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# The Washington Report

**for the week ended May 6, 2016**

## In This Issue

# Safety & Soundness

## Federal Reserve Proposes Rule to Impose Restrictions on Qualified Financial Contracts

On May 3, 2016, the Federal Reserve Board (Federal Reserve) issued a proposed rule that would require U.S. global systemically important banking institutions (GSIBs), the subsidiaries of any U.S. GSIB (other than a national bank or federal savings association), and the U.S. operations of foreign GSIBs (other than a national bank or federal savings association) to amend their non-cleared qualified financial contracts (QFCs) to prevent immediate cancellation of the QFC in the event of the entity entering bankruptcy or a resolution process. The proposal requires GSIBs to ensure that the QFCs to which they are a party provide that any default rights and restrictions on the transfer of the QFCs are limited to the same extent as they would be under Title II of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*. The proposal would also require GSIBs to ensure that their QFCs restrict the ability of counterparties to terminate the contract, liquidate collateral, or exercise other default rights based on the resolution of an affiliate of the GSIB. The proposal is open for comments until August 5, 2016; The Office of the Comptroller of the Currency is expected to issue a proposed rule that subjects national banks and federal savings associations that are GSIB subsidiaries to substantively identical requirements. [Press Statement] [Proposed Rule]

# Enterprise & Consumer Compliance

## CFPB Proposes to Limit Pre-Dispute Arbitration Agreements

On May 5, 2016, the Consumer Financial Protection Bureau (CFPB or Bureau) issued proposed rules that would generally prohibit mandatory arbitration clauses in contracts that prevent class action lawsuits. In particular, the proposed rules would impose two sets of limitations on the use of pre-dispute arbitration agreements by covered providers of consumer financial products and services. First, it would prohibit providers from using a pre-dispute arbitration agreement to bar a consumer from filing or participating in consumer class action and would require providers to insert language into their arbitration agreements reflecting this limitation. In addition, the proposal would require providers that use pre-dispute arbitration agreements to submit certain records relating to arbitral proceedings to the Bureau. The proposed rules would apply to providers of "certain consumer financial products and services in the core consumer financial markets of lending money, storing money, and moving or exchanging money," and to agreements entered into 180 days after the effective date of the rule. Comments will be accepted for 90 days following publication in the *Federal Register*.

The CFPB notes that it released a study on the use of mandatory arbitration clauses in consumer financial markets in March 2015, which found that few consumers ever bring individual actions against their financial service providers, whether in court or in arbitration, and that class actions provided consumers a more effective means to challenge these companies. They added that, over the five-year period they studied, at least 160 million class members were eligible for relief totaling $2.7 billion in cash, in-kind relief, and attorney's fees and expenses. [Press Statement] [Proposed Rule]

## CFPB Final Rule Permits Electronic Filing for Interstate Land Sales Full Disclosure Act

The Consumer Financial Protection Bureau (CFPB or Bureau) issued a final rule on May 2, 2016, that amends its Regulation J (*Land Registration*, 12 CFR Part 1010) and Regulation L (*Special Rules of Practice*, 12 CFR 2012), which implement the *Interstate Land Sales Full Disclosure Act* (ILSA). The regulatory authority over ILSA was transferred to the CFPB from the Department of Housing and Urban Development as part of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*. As amended, the regulations will permit developers to choose whether to submit ILSA filings on paper or via electronic means. The ILSA requires certain land developers to register their subdivisions and provide disclosures about the lots being offered, to protect consumers from deception or abuse. In conjunction with the release of the final rule, the CFPB announced the launch of a new webpage dedicated to ILSA that contains instructions for electronic filing once the rule becomes effective and new simplified instructions for making electronic payments for ILSA registration fees. [Press Statement] [Final Rule] [New ILSA Webpage]

## FDIC Seeks Input from Financial Institutions on Use of Mobile Financial Services to Enhance Economic Inclusion

On May 3, 2016, the Federal Deposit Insurance Corporation (FDIC) issued Financial Institution Letter (FIL) 32-2016, seeking input from financial institutions, consumer groups, and other stakeholders on its plans to explore how Mobile Financial Services (MFS) can be economically inclusive. The FDIC seeks to demonstrate how MFS can be successfully leveraged to promote and support underserved consumers' banking relationships. The FDIC notes that it recently conducted qualitative research to identify ways of using MFS to better engage underserved consumers in the banking system. The research identified six strategies that banks employing MFS might consider to better meet consumer needs:

- Increase consumer control over finances by improving access to timely account information;
- Expedite access to money;
- Make banking more affordable through better account management;
- Address real and perceived security shortfalls;
- Increase awareness of mobile tools; and
- Encourage long-term financial management.

The FDIC is seeking input from financial institutions through June 15, 2016, on their experience, including challenges, implementing these strategies. [FIL-32-2016]

# Insurance

## NAIC Issues Consumer Alert on Cybersecurity Risks and Guidance on Expectations for Insurance Company Consumer Protections

On May 5, 2016, the National Association of Insurance Commissioners (NAIC), working through its public education program *Insure U*, issued a Consumer Alert to highlight cybersecurity risks for individuals and small businesses and to outline related steps to strengthen their personal risk management efforts. The NAIC states that there were 781 U.S. data breaches affecting more than 150 million records in 2015 alone. More than one-third of all data breaches were due to hacking, representing a jump of more than 8 percent over 2014.

In addition to the Consumer Alert, the NAIC issued a *Roadmap for Cybersecurity Consumer Protections*, which NAIC states functions as a Consumer Bill of Rights and will be incorporated into NAIC model laws and regulations. The document describes the protections the NAIC believes consumers are entitled to receive from insurance companies,

agents, and other businesses when they collect, maintain and use personal consumer information, as well as what should happen in connection with a notice that a consumer's personal information has been involved in a data breach. NAIC adds that not all of these consumer protections are currently provided for under state law. [Press Statement] [Client Alert] [Roadmap]

# Capital Markets and Investment Management

## SEC Approves Final Rules to Implement JOBS Act and FAST Act Amendments to the Exchange Act Registration Requirements

On May 3, 2016, the Securities and Exchange Commission (SEC) revised rules relating to registration thresholds, termination of registration, and suspension of reporting under Section 12(g) of the *Securities Exchange Act of 1934* (Exchange Act) to implement provisions of the *Jumpstart Our Business Startups Act* (JOBS Act) and the *Fixing America's Surface Transportation Act* (FAST Act). The amendments also revise the definition of "held of record" to exclude certain securities held by persons who received them pursuant to employee compensation plans and establish a non-exclusive safe harbor for determining whether securities are "held of record" for purposes of registration under the Exchange Act.

As a result of changes under the JOBS Act and FAST Act, an issuer, that is not a bank, bank holding company, or savings and loan holding company is required to register a class of equity securities under the Exchange Act if it has more than $10 million of total assets and the securities are "held of record" by either 2,000 persons, or 500 persons who are not accredited investors. An issuer that is a bank, bank holding company, or savings and loan holding company is required to register a class of equity securities if it has more than $10 million of total assets and the securities are "held of record" by 2,000 or more persons. In addition, a bank, bank holding company, or savings and loan holding company may terminate or suspend the registration of a class of securities under the Exchange Act if the securities are held of record by fewer than 1,200 persons. [Press Statement] [Final Rules]

## CFTC Finalizes Rule Defining "Material Terms" for Swap Portfolio Reconciliations

On May 2, 2016, the Commodity Futures Trading Commission (CFTC) approved the release of a final rule that permits swap dealers (SDs) and major swap participants (MSPs) to exchange only "material terms" of swaps with their counterparties for purposes of portfolio reconciliation. The final rule also amends the definition of "material terms" in CFTC Regulation 23.500(g). This rule became effective on May 6. 2016, upon publication in the *Federal Register*. [Press Statement] [Final Rule]

## FINRA Notice Reminds Firms of Their Obligations to Report Large Options Positions

The Financial Industry Regulatory Authority (FINRA) issued Regulatory Notice 16-17 on May 5, 2016, to remind firms of their obligations to report large options positions to the Large Options Positions Reporting (LOPR) system as required under FINRA Rule 2360(b)(5). This reminder was issued against the backdrop of increased disciplinary actions taken against firms for non-compliance with the rule. Rule 2360(b)(5), which requires firms to report any options position in an account in which the firm has an interest. It is also required to report each customer, non-member broker, or non-member dealer account that has established an aggregate option position of 200 or more option contracts on the same side of the market covering the same underlying security. The Notice also provides an overview of options reporting requirements and consolidates previously issued guidance on this subject. [Regulatory Notice 16-17]

## BIS Publishes OTC Derivatives Statistics for December 2015

On May 4, 2016, the Bank for International Settlements (BIS) released its over-the-counter (OTC) derivatives statistics data as of December 2015. Key highlights follow:

- The global OTC derivatives markets saw a decline in activity in the second half of 2015. The notional amount of outstanding contracts fell by 11 percent from $552 trillion to $493 trillion between June 2015 and December 2015.
- The fall in notional amounts was accompanied by a sharp drop in the gross market value of outstanding derivatives contracts. The decline was particularly concentrated in interest rate swaps. Gross market values decreased 6 percent from June 2015 to December 2015, from $15.5 trillion to $14.5 trillion, which was the lowest level since 2007.
- Central clearing, which is a key agenda element in global regulators' efforts to reform OTC derivatives markets to reduce systemic risks, continued to make inroads. The share of credit default swaps booked with central counterparties rose to 34 percent at the end of December 2015, up from 31 percent in June 2015 and less than 10 percent in mid-2010. [Press Statement] [Statistical release]

## FINRA Board of Governors Approves Rule Proposals for Trading and Quoting Activity and Arbitration

The Financial Industry Regulatory Authority's (FINRA's) Board of Governors announced that it had approved a number of proposed rulemakings during the week of May 6. The proposals included amendments to Rule 5210 (*Publication of Transactions and Quotations*) and the Rule 9800 Series (*Temporary Cease and Desist Orders*) that would prohibit two specific types of quoting and trading activity that would be considered disruptive, and would establish an expedited process for issuing cease and desist orders to prevent firms from engaging in the activity or providing access to a customer that engages in the activity.

FINRA's Board also approved three proposals that would amend its rules related to arbitration (regarding Chairperson eligibility, motions to dismiss, and panel selection in customer cases with three arbitrators) and one rule addressing gifts, gratuities, and noncash compensation, which affected FINRA Rule 3220, *Influencing or Regarding Employees of Others*, and Rule 3222, *Business Entertainment*. [Press Statement]

## Enforcement Actions

During the week ended May 8, 2016, the Financial Industry Regulatory Authority (FINRA) announced that it had reached a settlement with broker-dealer that required the firm to pay a fine of $20 million and to pay $5 million in restitution to customers for making "material misrepresentations and omissions" on variable annuity (VA) replacement applications for its customers. FINRA found each misrepresentation and omission made the replacement VA product appear more beneficial to the customer, though the recommended VAs were typically more expensive than customers' existing VAs. Replacing one VA with another involves a comparison of the complex features of each security. Hence VA replacements are subject to regulatory requirements to ensure that a firm and its registered representatives compare costs and guarantees that are complete and accurate, which the broker-dealer's representatives did not do in this case. In addition, FINRA found the firm did not adequately train its registered representatives to compare the relative costs and guarantees involved in replacing one VA with another. Finally, FINRA found that the firm provided certain customers with misleading quarterly account statements that understated the total charges and fees incurred on certain VA contracts. The firm neither admitted nor denied the charges, but consented to the entry of FINRA's findings.

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# Financial Crimes

## Administration and Treasury Announces Steps to Address Money Laundering, Terrorist Financing, and Tax Evasion

On May 5. 2016, the Obama Administration and the U.S. Department of the Treasury (Treasury) announced the release of the Customer Due Diligence (CDD) Final Rule, which amends the *Bank Secrecy Act* (BSA) regulations. The CDD Final Rule explicitly sets forth several components of customer due diligence (CDD) that have long been expected under existing regulations, as well as incorporating a new requirement for covered financial institutions to collect beneficial ownership information. Specifically, the rule contains three core requirements: (1) identifying and verifying the identity of the beneficial owners of companies opening accounts; (2) understanding the nature and purpose of customer relationships to develop customer risk profiles; and (3) conducting ongoing monitoring to identify and report suspicious transactions and, on a risk basis, to maintain and update customer information. With respect to the new requirement to obtain beneficial ownership information, Treasury has clarified that, at a minimum, covered financial institutions will have to identify and verify for new customers, the identity of any individual who owns 25 percent or more of a legal entity, and an individual who controls the legal entity. Some exemptions do apply. Based upon comments received in response to the proposed rule that was published in August 2014, the final rule extends the proposed implementation period from one year to two years, expands the list of exemptions, and makes use of a standardized beneficial ownership form optional as long as a covered financial institution collects the required information.

In addition, the Administration and the Treasury announced they were putting forth a legislative proposal that would require companies to report beneficial ownership information at the time of a company's creation, and to establish penalties for failure to comply. The legislation would also make amendments to the current Geographic Targeting Order (GTO) authority which would clarify the ability of the Treasury's Financial Crimes Enforcement Network (FinCEN) to collect information under GTOs, such as bank wire transfer information.
[Press Statement] [Secretary's Letter] [Administration Announcement]

## Contact Us

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