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Safety & Soundness

Financial Stability Oversight Council Issues Update on Its Review of Asset Management Products and Activities

On April 18, 2016, the Financial Stability Oversight Council (FSOC) released a statement updating its review of potential risks to the financial stability of the U.S from asset management products and activities, and providing steps to be taken in response to these potential risks. The FSOC's evaluation addressed five key areas:

- Liquidity and redemption, where risks can arise in pooled investment vehicles particularly when investor redemption rights and underlying asset liquidity may not match.
- Leverage, and in particular, potential risks arising from the use of leverage by mutual funds, hedge funds, collective investment funds and separately managed accounts. The FSOC is concerned that leverage can magnify the impact of asset price movements on a fund's net assets and performance and may result in interconnections to other market participants through which financial stress could be transmitted to the broader financial system.
- Operational functions, including risks associated with the use of service providers that provide middle and back office functions, and focusing on the growing reliance on service providers, the concentration in some service provider markets, and the continuously evolving nature of the services provided.
- Securities lending, focusing on the need for more comprehensive information and efforts to improve regular data collection and reporting, interagency data sharing, and international participation.
- Resolvability and transition planning, where risks could be associated with stress scenarios affecting asset management firms, particularly in circumstances of market stress, or entities involving a high degree of complexity and multi-jurisdictional operations. [Press Statement] [Review Statement]

Securities and Exchange Commission (SEC) Chair Mary Jo White issued a statement expressing her support for the FSOC's review statement and indicating that the FSOC's work on this topic is complementary to the regulatory reforms the SEC is currently undertaking in its oversight of the asset management industry. [Chair Mary Jo White Statement]

Separately, Treasury Secretary Jacob J. Lew published an op-ed in the *Wall Street Journal* describing the FSOC's role to bring the entire financial regulatory community together to identify and address risks to financial stability across the system. He highlighted the FSOC's updated review of the asset management industry, and in particular, the focus on risks posed by "liquidity and redemption" and "leverage." The article was made available on the Department of the Treasury Web site. [Jacob J. Lew Statement]

OFR Releases Brief on Credit Ratings in Financial Regulation

On April 21, 2016, the U.S. Department of Treasury's Office of Financial Research (OFR) published a research Brief (number 16-04) entitled, *Credit Ratings in Financial Regulation: What's Changed Since the Dodd-Frank Act?* The *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act) called for eliminating credit ratings from federal financial regulation and substituting alternative standards of creditworthiness. Regulators responded by replacing credit ratings with alternative approaches, including the use of definitions, regulatory models, and evaluations by third parties other than NRSROs (nationally recognized statistical rating organizations). The OFR paper analyzes how regulators have replaced credit ratings and the potential challenges each of these options creates. [Press Statement] [OFR Brief]

Basel Committee Publishes Standards for Interest Rate Risk in the Banking Book

The Basel Committee on Banking Supervision (Basel Committee) issued standards for Interest Rate Risk in the Banking Book (IRRBB) on April 21, 2016. The standards revise the Basel Committee's 2004 *Principles for the management and supervision of interest rate risk*, which set out supervisory expectations for banks' identification, measurement, monitoring, and control of IRRBB. Key enhancements to the 2004 Principles include:

- Additional guidance on the expectations for a bank's IRRBB management process in areas such as the development of shock and stress scenarios and behavioral and modelling assumptions to be considered by banks in their measurement of IRRBB;
- Enhanced disclosure requirements to promote greater consistency, transparency and comparability in the measurement and management of IRRBB;
- An updated standardized framework, which could be mandated by supervisors or banks may choose to adopt; and
- A stricter threshold for identifying outlier banks, by reducing the threshold from 20 percent of a bank's total capital to 15 percent of a bank's Tier 1 capital.

Banks will be expected to implement the standards in 2018. [Press Statement] [Revised Standards]

Federal Reserve Offers Community and Small Regional Banks Off-Site Loan Reviews Option

On April 19, 2016, the Federal Reserve Board (Federal Reserve) issued Supervision and Regulation Letter SR 16-8 to announce the availability of new examination procedures for off-site loan reviews of community and small regional banks. Banks with less than $50 billion in total assets can opt to allow Federal Reserve examiners to review loan files off-site, during both full-scope or target examinations, as long as loan documents can be sent securely with all the required information to the Reserve Bank. The program is optional, and Reserve Banks are expected to make all efforts to accommodate a request for an off-site loan review. However, Reserve Banks may decline a request if they have justifiable reasons to believe that an off-site review would impede the examiners from efficiently and effectively assessing the institution’s asset quality and credit risk management process. [Press Statement] [SR 16-8]

Enterprise & Consumer Compliance

CFPB Issues Report on Online Payday Lending

The Consumer Financial Protection Bureau (CFPB) released a research report on April 20, 2016, that looks at the repayment processes of online payday and online instalment loans, and specifically online lenders’ attempts to debit a consumer’s checking account, and the behaviors of borrowers in that market. The report is a continuation of the CFPB’s earlier reports on payday loans and deposit advance products, and is expected to inform a proposed rulemaking on small dollar lending that the CFPB expects to release later this spring. The CFPB notes that its previous reports have raised concerns about the lending standards and loan structures of these products and their impact on the sustained use of the products.

The CFPB’s report finds that:

- Attempts by online lenders to debit payments from a consumer’s checking account add costs to online payday loans that can be significant and may be “hidden” to consumers.

- Half of online borrowers experience at least one debit attempt that overdrafts or fails. These borrowers pay an average of $185 in bank penalties (based on observations of 330 lenders over an 18 month period) due to debit collection attempt fails.
- Seventy percent of second debit attempts fail to collect money from the borrower, leading to more fees.
- One third of online borrowers assessed a bank penalty have their account closed involuntarily.
[Press Statement] [Report]

Enforcement Actions

The Consumer Financial Protection Bureau (CFPB or Bureau) announced that it has taken action against two co-founders of a company that allegedly bought and resold loan applications containing sensitive personal data to lenders and data brokers without assessing the sources of those leads or the purchasers to whom they were sold. The individuals held senior positions with one serving as chief financial officer and chief marketing officer while the other served as chief executive officer and chief technology officer. The CFPB alleges the individuals each helped to direct the strategy and business practices of the company. The CFPB previously filed charges against the company for violations of the unfair, deceptive, or abusive acts or practices (UDAAP) provisions of the *Consumer Financial Protection Act* in conjunction with its business practices. The CFPB is now similarly charging the two individuals and seeking monetary relief, injunctive relief, and penalties.

Capital Markets and Investment Management

FINRA Guidance Addresses Risks of Pension Income Stream Products

The Financial Industry Regulatory Authority (FINRA) issued Regulatory Notice 16-12, on April 18, 2016, to provide guidance to member firms about their responsibilities concerning the sale of pension income stream products. The guidance highlights that the products are complex and can present investor-protection issues, such as risks related to large commissions, lack of liquidity, and inadequate disclosure. In addition, the guidance highlights potential regulatory violations that may arise in the marketing and sale of pension income stream products. Firms that participate in the sales of these products are encouraged to adopt special procedures or training for associated persons, including suitability, and to ensure their procedures comply with applicable federal and state securities laws. [Press Statement] [Regulatory Notice]

FINRA to Begin Publication of ATS Block-Size Trade Data in October 2016

On April 22, 2016, the Financial Industry Regulation Authority (FINRA) issued Regulatory Notice 16-14 to announce that it will begin publishing alternative trading system (ATS) block-size trade data on its Web site on October 3, 2016. The information will be published monthly as a part of FINRA's ATS transparency initiative, which was designed to provide additional transparency to over-the-counter (OTC) trading in equity securities. FINRA began publishing volume and trade count information for equity securities executed in an ATS in June 2014. The initiative was recently expanded to include publication of the remaining non-ATS OTC equity volume by member firm and security, and publication is set to begin on April 25, 2016. [Regulatory Notice 16-14]

Contact Us

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

Amy Matsuo, Principal, National Leader, Financial Services Regulatory Risk Practice amatsuo@kpmg.com

Ken Albertazzi, Partner and National Lead, Financial Services Safety & Soundness kalbertazzi@kpmg.com

Kari Greathouse, Principal and National Lead, Enterprise and Consumer Compliance cgreathouse@kpmg.com

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

Barbara C. Matthews, Managing Director, Americas FS Regulatory Center of Excellence bcmatthews@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
Stacey Guardino sguardino@kpmg.com

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

Financial Crimes
Terry Pesce tpesce@kpmg.com

Insurance Regulation
Matthew McCorry memccorry@kpmg.com

Investment Management
Larry Godin lgodin@kpmg.com

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