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Safety & Soundness

Federal Reserve Announces Results of Comprehensive Capital Analysis and Review

On March 11, 2015, the Federal Reserve Board (Federal Reserve) announced the results of the 2015 Comprehensive Capital Analysis and Review (CCAR). Thirty-one bank holding companies (BHCs) submitted capital plans for the review and the Federal Reserve announcement indicated the agency did not object to 28 of these plans.

One institution received a conditional non-objection based on qualitative grounds. The Federal Reserve is requiring the institution to submit a new capital plan by the end of the third quarter to address certain weaknesses in its capital planning processes. The Federal Reserve objected to the plans of two firms on qualitative grounds. If the Federal Reserve objects to a capital plan based on quantitative or qualitative concerns, the institution may not make any capital distribution without the permission of the Federal Reserve.

The CCAR evaluates the capital planning processes and capital adequacy of the largest U.S.-based BHCs—those with $50 billion or more in assets—including the firms' planned capital actions such as dividend payments and share buybacks and issuances. CCAR is intended to ensure that the BHCs have effective capital planning processes and sufficient capital to absorb losses during stressful conditions, while meeting obligations to creditors and counterparties and continuing to serve as credit intermediaries. Information gathered through the CCAR assessment also serves as a key input into evaluations of a BHC's capitalization and overall financial condition.

The Federal Reserve notes that the results indicate the firms subject to CCAR have substantially increased their capital levels since the first round of stress tests led by the Federal Reserve in 2009. For the 31 BHCs in the 2015 CCAR, the common equity capital ratio, which compares high-quality capital to risk-weighted assets, more than doubled (increasing from 5.5 percent in the first quarter of 2009 to 12.5 percent in the fourth quarter of 2014), reflecting an increase in common equity capital of more than $641 billion to $1.1 trillion during the same period. Further, the firms, collectively, are projecting that they will continue building capital from the second quarter of 2015 through the second quarter of 2016.

Also on March 11, 2015, the Federal Reserve released corrected results for the supervisory stress test results released by the Federal Reserve during the week ended March 13, 2015 pursuant to the *Dodd-Frank Wall Street Reform and Consumer Protection Act*. Four firms participating in those test were found to have submitted incorrect data, which affected their starting tier 1 common capital ratios and by extension their post-stress minimum and ending tier 1 common capital ratios in the severely adverse and adverse scenarios. The Federal Reserve notes the corrections led to increases in these ratios for the affected firms.

Enterprise & Consumer Compliance

White House Introduces a Plan to Strengthen Consumer Protections for Student Borrowers

On March 10, 2015, President Barack Obama proposed a new "Student Aid Bill of Rights" that directs multiple entities, including the Department of Education, Department of Treasury, Office of Management and Budget, Office of Science and Technology Policy and Domestic Policy Council, the Consumer Financial Protection Bureau, and the Social Security Administration (cumulatively, the Agencies), to work together to make paying for higher education "an easier and fairer experience." In general, the Administration is directing the Agencies to work across the federal government to take steps that will help borrowers "afford their monthly loan payments including: (1) a state-of-the-art complaint system to ensure quality service and accountability for the Department of Education, its contractors, and colleges, (2) a series of steps to help students responsibly repay their loans including help setting affordable monthly payments, and (3) new steps to analyze student debt trends and recommend legislative and regulatory changes."

In a White House blog post, Department of Education Secretary Arne Duncan outlined the work the Administration would do together with the Agencies, including:

- Develop a process for borrowers to file complaints involving their federal student aid, and determine the best way to address those complaints. (The White House Fact Sheet states the Secretary of Education will create a Web site by July 2016 where student borrowers can file complaints or provide feedback about how lenders, servicers, collection agencies, and universities handle student loans.)
- Ensure the "banks that service federal loans are held to high standards and provide better information to borrowers; and raise the bar for debt collection to make sure that fees charged to borrowers are reasonable and that collectors are fair, transparent, and help borrowers get back on track."
- Use innovative strategies to improve borrowers' experience and improve customer service. Secretary Duncan adds that the Department of Education will find "new and better ways to communicate with student loan borrowers and create a centralized, easier process for repaying loans" It will investigate what changes to regulations and legislation, including bankruptcy law, may be necessary to protect borrowers – regardless of the type of loan they have.
- Work across the federal government to see what lessons can be learned from similar situations, like mortgage and credit card markets and other performance-based contracts, to make sure that consumer protections for students are continually strengthening.

CFPB Study Finds Arbitration Agreements Limit Relief for Consumers

On March 10, 2015, the Consumer Financial Protection Bureau (CFPB or Bureau) published the results of its Arbitration Study (study), which was conducted pursuant to a mandate in the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act). The report analyzes empirical evidence, including consumer contracts and court data, to understand the resolution of consumer finance disputes in arbitration and in the courts. The CFPB studied arbitration clauses in a number of different consumer finance markets including credit cards and checking accounts.

The CFPB summarizes that the study results indicated arbitration agreements restrict consumers' relief for disputes with financial service providers by limiting class actions. Other key findings follow:

- In the consumer finance markets studied, very few consumers individually seek relief through arbitration or the federal courts, while millions of consumers are eligible for relief each year through class action settlements.

- More than 75 percent of consumers surveyed did not know whether they were subject to an arbitration clause in their agreements with their financial service providers.
- Fewer than 7 percent of those covered by arbitration clauses realized that the clauses restricted their ability to sue in court.

The Dodd-Frank Act mandates that the CFPB conduct a study on the use of pre-dispute arbitration clauses in consumer financial markets, and it specifically prohibits the use of arbitration clauses in mortgage contracts. The Dodd-Frank Act also gives the CFPB the power to issue regulations on the use of arbitration clauses in other consumer finance markets if the Bureau finds that doing so is in the public interest and is consistent with the results of the Bureau's study.

CFPB Publishes New *Supervisory Highlights*

On March 11, 2015, the Consumer Financial Protection Bureau (CFPB or Bureau) published the winter 2015 edition of *Supervisory Highlights*, which offers supervisory insights into the regulatory violations uncovered by CFPB examiners as part of the Bureau's supervisory activities between July 2014 and December 2014. In particular, the report discusses examiners' findings in the areas of:

- Deceptive student loan debt collection practices;
- Unfair and deceptive overdraft practices;
- Mortgage origination violations;
- Fair lending violations; and
- Mishandled disputes by consumer reporting agencies.

This seventh edition of *Supervisory Highlights* also indicates that CFPB supervisory resolutions resulted in remediation of $19.4 million to more than 92,000 consumers. The CFPB notes that in all cases where CFPB examiners find violations of law, they alert the institutions to their concerns and outline necessary remedial measures. When appropriate, the CFPB opens investigations for potential enforcement actions.

Capital Markets and Investment Management

CFTC Solicits Public Comment in Response to the U.S. District Court Order Regarding Cross-Border Litigation

On March 10, 2015, the U.S. Commodity Futures Trading Commission (CFTC) requested public comment in response to the United States District Court for the District of Columbia's remand order in *Securities Industry and Financial Markets Association (SIFMA), et al. v. United States Commodity Futures Trading Commission* (Cross-Border Litigation). All comments are requested on or before May 11, 2015.

In the Cross-Border Litigation, three trade associations challenged the CFTC's 2013 interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations and asked the court to vacate 14 swap regulations to the extent of their application to overseas activities. In September 2014, the U.S. District Court for the District of Columbia granted summary judgment in favor of the CFTC in most respects and denied the plaintiffs the relief they were seeking. The court left the CFTC's regulations in force but remanded 10 swap regulations to the CFTC to supplement its consideration of costs and benefits as to those 10 regulations.

In its request for public comment, the CFTC clarifies its consideration of the costs and benefits of those ten rules subject to the order. The CFTC explains that its consideration of costs and benefits in the rulemaking proceedings reflected all evidence of costs and benefits in the administrative record, whether relevant to domestic activity, overseas activity, or both. Specifically, the CFTC is seeking public comment on:

- Which of the costs and benefits identified similarly apply to the rules' extraterritorial applications; and
- What differences exist, if any.

Following review of the comments, the CFTC intends to publish a further response (or responses) to the remand order, which would include any necessary further supplementation of or changes to its consideration of costs and benefits of the rules and address whether any changes to the substantive requirements of the rules are warranted.

BIS Committee on Payments and Market Infrastructures and IOSCO Begin Review of CCP Stress Testing

The Bank for International Settlements' (BIS) Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) announced on March 11, 2015, that they are undertaking a review of stress testing by central counterparties (CCPs).

The *Principles for financial market infrastructures* (PFMI), published by the CPMI and IOSCO in 2012, requires CCPs to carry out rigorous stress testing to determine the financial resources they need to manage both credit and liquidity risk, including a wide range of stress scenarios covering a variety of extreme but plausible market conditions. CPMI and IOSCO stated that the systemic importance of CCPs is growing substantially, owing in part to the drive for standardized OTC derivatives to be centrally cleared. They have determined that a review of CCP stress testing is timely in order to identify how the relevant PFMI standards are being implemented and whether additional guidance in this area is needed. CCPs, clearing participants, and other relevant stakeholders will be consulted in the course of the review.

SEC Chair White Discusses Disqualifications, Exemptions, and Waivers under the Federal Securities Laws

On March 12, 2015, Mary Jo White, Chair of the Securities and Exchange Commission (SEC or Commission), discussed disqualifications, exemptions, and waivers under the federal securities laws in remarks at the Corporate Counsel Institute held at Georgetown University. She also discussed ways major financial institutions could alter their corporate cultures to help deter wrongdoing.

Chair White said disqualifications are intended to "guard against future participation in certain capital market activities by entities or individuals whose misconduct suggests that they cannot be relied upon to conduct those activities in compliance with the law and in a manner that will protect investors and our markets."

In addressing conduct and culture at large institutions, Chair White said:

- Sanctions get the attention of boards and shareholders that can bring about constructive corrective action, ranging from changes in management to reduction or elimination of bonuses to an overhaul of corporate culture.
- Incentive compensation reforms designed to check excessive risk taking may bring about real change in companies with corporate cultures that encourage excessive risk-taking.
- The tone must be set at the top of the organization if it is to achieve a corporate culture demanding compliance with the law and the highest ethical standards.
- The "cost of doing business" mentality must be broken in order to genuinely transform a company's compliance culture.
- Strong deterrence and meaningful change in corporate culture are difficult and elusive challenges both in law enforcement and corporate governance.
- Strong enforcement actions against responsible individuals, especially senior executives, is the most effective deterrent.

Senate Subcommittee Conducts Hearing on Venture Exchanges and Small Cap Companies

On March 10, 2015, the Committee on Banking, Housing, and Urban Affairs' Subcommittee on Securities, Insurance, and Investment conducted a hearing on venture exchanges and small-cap companies. Four witnesses provided testimony including representatives of the Securities and Exchange Commission (SEC), two exchanges, and a venture capital firm.

The SEC representative provided an overview of market structure challenges for smaller companies, efforts that the SEC already has taken and is taking in this area, and statutory provisions that set the context for SEC review of venture exchange proposals.

The representative of one exchange said appropriately designed venture exchanges may give small companies access to capital not currently available to them and investors the ability to invest in smaller companies with greater regulatory scrutiny than is currently available in the over-the-counter market for unlisted securities.

The representative of the venture capital firm said:

- Fostering more IPOs, particularly at an earlier stage of company maturity, is important to job creation, to the long-term competitiveness of the U.S. securities markets, and to extending significant stock appreciation opportunities to retail investors in the public markets.
- In the absence of structural capital market changes, good companies will continue to tap private sources of capital and delay going public until employee liquidity needs cannot be satisfied in the public markets and a currency is required for broad, strategic M&A activity.
- Independent of whether a venture exchange is the right solution, the core liquidity challenges that exist in today's small cap market must be solved. A robust tick size pilot program of about three years is a crucial first step in gathering the empirical data required to set-up the proper trading rules for a proposed venture exchange. Also, empirical research should be undertaken to inform the adverse selection and liquidity bifurcation risks.

Another exchange representative said simple reforms to make the market structure attractive again for growth companies is needed. He recommended:

- Changing certain trading rules and listing requirements within a small company market tier to encourage and facilitate the ability for growth companies to raise capital on the public markets.
- Leveraging further the *Jumpstart Our Business Startups Act* (JOBS Act) to facilitate a growth platform for companies wishing to stay private.

Enforcement Actions

The Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA) recently announced the following enforcement actions:

- The SEC charged eight officers, directors, or major shareholders for violations of the beneficial ownership reporting requirements under federal securities laws. The SEC alleges that the eight failed to update their stock ownership disclosures to reflect material changes, including steps to take their companies private. Without admitting or denying the SEC's allegations, each of the respondents agreed to settle the proceedings by paying a financial penalty.
- FINRA charged a New York-based broker-dealer company and its president with defrauding customers in connection with the sale of a private placement offering. The two are charged with making unsuitable recommendations to customers and failing to establish, maintain or enforce a supervisory system, including written supervisory procedures. Without admitting or denying FINRA's findings, they settled the charges and agreed to pay full restitution of more than $1 million to harmed investors. The firm was fined $500,000 for fraud in connection with sales of a private placement offering. FINRA barred the company president from the securities industry.

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