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The Washington Report

Americas FS Regulatory Center of Excellence

The week ended February 17, 2017

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1. Safety and soundness

1.1 OFR publishes research on cybersecurity and financial stability

On February 15, 2017, the Office of Financial Research (OFR) published OFR Viewpoint 17-01, which analyzes the risk that cyber attacks can pose to financial stability and the approach taken by U.S. regulators to mitigate cybersecurity risk. The OFR states that cybersecurity incidents could threaten financial stability through i) the lack of substitutability in the payments system, ii) a loss of confidence in the financial system, and iii) damage to the integrity of key data.

The OFR Viewpoint finds that both financial services firms and regulators see cybersecurity as a key risk. U.S. regulators have emphasized cybersecurity threats in public statements, enforceable standards, and guidance documents. The OFR Viewpoint surveys regulators' different approaches and concludes that while U.S. financial regulators are making progress in addressing cyber risks in individual firms, there are still opportunities to improve with respect to third-party vendors, overseas counterparties, and cross-border service providers. The OFR suggests that financial regulators take a broader approach that focuses on the links among financial firms from the payments system, counterparty credit relationships, the use of common information technology (IT) systems and platforms, and financial markets.

To address financial stability risks related to cybersecurity, the OFR suggests the regulators collaborate to develop a common lexicon, a shared risk-based approach, and standardized data on cyber incidents and financial firms' cybersecurity preparedness.

[OFR Viewpoint]

1.2 OCC issues revised Comptroller's Licensing Manual

On February 16, 2017, the Office of the Comptroller of the Currency (OCC) issued a revised booklet on "Changes in Directors and Senior Executive Officers," which is part of the Comptroller's Licensing Manual. The revised booklet replaces the booklet of the same title issued in October 2009 with updated procedures and requirements following the integration of the Office of Thrift Supervision into the OCC in 2011. The booklet incorporates revised regulations addressing changes in directors and senior executive officers of national banks, federal savings associations, and federal branches; explains the requirements for prior notice for changes in directors and senior executive officers, explains the requirements for a technically complete notice; and discusses the 90-day review period and standards of review.

[Press Statement] [Revised Booklet]

2. Enterprise and consumer compliance

2.1 CFPB seeks public feedback on alternative forms of credit to consumer lacking credit history

On February 16, 2017, the Consumer Financial Protection Bureau (CFPB or the Bureau) launched an inquiry into ways to expand credit access for consumers without the requisite credit history to obtain a credit score. The Bureau is seeking public feedback on the benefits and risks of using alternative data sources, such as mobile phone bills and rent payments, in making lending decisions for consumers without a credit history. The Bureau will examine the following topics:

- Access to credit: Whether using alternative data to create or augment a credit score could increase access to credit by helping lenders better assess consumer creditworthiness.
- Process complexity: Whether relying on such alternate sources of information will make credit decisions more complex for both consumers and lenders.
- Impact on costs: Whether using alternative data and new technologies to analyze it will make the application process faster, lower operating costs for lenders, and lower loan costs for borrowers.
- Privacy and security: Whether alternate sources of data are more prone to privacy and security issues because standards are weaker or different than those of traditional data.
- Disparate impact: Whether the use of alternative data could impact certain groups in unexpected ways or create other potential fair lending concerns.

The CFPB estimates that 26 million Americans are "credit invisible," meaning they have no credit history with a nationwide consumer reporting agency, while another 19 million consumers have a credit history that has gone stale, or is insufficient to produce a credit score under most scoring models.

[Press Statement] [CFPB Request for Information]

2.2 FTC testifies before Senate committee on anti-fraud efforts affecting older people

On February 15, 2017, the Federal Trade Commission (FTC) testified before the Senate Special Committee on Aging about current trends relating to frauds affecting seniors and how the agency uses law enforcement and other tools to combat these frauds. The FTC identified several varieties of fraudulent and deceptive schemes that affect seniors, including: sweepstakes, prize promotions and lotteries, timeshare sales and re-sales, health care products and services, investments, business opportunities and work-from-home programs, technical support services, and charitable donations. The FTC also discussed the policy tools it uses to address these issues as well as outreach and educational efforts.

Three other witnesses provided testimony at the hearing, including representatives from the Internal Revenue Service (IRS) and a consumer advocacy group as well as a "senior" that testified about his personal experience with an IRS scam.

[Special Committee Hearing]

2.3 DC Circuit Court to rehear PHH v. CFPB

The U.S. Court of Appeals for the D.C. Circuit announced ***[]*** on February 16, 2017 that it would rehear a case decided in October 2016 that found unconstitutional the CFPB's structure of a single director that was removable only for cause. *PHH Corporation v. CFPB*, which was decided by a three-judge panel, will be reheard before the full court on May 24, 2017. The order to rehear the case vacates the previous judgment.

3. Capital markets and investment management

3.1 SEC and NSAA sign information sharing MOU for crowdfunding

On February 17, 2017, the Securities Exchange Commission (SEC) announced that it signed a Memorandum of Understanding (MOU) with the North American Securities Administrators Association (NSAA) to help facilitate interstate crowdfunding offerings. The MOU allows the two agencies to share information about their observations of the various securities offering exemptions available to companies at the state and federal level to ensure that the new exemptions are facilitating access to capital for small businesses. The SEC created a new exemption in 2016 to facilitate intrastate offerings by giving companies more flexibility to engage in intrastate offerings through Web sites and social media without having to register with the federal government. The SEC also amended its Regulation D to facilitate state-level exemptions for regional offerings.

[Press Statement] [Prepared Remarks] [MOU]

3.2 CFTC issues time-limited no-action transition letter

On February 13, 2017, the Commodity Futures Trading Commission's (CFTC) Division of Swap Dealer and Intermediate Oversight (DSIO) issued a time-limited no-action letter (CFTC Staff Letter 17-11) stating that the DSIO will not recommend an enforcement action against a swap dealer (SD) for failure to comply with the variation margin requirements for swaps from the March 1, 2017 compliance date to September 1, 2017. The no-action letter extends a grace period for compliance but does not postpone the March 1, 2017 compliance date. The grace period applies to SDs that have not completed the necessary credit support documentation with a counterparty or require additional time to implement operational processes to settle variation margin. SDs must also use best efforts to comply with the requirements with each counterparty as soon as possible after March 1, 2017. An SD must continue to post and collect variation margin with a counterparty in accordance with such arrangements until the SD is able to comply with the requirements. The SD must also comply with the March 1, 2017 requirements no later than September 1, 2017.

[Press Statement] [CFTC Staff Letter 17-11]

3.3 SEC approves additional disclosures on confirmations for trades with retail investors

The Financial Industry Regulatory Authority (FINRA) issued Regulatory Notice 17-08 to announce that the Securities and Exchange Commission (SEC) has approved amendments to the FINRA's Rule 2232 (Customer Confirmations) that require member firms to disclose additional information to retail customers for trades in certain fixed income securities. The amended Rule 2232 requires a member to disclose the amount of mark-up or mark-down it applies to trades with retail customers in corporate or agency debt securities. It also requires a member to disclose on all retail customer confirmations a reference, and a hyperlink if the confirmation is electronic, to a web page hosted by FINRA that contains publicly available trading data for the specific security that was traded as well as the execution time of the transaction, expressed to the second. These amendments will become effective on May 14, 2018.

[Press Statement] [Regulatory Notice 17-08]

3.4 Enforcement actions

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

- The SEC announced that a financial services firm has agreed to pay a penalty of $8 million and to admit wrongdoing for not adequately implementing policies and procedures with respect to the sale of inverse ETF (exchange-traded fund) products to certain advisory clients. The SEC's order found that, inconsistent with its policies and procedures, the firm failed to obtain client disclosure notices stating the risks involved with inverse ETFs and supervisors did not conduct risk reviews to assess the suitability of inverse ETFs for each advisory client. In addition, for certain of the inverse ETF products, the SEC found the firm failed to implement other provisions of its compliance policies and procedures including a requirement to monitor certain inverse ETF positions on an ongoing basis and to provide specific training on the products to financial advisors. The firm consented to the SEC's order and agreed to cease and desist from further violations.
- The SEC announced that a brokerage firm has agreed to pay a penalty of $100,000 to settle charges relating to the SEC's allegations that the firm failed to establish, maintain, and enforce written policies and procedures to prevent the misuse of material non-public information in connection with an affiliated hedge fund. The SEC further alleges that once such policies and procedures were put in place, they were not reasonably designed to prevent the misuse of material nonpublic information. The firm agreed to the SEC's terms without admitting or denying the findings.

4. Insurance

4.1 House Subcommittee hears testimony on U.S./EU Covered Agreement

The House Committee on Financial Services' Subcommittee on Housing and Insurance conducted a hearing on February 16, 2017 on the topic of "Assessing the U.S./EU Covered Agreement." Completion of the Covered Agreement (Agreement), which addresses insurance and reinsurance between the United States and the European Union (EU), was announced on January 13, 2017 by the U.S. Department of the Treasury's Federal Insurance Office (FIO) and the U.S. Trade Representative (USTR). The Agreement is currently in a 90-day lay over period that permits Congress the opportunity to review it and provide comment. However, Congressional approval is not required and FIO and the USTR may bring the Agreement into effect at the end of the 90-day period.

Four witnesses provided testimony including representatives from the National Association of Insurance Commissioners, the National Association of Mutual Insurance Companies, and the American Insurance Association along with testimony from the former FIO Director. Two of the witnesses were not in favor of the Covered Agreement, suggesting that it did not give full "recognition" to the U.S. insurance regulatory system or give "sufficient benefit" or certainty to the U.S. insurance sector. They each urged the Trump Administration to renegotiate. In contrast, the remaining two witnesses stated the Agreement would positively impact the U.S. insurance regulatory system, the U.S. insurance sector, and the U.S. economy.

[Subcommittee Hearing]

5. Alternative finance

5.1 IOSCO publishes FinTech research report

On February 8, 2017, the Board of the International Organization of Securities Commissions (IOSCO) published a research report on the delivery of securities and capital markets products and services through FinTech. Specifically, the report examines alternative financing platforms, retail trading and investment platforms, institutional trading platforms, and distributed ledger technologies (DLT). The IOSCO developed the report in collaboration with the G20 and the Financial Stability Board (FSB).

Some of the specific regulatory points outlined by the research report include:

- The risk of regulatory arbitrage may be overcome through international cooperation and greater exchange of information among regulators.
- Regulators may face challenges addressing Fintech development while fulfilling their regulatory mandate, such as promoting investor protection, market fairness, and financial stability.
- New distribution and business models for products and services reduce compliance costs and increase accessibility to a broader investor base through a shift towards "digital customer onboarding" and "e-KYC".
- Cybersecurity and data protection will emerge as key FinTech priorities among regulators across developed and emerging markets.
- Because securities trading and investing through FinTech is aimed at retail investors, financial literacy and investor education will likely emerge as key priorities for regulators
- Several regulators have established FinTech offices to help innovative start-ups and technology firms understand how their products and services intersect with financial regulation.
- Some regulators are exploring the possibility of introducing regulatory sandbox frameworks under which FinTech companies may be granted certain regulatory flexibilities.

[Research Report on FinTech]

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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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