasury Department) and the U.S. Department of Housing and Urban Development (HUD) announced on December 4, 2014, that approximately one million borrowers with federally-subsidized modifications to their mortgages would receive added incentives to encourage them to remain current on their loans.

Under the Home Affordable Modification Program (HAMP), borrowers who make on-time payments have been able to earn up to $5,000 toward their principal balance over the first five years of a modified loan. The Treasury Department and HUD said that current borrowers can now earn an additional $5,000 in the sixth year of the modified loan, resulting in $10,000 in total balance reductions. Those borrowers will also have the option to re-amortize the reduced balance to lower their monthly payments.

For borrowers that did not qualify for the HAMP program and who are in the HAMP Tier 2 alternative program, the Treasury Department and HUD also announced they are:

- Reducing the interest rate for HAMP Tier 2 by 50 basis points; and
- Extending the $5,000 pay-for-performance incentive to HAMP Tier 2 borrowers in good standing at the end of the sixth year of their modification.

The Treasury Department and HUD also enhanced their short sale and deed-in-lieu programs by increasing the amount of relocation assistance provided to homeowners from $3,000 to $10,000 to better reflect increased rents and the cost of moving.

Insurance

NAIC Forms Cybersecurity Task Force

The National Association of Insurance Commissioners (NAIC) recently announced that it formed a special task force to help coordinate insurance issues related to cybersecurity. The task force will make recommendations to the NAIC Executive Committee and coordinate NAIC efforts regarding:

- Protecting information housed in insurance departments and the NAIC;
- Protecting consumer information collected by insurers; and
- Collecting information on cyber-liability policies being issued in the marketplace.

The NAIC stated that it created the task force because of its growing commitment to address cybersecurity in the insurance sector. State regulators serve on the U.S. Department of Treasury Financial Banking and Information Infrastructure Committee and on the Executive Branch and Independent Agency Regulatory Cybersecurity Forum where they work with federal regulators to address cyber threats in the United States.

Capital Markets & Investment Management

CFTC Reopens Comment Periods for Position Limits Proposal and Aggregation Proposal

The U.S. Commodity Futures Trading Commission (CFTC) published a notice in the *Federal Register* on December 3, 2014, announcing that it will reopen the comment periods for two proposed rules: the Position Limits Proposal issued on December 12, 2013, and the Aggregation Proposal issued on November 15, 2013. Both comment periods will be reopened for a period of 45 days beginning on December 9, 2014, and closing on January 22, 2015.

The CFTC stated that it is reopening the comment periods in anticipation of questions and comments that may arise from its December 9, 2014 Agricultural Advisory Committee (Committee) meeting where the Committee will consider, among other matters, deliverable supply and exemptions for bona fide hedging positions. The Position Limits Proposal is intended to establish speculative position limits for 28 exempt and agricultural commodity futures and options contracts and the physical commodity swaps that are economically

equivalent to such contracts. The Aggregation Proposal is intended to amend existing regulations setting out the CFTC's policy for aggregation under its position limits regime.

The CFTC has requested that comments be limited to the following issues as they pertain to agricultural commodities: hedges of a physical commodity by a commercial enterprise; and the process for estimating deliverable supplies used in the setting of spot month limits.

CFTC Commissioner Mark P. Wetjen Discusses a Centrally Cleared, Global Swaps Market

On December 4, 2014, Commissioner Mark P. Wetjen of the Commodities Future Trading Commission (CFTC) delivered a speech entitled *Ensuring the Promise of a Centrally Cleared, Global Swaps Market: Next Steps* at the FIA Asia Derivative Conference. He focused his remarks on:

- Improving transparency, particularly with respect to standardizing stress tests;
- Assessing loss mutualization by considering a requirement for central counterparty (CCP) capital contributions to the guarantee fund, as well as the appropriate allocation of losses in the default waterfall; and
- Ensuring that recovery and wind down plans are effective and realistic, including whether to prohibit CCPs from allocating losses to customers in their recovery plans.

Commissioner Wetjen said clearing provides market benefits by mitigating counterparty risk and promoting transparency, which can help bolster market confidence. He is concerned, however, that concentration of risk in CCPs will continue to grow as clearing volumes increase. Such concentration risk, he suggested, can be mitigated through both market discipline and global regulatory coordination, and he recommended that the CFTC begin exploring soon whether to:

- Further require standardized stress tests by Derivatives Clearing Organizations (DCOs) to improve transparency and better enable global coordination;
- Specifically require DCOs to contribute capital to the guarantee fund and specify when it should be tapped vis-a-vis non-defaulting member contributions; and
- Prohibit a DCO from allocating losses to customers in its recovery plan.

Commissioner Wetjen said he intends to call a meeting of the CFTC's Global Markets Advisory Committee "where market participants and regulators can meet to further examine, discuss, and produce a recommendation regarding these important CCP risk-management issues."

In concluding, he said other issues also deserve attention from regulators, including those surrounding the treatment of segregated margin in the leverage ratio calculation under the Basel III leverage ratio framework and disclosure requirements.

SEC Commissioner Stein Discusses Investor Protection Efforts

On December 4, 2014, Commissioner Kara M. Stein of the Securities and Exchange Commission (SEC or Commission) discussed three areas where she believed the SEC should focus its investor protection efforts. Speaking only for herself and not the SEC, Commissioner Stein said the SEC should:

- Optimize and enhance the disclosures intended to empower investors by:
    - Requiring "genuinely meaningful and useful disclosures" for different types of investors;

  - Testing how ordinary consumers understand information presented in corporate disclosures;
  - Recognizing the differences between, and the needs of, different types of investors by "looking beyond the annual and quarterly reports, and considering how and when other information is presented;"
  - Providing different "layers" of disclosure to different types of investors. More sophisticated investors may want a great deal of detailed data, while ordinary investors "may be better served by a clearer summary that identifies only the most important information."
  - Leveraging technology to empower investors, regardless of the content of the disclosures themselves. Information should continue to be provided to the SEC in a structured format, but "we should move quickly to add what we call 'in-line XBRL' to annual reports, which is essentially embedding the data tags within the filed document itself instead of having two separate filings. This would reduce errors and eliminate the burden on filers who must file in two formats.
- Continue to do more to align the interests of investors, companies, and other market participants by analyzing the SEC's approach to regulation, and ensuring that its approach is "sound and well-reasoned." She suggested the SEC should also consider:
  - How to better align the interests of broker-dealers with the investors they serve; and
  - How to improve the dialogue between companies and their shareholders to the benefit of both.
- Hold those who don't follow the rules accountable by:
  - Carefully considering "in a fair and transparent manner" any requests for waivers from Rule 506 of Regulation D, the "bad actor" rule for private offerings; and
  - Being flexible and nuanced in its approach to these waivers rather than providing a "yes" or "no" response to waiver requests.

Enforcement Actions

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

- The SEC charged the California-based owner of several investment entities with fraudulently selling $900,000 shares of stock that the individual purported to own and misappropriating the proceeds to personal use. The SEC seeks permanent injunctions, the return of ill-gotten gains, and a financial penalty.
- The SEC charged two former executives of a Wisconsin-based company with fraud, alleging they falsified disclosures and accounting records to meet covenants in its lease agreements and avoid an acceleration of the contract payments. The SEC is seeking disgorgement, civil penalties, and officer and director bars. For one of the executives, the SEC is also seeking a bar from appearing before the SEC as an accountant.
- The SEC charged a Montana-based penny stock promoter with orchestrating a fraudulent pump-and-dump scheme involving the stock of a Northern Virginia-based company. The stock promoter agreed to settle the SEC's charges and be barred from the penny stock industry. The SEC anticipates that the stock promoter will be liable for disgorgement and prejudgment interest in excess of $900,000 as a result of parallel criminal action brought by the U.S. attorney.
- The SEC charged a Virginia-based bank holding company and its former chief financial officer (CFO) with improperly accounting for a deferred tax asset (DTA) that was not fully realizable due to the company's deteriorating loan portfolio and financial condition. Without admitting or denying the findings, the bank agreed to pay a $200,000 penalty to

settle the SEC's charges. The former CFO agreed to pay $25,000 to settle the charges against him personally.

- The CFTC announced that an individual who operated a New York-based commodity pool was sentenced to 10 years in federal prison for charges related to the operator's participation in a $1.3 billion investment scam. The operator pled guilty to a six-count criminal indictment on the charges, including a commodities fraud charge.
- The CFTC charged a Pennsylvania-based commodity pool operator and the individual who managed it with fraud and misappropriation of customer funds. The individual and commodity pool operator agreed to settle the CFTC's charges and jointly pay a $414,000 civil monetary penalty and restitution totaling $405,378 to defrauded customers. The individual also agreed to permanent bans from registering, trading, and engaging in CFTC-regulated activities.
- The CFTC announced that a U.S. District Court judge entered an Order of default judgment against a Florida-based commodity distributor and its sole owner for engaging in illegal, off-exchange transactions with retail customers on a leveraged, margined, or financed basis. The Order requires them to pay $337,266 in restitution and a $1,011,800 civil monetary penalty. The Order also imposes permanent trading, solicitation, and registration bans.

Recent Supervisory Actions against Financial Institutions

Last Updated: December 5, 2014

Agency	Institution Type	Action	Date	Synopsis of Action
CFPB	Nonbank Debt Services Provider	Consent Order	12/04	The Consumer Financial Protection Bureau assessed a civil money penalty against a New Jersey-based debt settlement services provider for charging consumers illegal upfront fees in violation of the Federal Trade Commission's Telemarketing Sales Rule.
Federal Reserve Board	State Member Bank	Consent Order	11/26	The Federal Reserve Board assessed a civil money penalty against a state member bank in connection with violations of Regulation H, which implements the National Flood Insurance Act.
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.*

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

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