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# Safety & Soundness

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## OCC Releases Semiannual Risk Perspective Report

The Office of the Comptroller of the Currency (OCC) released the Spring 2016 edition of its *Semiannual Risk Perspective* report on July 11, 2016. The report highlights safety and soundness risks facing national banks and federal savings associations based on data through December 31, 2015. The OCC finds that strategic, credit, operational, and compliance risks remain top concerns. Additional areas identified by the OCC as warranting awareness and monitoring, include: interest rate risk, interactions with marketplace lending firms, and allowances for loan and leases losses. Highlights from the report include the following:

- Strategic risk remains a concern due to increased competition from nonbanks and financial technology firms, along with pressure to offer new and innovative products.
- Strong loan growth combined with easier underwriting standards heightens credit risk, especially in the areas of: indirect auto lending, leveraged lending, and commercial real estate lending.
- Operational risk concerns include: increasing cyber threats, reliance on third-party service providers, resiliency planning, and compliance risks arising from new rule changes and associated technology/systems changes.
- Banks face compliance challenges meeting the integrated mortgage disclosure requirements, the *Military Lending Act* requirements (new amendments take effect on October 3, 2016), and *Bank Secrecy Act* risks.

[\[Press Statement\]](#) [\[Semiannual Risk Perspective Report\]](#)

## Basel Committee Publishes New Capital Standard for Simple, Transparent, and Comparable Securitizations

On July 11, 2016, the Basel Committee on Banking Supervision (Basel Committee) published revisions to its capital standards for “simple, transparent, and comparable” (STC) securitizations. The updated standard sets out additional criteria for differentiating the capital treatment of STC securitizations from that of other securitization transactions. In particular, it includes scaled down risk weights for STC securitization exposures. It also reduces the risk weight floor for senior exposures from 15 percent to 10 percent. [\[Press Statement\]](#) [\[Revised Securitization Framework\]](#) [\[STC Criteria\]](#)

## BIS Issues Correspondent Banking Report and Recommendations

On July 13, 2016, the Bank for International Settlements’ (BIS) Committee on Payments and Market Infrastructures (CPMI) issued a final report and recommendations on Correspondent Banking. The report responds to growing concentration in the network of bank correspondent relationships. The CPMI suggests this trend implies a threat that cross-border payment networks could fragment and the range of available options for these transactions could narrow. The report outlines the main types of correspondent banking arrangements, summarizes recent developments, and considers the underlying drivers of correspondent banking. It also makes recommendations for five separate potential measures to facilitate correspondent banking services: (i) Know-Your-Customer (KYC) utilities; (ii) use of the Legal Entity Identifier (LEI) in correspondent banking; (iii) information-sharing initiatives; (iv) payment messages; and (v) use of the LEI as additional information in payment messages. [\[Press Statement\]](#) [\[Report\]](#)

## Basel Committee Publishes Net Stable Funding Ratio FAQs

The Basel Committee on Banking Supervision (Basel Committee) issued Frequently Asked Questions (FAQs) and answers regarding the Basel III Net Stable Funding Ratio (NSFR) on July 13, 2016. The FAQs include technical elaboration of the

rules text and interpretative guidance. The goal is to promote consistent global implementation of the NSFR requirements. The FAQs cover thirty-three questions and answers across five categories: definitions, repo/secured lending, derivatives, maturity, and others. [\[Press Statement\]](#) [\[FAQs\]](#)

## OFR Issues Brief on New Multilayer Map of the Financial System

On July 14, 2016, the Office of Financial Research (OFR) released analysis providing a new approach to identifying potential paths of contagion in the U.S. financial system based on network analysis (Brief 16-06, *Looking Deeper, Seeking More: A Multilayer Map of the Financial System*). The OFR network map uses three layers, each representing a key function of the financial system: flows of short-term funding, collateral, and assets. These layers are then linked by certain types of financial system participants: large banks, hedge funds, central counterparties, and other market participants that contribute to two or more types of financial flows. The OFR indicates that the resulting multilayer map reveals new potential channels of contagion that are not visible in a single-layer map. The OFR analysis also indicates that new data sets (e.g., comparable data on current exposures and holdings of market participants) would facilitate a deeper analysis of potential contagion scenarios. [\[OFR Management Team's Remarks\]](#) [\[Brief\]](#)

# Enterprise & Consumer Compliance

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## Enforcement Actions (Overdraft Services and Debt Collection)

The Consumer Financial Protection Bureau (CFPB or Bureau) and the Federal Trade Commission (FTC) announced the following enforcement action in the past week:

- The CFPB entered into a consent order with a bank to address the CFPB's findings that the bank, through a telemarketing vendor, engaged in illegal and improper overdraft service practices. These practices allegedly included:
  - Enrolling consumers into the overdraft service program without their consent;
  - Deceiving consumers about the fees associated with the overdraft service program; and
  - Falsely claiming that calls from the telemarketing vendor were not a sales pitch.

The order requires the bank to pay a civil money penalty of \$10 million. In addition, the bank must contact all customers enrolled in the overdraft service program through the telemarketer to provide them opportunity to give affirmative consent to participate in the overdraft service. The bank must also stop using any third-party vendor to conduct telemarketing of its overdraft service, and must increase its oversight of all other third-party vendors it uses to engage in telemarketing of consumer financial products or services.

- The FTC announced that two debt collectors and three companies charged with abusive debt collection practices, including making false threats and other illegal collection tactics, have agreed to a stipulated final order that bans them from participating in the debt collection business as well as advertising, marketing, promoting, offering for sale, selling or buying any consumer or commercial debt or any consumer information related to a debt. Additionally, the order imposes a penalty of \$4.8 million that will be partially suspended upon the surrender of certain assets. The full penalty will become due immediately if the defendants are found to have misrepresented their financial condition. The FTC's charge was made as a part of Operation Collection Protection, an ongoing federal-state-local initiative to identify and stop debt collectors using deceptive and abusive collection practices.

# Insurance

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## FIO to Monitor Affordability of Automobile Insurance

On July 13, 2016, the U.S. Department of the Treasury's Federal Insurance Office (FIO) announced the adoption of a new methodology to monitor the affordability of auto insurance for "Affected Persons" (defined to include 1) persons living in majority minority ZIP Codes, and 2) persons living in majority Low- and Moderate-Income (LMI) ZIP Codes). It will determine affordability using an Affordability Index calculated by dividing the average annual personal automobile liability premium in the voluntary market by the median household income for ZIP Codes identified as being majority-minority or majority-LMI. FIO will presume that personal automobile liability insurance is affordable for Affected Persons if the Affordability Index is less than or equal to 2 percent.

FIO will undertake its first affordability study using premium data received and aggregated by statistical agents (FIO notes that 20 states currently require insurers to report ZIP-Code level automobile premium data) as well as data publicly available through the U.S. Census Bureau. For its second study, which will be conducted in 2017, FIO will request data from insurers that have a statutory surplus greater than \$500 million as of December 31, 2015, and who annually collect more than \$500 million of premium for personal automobile insurance. Insurers that do not currently provide data to statistical agents will be asked to voluntarily provide such information. FIO will publicly report its findings annually, noting trends in the Affordability Index relative to each of the ZIP Codes analyzed.

Title V of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* authorizes the FIO to monitor the extent to which traditionally underserved communities and consumers, minorities, and low- and moderate-income persons have access to affordable insurance products for all lines of insurance other than health insurance.

[\[Press Statement\]](#) [\[Federal Register Notice\]](#)

## IAIS Launches Self-Assessment and Peer Review on Information Exchange and Supervisory Cooperation

On July 14, 2016, the International Association of Insurance Supervisors (IAIS) launched a thematic self-assessment and peer review for global insurance regulators and supervisors on Insurance Core Principles (ICPs) 3, *Information Exchange and Confidentiality Requirements*, and 25, *Supervisory Cooperation and Coordination*. The deadline for submission of the self-assessment and peer review responses on ICPs 3 and 25 is August 14, 2016. [\[Press Statement\]](#)

# Capital Markets and Investment Management

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## SEC Adopts Final Rules for Regulatory Reporting and Disclosure of Security-Based Swap Transactions

On July 13, 2016, the Securities and Exchange Commission (SEC) adopted amendments and guidance with respect to its rules on regulatory reporting and public dissemination of security-based swap transactions, known as Regulation SBSR. The new rules and guidance implement mandates under Title VII of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act) and seek to increase transparency in the security-based swaps market. Among other things, the final rules:

- Assign reporting duties for platform-executed security-based swaps submitted for clearing, and for security-based swaps resulting from the clearing process;
- Establish regulatory reporting and public dissemination requirements for certain cross-border security-based swaps;
- Prohibit registered Swap Data Repositories (SDRs) from imposing fees or usage restrictions on the security-based swap transaction data that Regulation SBSR requires them to publicly disseminate; and
- Establish a new compliance schedule for the portions of Regulation SBSR for which the SEC has not previously specified compliance dates. Under the new compliance schedule, transaction reporting will not begin until after security-based swap dealers and major security-based swap participants have registered with the SEC.

The SEC also issued guidance with respect to the application of Regulation SBSR to security-based swaps resulting from prime broker arrangements and from the allocation of cleared security-based swaps.

The final rules will become effective 60 after publication in the *Federal Register*. [\[Press Statement\]](#) [\[Final Rule\]](#)

## SEC Proposes to Enhance Order Handling Information Available to Investors

On July 13, 2016, the Securities and Exchange Commission (SEC) proposed amendments to Rules 600 and 606 of Regulation National Market System (NMS) to require broker-dealers to provide additional disclosure to customers about the routing of their orders.

For institutional orders, the proposed rules would require broker-dealers to provide a customer, upon request, a report on the routing and execution of that customer's orders (orders in exchange-listed stocks with an original market value of at least \$200,000), containing specified monthly data for the previous six months. The customer-specific report also would require detailed order handling information for each venue to which the broker-dealer routed institutional orders for the customer. This data would be presented in the aggregate. It will also be broken down by the following categories of order routing strategies: passive, neutral, and aggressive. Separately, broker-dealers would also be required to make public on a quarterly basis, the aggregated reports of their handling of all institutional orders.

For retail orders, the proposed rules would expand the information included in existing retail order disclosures to require:

- Limit order information to be broken-down to marketable and non-marketable categories;
- Disclosure of the net-aggregate amount of any payment for order flow received, payment for any profit-sharing relationship received, transaction fees paid, and transaction rebates received by a broker-dealer from certain venues; and
- Broker-dealers to describe any terms of payment for order flow arrangements and profit sharing relationships with certain venues that may influence their order routing decisions.

The comment period will be open for 60 days following publication in the *Federal Register*.

[\[Press Statement\]](#) [\[Proposed Rule\]](#)

## House Passes Bills to Terminate Registration Exemption for U.S. Territories and Expand Application of Blue Sky Exemptions

The U.S. House of Representatives passed H.R. 5322, the *U.S. Territories Investor Protection Act of 2016*, on July 11, 2016. The bill would amend a section of the *Investment Company Act of 1940* (Act), to terminate an exemption from registration for investment companies located in Puerto Rico, the Virgin Islands, and any other possession of the United States. Such companies are currently exempt from registration under the Act provided their shares are sold solely to the residents of the territory in which they are located. Investment companies qualifying to use the current exemption would receive a three-year safe harbor. The bill additionally authorizes the SEC to delay further the effective date for terminating the exemption for a maximum of three years following the initial three year safe harbor. [\[Press Statement\]](#)

On July 12, 2016, the House of Representatives passed the H.R. 5421, the *National Securities Exchange Regulatory Parity Act of 2016*. This bill seeks to create an equal market playing field for exchanges by amending provisions of the *Securities Act of 1933* that currently provide a “blue sky” exemption for securities listed and traded on the following national securities exchanges: the New York Stock Exchange, American Stock Exchange and NASDAQ, or whose listing standards are substantially similar to these exchanges. The “blue sky” exemption relieves certain securities from individual state-by-state registration. The bill would eliminate the specific references to those venues, and generally provide a “blue sky” exemption for any security listed on a “national securities exchange” registered with the SEC and whose listing standards have been approved by the SEC. [\[Press Statement\]](#)

## Enforcement Actions

The Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC) announced the following enforcement action in the past week:

- The SEC announced that a broker-dealer admitted wrongdoing and agreed to pay a \$7 million penalty to settle charges that a computer coding error caused the firm to provide the agency with incomplete “blue sheet” information about trades executed during a 15-year period from 1999 to 2014. Further, following discovery of the coding error, the firm failed to report promptly the incident to the SEC or take steps to produce the omitted data.
- The SEC charged an investment advisory firm with failing to disclose properly to clients the additional transaction costs charged to them beyond the “wrap fees” they paid to cover the cost of several services bundled together. An SEC investigation revealed that while the investment firm disclosed to investors that client trades were typically executed through the sponsoring broker, they actually used brokers other than the wrap program sponsor to execute a majority of the wrap program trading. This resulted in additional costs to clients for those transactions. Though the firm did disclose that some “trading away” from the sponsoring broker could occur, the SEC found the firm inaccurately described the frequency, rendering its disclosures materially misleading. The firm agreed to be censured and pay a penalty of \$300,000.
- The CFTC issued an order filing and simultaneously settling charges against a registered Introducing Broker and its sole owner, a registered Associated Person, for committing solicitation fraud in connection with options on futures contracts traded on the Chicago Board of Trade and the Commodity Exchange, Inc. It also charged the owner of the firm with willfully making material false statements to the National Futures Association in connection with its investigation of the fraud. The respondents were required to pay a total of \$7.2 million in restitution and civil monetary penalty to settle charges. The CFTC order permanently prohibits them from trading on any registered entity, as defined in the *Commodity Exchange Act*, or registering with the CFTC. It also bars them permanently from engaging in any commodity-related activities.

# Financial Crimes

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## FinCEN Fines Card Club for BSA/AML Violations

On July 15, 2016, the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) announced that it had reached an agreement with a card club (a type of gambling casino) to settle charges that it violated the program and reporting requirements of the *Bank Secrecy Act* (BSA). The Internal Revenue Service (IRS), acting on delegated authority from FinCEN, found that since September 1, 2009, the card club has failed to implement and maintain an effective anti-money laundering (AML) program, report large cash transactions, file many suspicious activity reports (SARs), and keep certain required records. The card club also failed to use all available information to identify and verify customer information, or to determine occurrences of transactions or patterns that would warrant the filing of an SAR. In certain cases, the card club was found to have continued to conduct business with patrons that the club had previously identified as suspicious, and in at least one instance where the customer refused to provide identification and had been the subject of several previous SAR filings.

The card club admitted to violating the BSA's program and reporting requirements, and agreed to pay a civil monetary penalty of \$2.8 million to settle the charges. Additionally, the card club agreed to certain future undertakings, including periodic independent reviews to examine and test its BSA/AML program.

## Legislative Update

The House of Representatives has passed the following bills from the Financial Services Committee's Task Force to Investigate Terror Finance:

- H.R. 5594, the *National Strategy for Combating Terrorist, Underground, and Other Illicit Financing Act*: would require the President to develop and publish an annual government-wide strategy to combat money laundering and terrorist financing. The report would give the Congress a roadmap for the allocation of resources or the addition of any new authorities to keep ahead of innovations by criminals or terrorists.
- H.R. 5602, *to amend title 31, United States Code, to authorize the Secretary of the Treasury to include all funds when issuing certain geographic targeting orders, and for other purposes*: would authorize the Treasury Secretary to issue "geographical targeting orders" requiring more-detailed reporting to the Treasury Department regarding certain types of transactions (coins, currency, and monetary instruments) in a specific area for a limited amount of time.
- H.R. 5607, the *Enhancing Treasury's Anti-Terror Tools Act*: seeks to enhance a number of the tools that the Treasury Department uses in its efforts to combat the financing of terror, money laundering and related illicit finance. This includes enhancing various reporting requirements to be made by the Treasury Secretary to the Congress. A section of the bill would direct the Treasury Secretary to report on the advisability and the implications of placing the Treasury Office of Terrorism and Financial Intelligence – which includes the FinCEN financial intelligence unit and the Office of Foreign Assets Control (OFAC) sanctions enforcement unit – into a standalone bureau, similar to the Federal Bureau of Investigation. [\[Press Statement\]](#)

# Alternative Finance

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## House Financial Services Subcommittee Conducts Hearing on Marketplace Lending

On July 12, 2016, the House Committee on Financial Services' Subcommittee on Financial Institutions and Consumer Credit conducted a hearing on marketplace lending. The purpose of the hearing was to examine the opportunities and challenges related to Financial Technology (FinTech), understand the development of online marketplace lending, including how online lenders and banks interact, and evaluate the current regulatory structure and associated policy developments.

Marketplace lenders use online lending platforms and underwriting algorithms to provide expanded access to credit for small businesses and consumers. In some cases, these firms establish partnerships with banks.

The committee issued the following key takeaways from the hearing:

- Online marketplace lending has been expanding access to credit by providing loans to certain borrowers who otherwise might not have been able to access capital.
- New credit models present an opportunity to leverage technology to further expand access to credit in underserved markets. [\[Press Statement\]](#)

# Brexit

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## Office of Financial Research Analyzes Impact of Brexit on Global Financial Markets

The Office of Financial Research (OFR) released a document on July 14, 2016, that examines the impact of the Brexit vote - the United Kingdom's (U.K.) decision to leave the European Union (EU) - on financial markets in the second quarter of 2016. Key after-effects of Brexit as summarized by the OFR include:

- The vote dented market confidence, generating considerable uncertainty about the rules governing the U.K.'s financial and economic transactions with other countries. Though market volatility has subsided for the time being, policy uncertainty and the ultimate financial and political spillovers are expected to last for months or years, leaving markets vulnerable to further confidence shocks.
- Global risk assets sold-off sharply in response to the vote. The U.K. currency and European financial stocks were hit hardest; they remain much weaker than before the vote. Following initial declines, net U.S. risk assets have rebounded sharply. European equities have also recovered more than half their declines.
- Interest rates have been pushed to historic lows in the U.S., U.K., and Germany with an increased flow of investments to safe havens.
- The British pound fell to its lowest level in more than 30 years. Banks and other financial institutions were very hard hit in the market sell-offs. U.S. bank stocks also fell sharply, though less than their European counterparts.
- Secured funding rates in the U.S. increased before and after the referendum.
- The week after the referendum, global equities, bonds, and emerging market currencies mostly retraced losses sustained in the two trading days after the vote. Investors were reportedly reassured by the absence of dislocations



in major markets or financial institutions after the vote, and by the willingness of the Bank of England and European Central Bank to provide liquidity support as needed. [\[OFR's Financial Markets Monitor\]](#)

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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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