The Washington Report

Americas FS Regulatory Center of Excellence

The week ended January 27, 2017

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Contents

1. Safety and soundness

1.1 OCC publishes examination procedures supplementing previous guidance on third-party risk management

The Office of the Comptroller of the Currency (OCC) published Bulletin 2017-7 on January 24, 2017, announcing the release of examination procedures to supplement OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance," which was issued in October 2013. The supplemental procedures are designed to promote consistency when examining national banks' and federal savings associations' (collectively, banks) risk management of third-party relationships. These procedures expand on the core assessment contained in the "Community Bank Supervision," "Large Bank Supervision," and "Federal Branches and Agencies Supervision" booklets of the Comptroller's Handbook using concepts and definitions contained in OCC Bulletin 2013-29. The OCC summarizes that the procedures are designed to help examiners:

- Tailor the examination of each bank commensurate with the level of risk and complexity of the bank's third-party relationships.
- Assess the quantity of the bank's risk associated with its third-party relationships.
- Assess the quality of the bank's risk management of third-party relationships involving critical activities.
- Determine whether there is an effective risk management process throughout the life cycle of the third-party relationship.

[OCC Bulletin 2017-7]

1.2 FSB publishes reports on re-hypothecation of client assets and collateral re-use

On January 25, 2017, the Financial Stability Board (FSB) published two reports, including:

- *Re-hypothecation and Collateral Re-use: Potential Financial Stability Issues, Market Evolution, and Regulator Approaches:* This report describes potential financial stability issues associated with re-hypothecation of client assets and collateral re-use. Additionally, the report explains the evolution of market practices and current regulatory approaches with respect to hypothecation of client assets. It examines the possible arguments for and challenges of harmonizing regulatory approaches to re-hypothecation of client assets, and also describes possible residual financial stability risks associated with collateral re-use. The report concludes that there is no immediate case for harmonizing regulatory approaches to re-hypothecation. (For the purposes of this report, re-hypothecation is defined narrowly as "any use of client assets by a financial intermediary" such as broker-dealers.)
- *Non-Cash Collateral Re-use: Measure and Metrics:* This report finalizes the measures and metrics of non-cash collateral re-use in securities financing transactions that authorities will monitor for financial stability purposes. The data are restricted to collateral received and subsequently re-used in securities financing transactions. Member jurisdictions are expected to begin official data collection and aggregation at the end of 2018 and the data related to collateral re-use will be transmitted to the FSB for global aggregation beginning January 2020.

The reports are part of the FSB's work to "transform shadow banking into resilient market-based finance" and, in particular, its work to dampen procyclicality and other financial stability risks in securities financing transactions. Both reports further indicate that the practices of re-hypothecation of client assets by financial intermediaries and of re-use by market participants of collateral received help to increase the availability of collateral in the financial system and reduce the cost of using collateral, and consequently reduce transaction and liquidity costs. Through these reports, the FSB encourages authorities to consider monitoring collateral re-use activities beyond securities financing transactions as appropriate. The FSB also highlights the need to review the scope, measure, and metrics of collateral re-use.

[Press Statement] [Re-Hypothecation and Collateral Re-Use] [Non-Cash Collateral Re-use]

1.3 Basel Committee publishes FAQs for market risk capital requirements

On January 26, 2017, the Basel Committee on Banking Supervision (Basel Committee) published the first set of frequently asked questions (FAQs) on the revised minimum capital requirements for market risk published in January 2016. A total of 16 questions and answers are included, providing clarifications to issues related to the standardized approach and the internal models approach.

[Press Statement] [FAQ Document]

2. Enterprise and consumer compliance

2.1 Enforcement action

The Consumer Financial Protection Bureau (CFPB) announced that it had entered into separate consent orders with two affiliated mortgage servicers to address the CFPB's findings that they each engaged in deceptive practices in violation of the Consumer Financial Protection Act as well as provisions of the Real Estate Settlement Procedures Act with regard to loan modifications and foreclosure relief. The CFPB alleges the mortgage servicers misled borrowers about available options to avoid foreclosure or burdened them with excessive paperwork demands when applying for foreclosure relief. The CFPB also alleges that one of the mortgage companies violated the Fair Credit Reporting Act by reporting to credit report companies settled accounts as charged off and sending negative information to credit report companies after receiving a notice of error from a consumer. In total, the CFPB orders require the mortgage servicers to pay an estimated $21.4 million to compensate harmed consumers and $7.4 million in civil money penalties.

3. Capital markets and investment management

3.1 CFTC extends comment period on supplemental proposal to Regulation AT

The Commodity Futures Trading Commission (CFTC) announced on January 23, 2017 that it is extending from January 24, 2017 until May 1, 2017 the comment period applicable to its supplemental notice of proposed rulemaking (SPNR) for Regulation Automated Trading (Regulation AT). The SPNR modifies certain rules set forth in the CFTC's proposed Regulation AT, which was published in December 2015. As published, proposed Regulation AT introduces a series of risk controls, transparency measures, and other safeguards to enhance the safety and soundness of automated trading on all designated contract markets.

[Press Statement] [Extension Notice] [Regulation AT Proposal]

3.2 Enforcement actions

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

— The CFTC issued an order filing and settling charges against an Introducing Broker and its Futures Commission Merchant affiliate for non-compliance with applicable record-keeping rules and failure to diligently supervise. The CFTC alleges that between October 2009 and January 25, 2014 the Broker did not preserve and maintain certain audit trail logs for its customers. Similarly, the Futures Commission Merchant did not preserve and maintain customer audit trail logs after becoming registered as a Futures Commission Merchant in February 2013. The CFTC Order required the two firms to jointly pay a $280,000 civil monetary penalty and to cease and desist from further violations. The Order also required the brokerage firm to improve its recordkeeping procedures by updating policies and procedures and providing appropriate compliance training to officers and employees.

— The SEC announced that a dually registered investment adviser and broker-dealer agreed to pay $18.3 million to settle charges that it overbilled investment advisory clients and misplaced client contracts. According to the SEC, at least 60,000 advisory clients were overcharged approximately $3.2 million in unauthorized fees because the firm failed to confirm the accuracy of billing rates entered into its systems. The firm also improperly collected fees during time periods when clients suspended their accounts. The firm consented to the SEC's cease-and-desist order and agreed to undertakings related to its fee-billing and books-and-records practices. The firm is required to pay $3.2 million in disgorgement of the excess fees collected due to the missing contracts plus $800,000 in interest and a $14.3 million penalty.

- The SEC announced that an investment adviser agreed to be banned from the securities industry after the agency uncovered an illegal cherry-picking scheme through its data analysis used to detect suspicious trading patterns. The SEC alleged that the investment adviser and his firm defrauded clients of approximately $1.3 million through the scheme where he allocated profitable trades to his personal account and unprofitable trades into the client accounts. The SEC's order charges the adviser and his firm with violating the Securities Exchange Act and the Investment Advisers Act. The investment adviser and the firm agreed to be permanently enjoined from future misconduct, and the adviser consented to the issuance of an SEC order barring him from the securities industry.
- The SEC announced that two firms agreed to settle charges they made false and misleading statements about a foreign exchange trading program they sold to investors. The SEC levied a fine of approximately $2.96 million to each of the firms, which are dually registered with the SEC as investment advisers and broker-dealers. The SEC alleged the brokers failed to adequately disclose that investors could be taking on more leverage than suggested by the program's past performance and risk metrics, which had been used in marketing materials, and that markups would be charged on trades. The SEC also alleged the undisclosed leverage and markups resulted in significant investor losses.
- The SEC charged two former executives of an asset management company with violating the Foreign Corrupt Practices Act by paying bribes to foreign government officials in an effort to win business in their countries. The SEC alleges the individuals, as the masterminds behind the bribery scheme, also aided and abetted their company's violations. The SEC is seeking monetary penalties against the executives among other remedies.

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