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Safety & Soundness

Agencies Adopt Final Rule to Implement Credit Risk Retention Requirements

On January 30, 2015, the Office of the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the U.S. Securities and Exchange Commission, the Federal Housing Finance Agency, and the U.S. Department of Housing and Urban Development (collectively, the Agencies) adopted a final rule to implement the credit risk retention requirements of Section 15G of the *Securities Exchange Act of 1934*, as added by Section 941 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*.

The final rule:

- Requires sponsors of asset-backed securities to retain at least 5 percent of the credit risk of the assets underlying the securities and does not permit sponsors to transfer or hedge that credit risk during a specified period.
- Applies to asset-backed securities issued on or after December 24, 2015, if the securities are backed by residential mortgages. The final rule applies to all other classes of asset-backed securities issued on or after December 24, 2016.
- Defines "qualified residential mortgages" (QRMs) to include all loans that meet the "qualified mortgage" (QM) definition issued by the Consumer Financial Protection Bureau (CFPB). Securitizations of QRMs are exempt from risk retention requirements.
- Does not include cash flow restrictions on the eligible horizontal residual interest, which is a first-loss asset-backed security interest that satisfies the risk retention requirements.

Federal Reserve Issues Plan to Improve the U.S. Payment System

On January 26, 2015, the Federal Reserve Board (Federal Reserve) issued a multi-faceted plan for collaborating with payment system stakeholders to create a safer, more efficient, and faster payment system. Entitled "Strategies for Improving the U.S. Payment System," the plan reflects the contributions of thousands of payments participants and stakeholders, including large and small businesses, emerging payments firms, card networks, payment processors, consumers, and financial institutions.

The paper:

- Discusses desired outcomes for the payment system and outlines the strategies and tactics the Federal Reserve will pursue, in collaboration with stakeholders, to help achieve these outcomes;
- Outlines the Federal Reserve's intent to establish a task force to identify effective approaches for implementing safe, ubiquitous, faster payment capabilities; and
- Calls for a task force to advise the Federal Reserve on reducing payment fraud and advancing the safety, security, and resiliency of the payment system.

Additionally, the Federal Reserve intends to pursue efforts to enhance payment system efficiency through work on standards, directories, and business-to-business payment improvements, alongside efforts to enhance Federal Reserve-provided services for same-day automated clearing house, risk management, and settlement.

Federal Reserve Issues Proposed and Interim Final Rules Regarding Capital Requirements for Small Bank Holding Companies

On January 29, 2015, the Federal Reserve Board (Federal Reserve) issued a proposed rule that would raise the asset size threshold for determining the applicability of its Small Bank Holding Company Policy Statement (Regulation Y, Appendix C) (Policy Statement) from $500 million to $1 billion, and would also expand the scope of the Policy Statement to include savings and loan holding companies (SLHCs) that meet the Policy Statement's requirements.

The Federal Reserve also proposed to:

- Make related and conforming revisions to:
  - Regulation Y and Regulation LL, the Federal Reserve's regulations governing the operations and activities of bank holding companies (BHCs) and SLHCs, respectively; and
  - Regulation Q, the Federal Reserve's regulatory capital regulation.
- Change the reporting requirements for BHCs and SLHCs that meet the requirements of the Policy Statement (as proposed)

Separately, the Federal Reserve also adopted an interim final rule to exempt SLHCs that have total consolidated assets of less than $500 million and meet certain other requirements from the agency's regulatory capital requirements (Regulation Q). The amendments are effective immediately. They implement Public Law 113-250, which exempts small SLHCs that would meet the requirements of the Policy Statement if they were BHCs from the minimum capital requirements mandated by Section 171 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*.

In connection with this interim final rule, the Federal Reserve proposed to remove the requirement that qualifying SLHCs complete Schedule SC-R, Part I (Regulatory Capital Components and Ratios), of form FR Y-9SP (Parent Company Only Financial Statements for Small Holding Companies).

The Federal Reserve has requested comments be submitted on or before March 4, 2015 for both the proposed rule and interim final rule.

Federal Reserve Governor Tarullo Discusses Macroprudential Policy Objectives

On January 30, 2015, Federal Reserve Board Governor Daniel K. Tarullo addressed the Office of Financial Research and the Financial Stability Oversight Council's Annual Conference on "Evaluating Macroprudential Tools: Complementarities and Conflicts." In his speech entitled, *Advancing Macroprudential Policy Objectives*, Governor Tarullo discussed macroprudential objectives that he said are "both realistic and important to incorporate into a near- to medium-term policy agenda." Those objectives included:

- Continuing the task of ensuring that very large, complex financial institutions do not threaten financial stability;
- Developing policies to deal with leverage risks and susceptibility to runs in financial markets that are not fully contained within the universe of prudentially regulated firms;
- Dealing with the vulnerabilities associated with the growing importance of central counterparties.

In his concluding remarks, Governor Tarullo said a "macroprudential policy perspective means taking account of system-wide effects as financial regulation is developed and implemented." He indicated, however, that agreement at a high level does not assure agreement on the priorities for regulatory attention, or the specific regulations that should be adopted. He stated that even the best-conceived macroprudential policies cannot compensate totally for the risks created by key macroeconomic or financial conditions. He stated that the macroprudential policy perspective should "force us all to think about issues like arbitrage, correlated risks and responses, and externalities in a more explicit and regular fashion than was evident in pre-crisis practice."

Basel Committee Releases Revised Pillar III Disclosure Requirements

On January 28, 2015, the Bank for International Settlements Basel Committee on Banking Supervision (Basel Committee) issued the final standard for the revised Pillar 3 disclosure requirements. The revised disclosure requirements are intended to enable market participants to compare banks' disclosures of risk-weighted assets. The revisions focus on improving the transparency of the internal model-based approaches that banks use to calculate minimum regulatory capital requirements.

The revised standard retains the structure of the Basel Committee's June 2014 consultative paper though key changes involve:

- Rebalancing the disclosures required quarterly, semi-annually, and annually;
- Streamlining the requirements related to disclosure of credit risk exposures and credit risk mitigation techniques; and
- Clarifying and streamlining the disclosure requirements for securitization exposures.

The revised requirements will take effect at the end of 2016. They supersede the existing Pillar III disclosure requirements first issued as part of the Basel II framework in 2004 and the Basel 2.5 revisions and enhancements introduced in 2009.

Basel Committee Releases Survey Findings on Evolving Supervisory Practices Relevant to Financial Inclusion

On January 30, 2015, the Bank for International Settlements' Basel Committee on Banking Supervision (Basel Committee or BCBS) published a report entitled *Range of practice in the regulation and supervision of institutions relevant to financial inclusion.* This Basel Committee report reveals the extent to which supervisory and regulatory practices are evolving in response to the emergence of new institutions, financial products, and intermediation channels that service poor and low-income customers in different jurisdictions. Undertaken by the Basel Consultative Group, the report sets out findings from a survey of over 50 Basel Committee members and non-members.

BCBS stated that the results of the survey will serve as background to further work within the Basel Committee to assess the application of the 2012 Core Principles for Effective Banking Supervision to entities and activities relevant to financial inclusion.

Enterprise & Consumer Compliance

CFPB Issues Proposed Rule to Amend Certain 2013 Mortgage Rules Relating to Small Creditors and Rural or Underserved Areas Under the Truth in Lending Act

The Bureau of Consumer Financial Protection (CFPB or Bureau) issued a proposed rule on January 29, 2015, that would revise the Bureau's regulatory definitions of "small creditor," and "rural and underserved areas," for purposes of certain special provisions and exemptions contained in several of its mortgage rules. The CFPB has requested that comments be submitted by March 30, 2015.

In particular, the proposed rule would:

- Raise the loan origination limit for small-creditor status from 500 first-lien mortgage loans to 2,000 and exclude loans held in portfolio by the creditor and its affiliates.

- Include the assets of the creditor's mortgage-originating affiliates in calculating whether a creditor is under the $2 billion asset limit.
- Expand the definition of "rural" to include census blocks that are not in an urban area as defined by the Census Bureau.
- Provide a grace period for creditors that exceeded the origination limit or asset-size limit in the preceding calendar year and creditors that no longer operated predominantly in rural or underserved areas during the preceding calendar year that would permit them to operate as if they had met the thresholds, in certain circumstances, for applications received before April 1 of the current calendar year.
- Adjust the time period used in determining whether a creditor is operating predominately in rural or underserved areas, from any of the three preceding calendar years to the preceding calendar year.
- Extend the temporary transition period for small creditors to include balloon-payment mortgage transactions regardless of whether they operate in predominantly rural or underserved areas to certain transactions for which the applications are received before April 1, 2016.

CFPB Issues Supervisory Compliance Bulletin Regarding Treatment of Confidential Supervisory Information

On January 27, 2015, the Consumer Financial Protection Bureau (CFPB or Bureau) issued Compliance Bulletin 2015-01 to remind supervised financial institutions of existing regulatory requirements regarding confidential supervisory information (CSI). With limited exceptions, persons in possession of confidential information, including CSI, may not disclose such information to third parties.

The Bulletin:

- Defines CSI and provides examples;
- Highlights certain legal restrictions on the disclosure of CSI; and
- Explains that private confidentiality and non-disclosure agreements neither alter the legal restrictions on the disclosure of CSI nor impact the CFPB's authority to obtain information from covered persons and service providers in the exercise of its supervisory authority.

FDIC Releases Second Technical Assistance Video on the CFPB's Mortgage Rules

On January 27, 2015, the Federal Deposit Insurance Corporation (FDIC) released the second in a series of three new technical assistance videos developed to assist bank employees in meeting regulatory requirements. These videos address compliance with certain mortgage rules issued by the Consumer Financial Protection Bureau (CFPB). The second video covers the Loan Originator Compensation Rule.

The first video, released on November 19, 2014, covered the Ability to Repay and Qualified Mortgage Rule. The FDIC expects to release the third video covering the Servicing Rule in February. The three technical assistance videos are intended for compliance officers and staff responsible for ensuring the bank's mortgage lending operations comply with CFPB rules.

FDIC Encourages Institutions to Use Risk-Based Approach When Assessing Individual Customer Relationships

The Federal Deposit Insurance Corporation (FDIC) issued a Financial Institution Letter (FIL 5-2015) on January 28, 2015, to encourage insured depository institutions to take a risk-based approach in assessing individual customer relationships rather than declining to provide banking services to entire categories of customers without regard to the risks presented by an individual customer or the financial institution's ability to manage the risk. The letter states that institutions are expected to assess the risks posed by an individual customer on a case-by-case basis and to implement controls to manage the relationship commensurate with the risks associated with each customer.

Regulators Release Guidance on Private Student Loans with Graduated Repayment Terms at Origination

On January 29, 2015, five federal financial regulatory agencies (the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Consumer Financial Protection Bureau, and the National Credit Union Administration – collectively, the Agencies) in conjunction with the State Liaison Committee (SLC) of the Federal Financial Institutions Examination Council (FFIEC), issued guidance for financial institutions on private student loans with graduated repayment terms at origination. This guidance provides principles for financial institutions to consider in their policies and procedures for originating private student loans with graduated repayment terms.

The guidance states that banks that originate private student loans with graduated repayment terms may align borrowers' income levels with loan repayment requirements in a manner consistent with safe and sound lending practices. It also directs institutions to provide disclosures that clearly communicate the timing and the amount of payments to facilitate a borrower's understanding of the loan's terms and features.

In a joint release, the Agencies and the SLC stated that they recognize "the competitive job market, traditionally low entry-level salaries, and higher student debt loads can contribute to some borrowers preferring greater flexibility with their payments as they transition into the labor market."

FTC Charges Two Auto Title Lenders with Deceptive Advertising

On January 30, 2015, the Federal Trade Commission (FTC) announced that it charged two Georgia-based car title lenders with deceptive advertising. These are the first cases the FTC has brought against car title lenders. The FTC alleges that the companies violated the *Federal Trade Commission Act* and the *Truth in Lending Act* (TILA) when they advertised zero percent interest rates for 30-day car title loans without disclosing important loan conditions or the increased finance charge imposed after the introductory period ended. Without admitting or denying the FTC's findings, the companies agreed to settle the charges.

The proposed settlements prohibit the companies from:
- Failing to disclose all the qualifying terms associated with obtaining a loan at its advertised rate;
- Failing to disclose what the finance charge would be after an introductory period ends; and
- Misrepresenting any material terms of any loan agreements.

One of the companies is also prohibited from stating the amount of any down payment, number of payments or periods of repayment, or the amount of any payment or finance charge without clearly and conspicuously stating all the terms required by TILA and Regulation Z.

FHFA Director Addresses Sustainable Housing Finance at Hearing of U.S. House Committee on Financial Services

On January 27, 2015, the U.S. House Committee on Financial Services (Committee) held a hearing entitled "Sustainable Housing Finance: An Update from the Director of the Federal Housing Finance Agency (FHFA)." The Honorable Melvin Watt, Director of the Federal Housing Finance Agency, provided an update to the Committee on:
- Measures FHFA has taken as conservator of Fannie Mae and Freddie Mac;
- FHFA's current Strategic Plan for Fannie Mae and Freddie Mac;
- The current financial condition of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks (FHLBs);
- The current state of private sector participation in the housing finance market;
- Whether adequate steps are being taken to encourage additional private capital in this market; and
- Additional actions FHFA has taken as regulator of Fannie Mae, Freddie Mac, and the FHLBs.

In a lengthy discussion following his testimony, Director Watt was criticized by some Committee members for adopting policies that they said could result in another housing crash requiring a taxpayer bailout. Specifically, Committee Chairman Jeb Hensarling criticized the suspension of a guarantee fee increase, the adoption of 97 percent loan-to-value (LTV) ratios, and funding of the Affordable Housing Trust Fund. Some Committee members questioned whether adequate steps are being taken to encourage additional private capital in this market.

Other Committee members praised Director Watt for the FHFA's efforts to expand access to mortgages and particularly for raising LTV ratios and funding the Affordable Housing Trust Fund.

Capital Markets & Investment Management

CFTC Commissioner Giancarlo Proposes Alternative to CFTC's Swaps Trading Rules

On January 29, 2015, U.S. Commodity Futures Trading Commission (CFTC) Commissioner J. Christopher Giancarlo released a whitepaper entitled *Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank.* The paper analyzes the CFTC's implementation of its swaps trading regulatory framework under Title VII of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act) and proposes an alternative that Giancarlo states is more effective. Commissioner Giancarlo's paper describes the CFTC's swaps trading rules as flawed because they "increase market fragility and the systemic risk that the Dodd-Frank reforms were predicated on reducing." He stated that his framework "offers a comprehensive, cohesive and flexible alternative that betters aligns with swaps market dynamics and is more true to Congress's stated intentions."

Enforcement Actions

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

- The SEC charged a New York-based broker dealer and investment advisory firm with violating federal securities laws while improperly selling penny stocks in unregistered offerings on behalf of customers. In settling the charges, the firm admitted wrongdoing and agreed to pay $10 million. The firm also agreed to be censured and to retain an independent consultant to review its policies and procedures over a five-year period. Separately, the firm will pay $10 million to settle a parallel action by the U.S. Department of the Treasury Financial Crimes Enforcement Network (FinCEN).
- The SEC charged an Illinois-based company, its two co-founders, and its former chief operating officer with selling more than nine billion shares of penny stocks through purported stock-based loans, block trades, and other transactions without registering with the SEC as a broker-dealer. Without admitting or denying the SEC's findings, they agreed to collectively pay more than $4.3 million in disgorgement, prejudgment interest, and penalties to settle the charges. The former chief operating officer agreed to accept a three-year bar from the securities industry and penny stock offerings.
- The CFTC charged an individual and his Florida-based company for engaging in illegal, off-exchange transactions, for committing fraud in connection with those illegal transactions, and for operating as an unregistered Futures Commission Merchant (FCM). Without admitting or denying the findings, the individual and his company settled the CFTC's charges and agreed to pay restitution of approximately $5.9 million and a civil monetary penalty of $3.75 million. They also agreed to permanent registration and trading bans.

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