The Washington Report

Americas FS Regulatory Center of Excellence

The week ended November 4, 2016

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2. Enterprise and consumer compliance

2.1 CFPB releases Supervisory Highlights

The Consumer Financial Protection Bureau (CFPB or Bureau) released its Supervisory Highlights report on October 31, 2016 summarizing work generally completed between May and August 2016. The report highlights issues in the areas of student loan servicing, auto loan origination and servicing, mortgage origination, and debt collection. The report also highlights certain fair lending issues and findings associated with redlining and language services for non-English proficient consumers.

Coincident with the release of the Supervisory Highlights, the CFPB also released:

— Revised exam procedures for student lending and servicing;

— Updates to CFPB guidance on compliance for service providers; and

— New exam procedures for reverse mortgage servicing.

[Press Statement] [Supervisory Highlights]

2.2 Agencies publish proposed rule to implement private flood insurance provisions of the Biggert-Waters Act

On October 31, 2016, the Federal Reserve Board (Federal Reserve), the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency (OCC), the National Credit Union Administration, and the Farm Credit Administration jointly issued a Notice of Proposed Rule Making that would implement the private flood insurance provisions of the Biggert-Waters Flood Insurance Reform Act of 2012 (Biggert-Waters) and amend the agencies' regulations with respect to loans in areas vulnerable to floods.

Federal flood insurance laws require regulated lending institutions to ensure that flood insurance is purchased in connection with loans secured by real estate located in areas having special flood hazards. The joint proposed rule would:

— Assist lending institutions in identifying private flood insurance policies they would be required to accept;

— Establish criteria to apply in determining that coverage offered by a mutual aid society provides the type of policy or coverage that qualifies as "flood insurance;" and

— Clarify and permit regulated lending institutions to accept flood insurance provided by private insurers that does not meet the statutory definition of "private flood insurance" on a discretionary basis and subject to certain restrictions.

The proposed rule is the second proposal released by the agencies to address private flood insurance. The previous proposal was released in October 2013. Comments on the current proposed rule are requested by January 6, 2017. [Press Statement] [Notice of Proposed Rulemaking]

2.3 Enforcement Actions

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

— The FTC obtained a final judgment and court order banning a group of debt collectors from the collection business and further ordering them to pay nearly $11 million in monetary relief. This action forms a part of Operation Collection Protection, a continuing nationwide crackdown on collectors whose illegal tactics include harassing phone calls and false threats of lawsuits and arrest.

— The CFPB and the New York Attorney General jointly filed a lawsuit in a federal district court against two individuals and their network of interrelated debt collection companies (collectively, the Defendants) to address allegations they violated the Fair Debt Collection Practices Act and the prohibitions against unfair, deceptive, or abusive acts or practices in conjunction with a nationwide debt collection scheme. The lawsuit alleges that the Defendants harassed, threatened, and deceived millions of consumers into paying inflated debts and amounts they did not owe. The CFPB is seeking civil money penalties and redress for harmed consumers.

— The CFPB took action against a company that originates pawn and auto title loans alleging the company violated the Truth-in-Lending Act and its implementing regulation, Regulation Z, by misstating charges and the related annual percentage rate associated with pawn loans. The CFPB is seeking restitution for harmed consumers and civil money penalties.

3. Capital markets and investment management

3.1 CFTC approves supplemental proposal modifying portions of its Regulation AT proposed rule

The U.S. Commodity Futures Trading Commission (CFTC) issued a notice of proposed rulemaking (NPR) in December 2015 that seeks to establish a series of risk controls, transparency measures, and other safeguards to enhance the safety and soundness of automated trading on all designated contract markets (DCMs). The proposed rule was referred to as Regulation Automated Trading (Regulation AT) and was issued for the purpose of reducing risk and increasing transparency in algorithmic order origination and electronic trade execution on all U.S. futures exchanges.

On November 4, 2016, the CFTC approved a supplemental proposal to Regulation AT that would modify certain rules set forth in the December 2015 NPR, including:

— Revising the proposed risk control framework to concentrate pre-trade risk controls at a minimum of two levels rather than three. The first level of controls would reside with: (1) "AT Persons" for their Algorithmic Trading and their Electronic Trading; and (2) with futures commission merchants (FCMs) for all Electronic Trading originating with any market participant other than AT Persons. DCMs would constitute the second level of pre-trade risk controls for all Electronic Trading.

— Reducing the number of market participants who are required to register as AT Persons under Regulation AT by adding a minimum trading volume test to the criteria for determining who is an AT Person;

— Replacing requirements proposed in the NPR that AT Persons and clearing member FCMs prepare certain annual reports with a streamlined annual certification requirement;

— Addressing algorithmic trading source codes through new provisions regarding recordkeeping and access. Specifically, the Supplemental rule proposes that access to source code by the Division of Market Oversight be limited to special calls issued by the Commission itself; and

— Providing AT Persons with options for compliance with certain elements of Regulation AT when using third-party algorithmic trading systems.

The Supplemental proposal will be open for a 60-day comment period following publication in the Federal Register. [Press Statement] [Supplemental notice of proposed rulemaking]

3.2 FINRA announces targeted exam for cross-selling programs

On October 31, 2016, the Commodity Futures Trading Commission (CFTC) issued Orders of Registration to the following Foreign Boards of Trade (FBOT): Eurex Deutschland (Eurex); CME Europe Limited (CMEEL); ICE Futures Europe (IFE); The London Metal Exchange (LME) and London Stock Exchange plc. (LSE). These Orders allow each of the FBOTs to provide identified members or other participants located in the U.S. with direct access to their electronic order entry and trade matching system. The Orders were issued according to CFTC regulations that require, among other things, FBOTs to possess the attributes of an established, organized exchange and to be subject to continued oversight by a regulator that provides comprehensive supervision and regulation that is comparable to the supervision and regulation exercised by the CFTC.

The CFTC issued five other Orders of Registration during 2016 [Press Statement]

3.3 CFTC signs Counterpart to MOU with Canadian authorities

On November 2, 2016, the Commodity Futures Trading Commission (CFTC) signed a Counterpart to a 2014 Memorandum of Understanding (MOU) with the Superintendent of Securities for Newfoundland and Labrador (SNL) and the Deputy Minister for Intergovernmental Affairs of Canada. The MOU relates to cooperation and the exchange of information with respect to entities that operate in the United States and Canada. The scope of the MOU includes markets and organized trading platforms, central counterparties, trade repositories, and intermediaries, dealers, and other market participants. [Press Statement] [Counterpart to MOU]

3.4 CFTC extends relief period for swaps in certain package transactions

On November 1, 2016, the Commodity Futures Trading Commission (CFTC) issued CFTC Letter 16-76 to further extend the time limited no-action relief for swaps executed as part of a package transaction in categories that currently receive relief under CFTC Letter 15-55. This extension will enable the CFTC's Division of Market Oversight to continue assessing the appropriate response for applying the trade execution requirement to swaps in certain types of package transactions. The relief is extended through November 15, 2017.

The categories of package transactions covered by the Letter include those in which at least one individual swap component is made available to trade (MAT) and subject to the trade execution requirement, and one of the following applies:

— At least one individual component is a bond issued and sold in the primary market;

— All other components are contracts for the purchase or sale of a commodity for future delivery;

— At least one of the components is a CFTC swap that is not subject to the clearing requirement;

— At least one of the components is not a swap - excluding U.S. Dollar Swap Spreads, MAT/Futures, MAT/Agency MBS, and MAT/New Issuance Bond; and

— At least one of the components is a swap over which the CFTC does not have exclusive jurisdiction.

[Press Statement] [CFTC Letter 16-76]

3.5 IOSCO publishes report on implementation of G20/FSB recommendations for securities markets

On October 28, 2016, the International Organization of Securities Commissions (IOSCO) published a report on the implementation of the G20 and the Financial Stability Board's (FSB) post-crisis recommendations aimed at strengthening the securities markets. The 2016 Implementation Report was prepared by IOSCO's Assessment Committee as part of its G20 Markets Reform Review Project. The report focused on the following reform areas with respect to the securities markets:

— Hedge funds;

— Structured products and securitization;

— Oversight of credit rating agencies (CRAs);

— Measures to safeguard the efficiency and integrity of markets; and

— Supervision and regulation of commodity derivative markets.

The IOSCO reports that most responding jurisdictions have taken steps to implement the G20/FSB recommendations and IOSCO guidance in each reform area. Implementation is particularly advanced in relation to hedge funds, structured products and securitization, and the oversight of CRAs where most jurisdictions had implemented reforms in these areas by 2014. Implementation of the other G20/FSB recommendations continue to progress. [Press Statement] [Implementation Report]

3.6 SEC posts additional economic analysis as part of its proposed rule on derivatives use by registered funds

On November 1, 2016, the Securities and Exchange Commission (SEC) released additional economic analysis related to its proposed rule on the use of derivatives by registered funds and business development companies, which was released for comment in December 2015. The analysis is posted in the comments file for the proposed rule and the SEC invites interested parties to provide comment.

The purpose of the proposed derivatives rule is to enhance the regulation of the use of derivatives by registered investment companies, including mutual funds, exchange-traded funds (ETFs) and business development companies. It seeks to limit the funds' use of derivatives and would require them to put risk management measures in place to ensure better investor protections. The SEC believes that the economic analysis would be informative in evaluating comments on the proposed rule, which suggested using risk-adjustment and haircut schedules that were originally developed for other regulatory purposes. The analysis evaluates the internal consistency of these schedules across asset classes and categories for purposes of risk-adjustment and risk-weighting with respect to the rule. [Press Statement] [Analysis: Risk Adjustment and Haircut Schedules]

3.7 Enforcement Actions

The Financial Industry Regulatory Authority (FINRA) fined eight firms a total of $6.2 million for failing to supervise the sale of variable annuities (VAs). Five of the firms were also ordered to pay more than $6 million in redress to customers who purchased "L-share" VAs with potentially incompatible, complex and expensive long-term minimum-income and withdrawal riders. L-share VAs are complex investment products combining insurance and security features designed for short-term investors willing to pay higher fees in exchange for shorter surrender periods. L-shares also pay greater compensation to registered representatives than do traditional share classes. The firms charged by FINRA were alleged to have inadequate systems to supervise VAs with multiple share classes and further failed to identify "red flags" of broad patterns of potentially unsuitable sales of these complex products or to provide their registered representatives with the required guidance on the class of customers for which the costs and features of L-share VAs would be suitable. In settling the matter, the firms neither admitted nor denied the charges but consented to the entry of FINRA's findings.

4. Alternative Finance

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This item was also covered under the Safety and Soundness section above.

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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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