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The Washington Report

Americas FS Regulatory Center of Excellence

The week ended May 12, 2017

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1. Safety and soundness

1.1 FSB publishes global shadow banking report

The Financial Stability Board (FSB) published a report on May 10, 2017, summarizing the results of its annual global shadow banking monitoring exercise for 2016. The exercise assesses global trends and risks in the shadow banking system across member jurisdictions (28 in 2016). The report concludes that no new risks had been identified at the global level requiring regulatory action but encourages member jurisdictions to maintain and continue to invest in an effective and ongoing program of surveillance, data sharing and analysis to support judgements for any future required regulatory response.

The FSB highlights the following findings from the 2016 exercise:

— Shadow banking activity was $34 trillion in 2015 equivalent to 13 percent of total financial assets, an increase of around 3.2 percent over the previous year.

— Credit intermediation associated with Collective Investment Vehicles (CIVs) comprised 65 percent of shadow banking and has grown by around 10 percent on average over the past four years. It is largely driven by liquidity, leverage and maturity transformation.

— Non-bank financial entities engaging in loan provision that are dependent on short-term funding grew by 2.5 percent in 2015. In some jurisdictions, finance companies tended to have relatively high leverage and maturity transformation, which makes them relatively more susceptible to rollover risk during periods of market stress.

The 2016 exercise also collected new data to measure interconnectedness among the bank and the non-bank financial sectors and to assess short-term wholesale funding. The data suggest a decline since 2015 in bank credit exposures to and funding from "Other Financial Intermediaries." These levels, however, are above the levels before the 2007-2009 financial crisis.

[Press Statement] [Report]

2. Enterprise and consumer compliance

2.1 CFPB issues RFI and white paper on small business credit

On May 10, 2017, the Consumer Financial Protection Bureau (CFPB of the Bureau) released a Request For Information (RFI) on the small business lending market. The RFI will inform the Bureau's work on a business lending data collection rulemaking that is required to implement section 1071 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which requires financial institutions to compile, maintain, and report information concerning credit applications made by women-owned, minority-owned, and small businesses.

The Bureau seeks to learn more about:

— The small business financing market, including the products that are offered to small businesses, including women-owned and minority-owned small businesses, as well as the financial institutions that offer such credit;

— The business lending data that financial institutions currently use and may be maintained in connection with credit applications made by small businesses, including women-owned and minority-owned small businesses, and the potential complexity and cost of small business data collection and reporting; and

— Privacy concerns related to the section 1071 disclosures

The comment period for the public inquiry will end 60 days after the RFI is officially published in the Federal Register

[Press Statement] [Request for Information]

Concurrent with the release of the RFI, the CFPB also released a white paper that reviews available data on small business lending and presents initial findings of its research with a focus on lending to women-owned and minority-owned small businesses.

[Whitepaper]

2.2 Enforcement Actions

The Federal Deposit Insurance Corporation (FDIC) announced the following enforcement action in the past week:

— On May 11, 2017, the FDIC reached a settlement with an insured state-chartered nonmember bank and two of its institution-affiliated parties to address the FDIC's findings they engaged in unfair and deceptive practices, in violation of Section 5 of the Federal Trade Commission (FTC) Act. The bank is required to pay $3 million in restitution to harmed consumers and a civil penalty of $151,000. The other two parties are required to pay a fine of $91,000 in total. The bank was alleged to have charged interest to consumers who paid off their loans within six months when the loans were promoted as six-month interest free, sold add-on products in conjunction with loans without clearly disclosing the terms of those products, and failed to provide consumers the opportunity to exercise the monthly premium payment option.

3. Capital markets and investment management

3.1 FINRA approves proposals to strengthen controls on high-risk brokers

On May 11, 2017, the Board of Governors of the Financial Industry Regulatory Authority (FINRA) announced that it approved proposals to strengthen controls on brokers with a history of significant past misconduct as well as to increase accountability for firms that choose to employ high risk brokers. The proposals will be released for public comment in a forthcoming Regulatory Notice. Among other things, they would enable adjudicators to consider more severe sanctions when an individual's disciplinary history includes past misconduct and allow hearing panels, in appropriate circumstances, to restrict activities of firms and individuals while a disciplinary matter is on appeal.

FINRA further stated that it will also issue a Regulatory Notice to reinforce and clarify firms' existing supervisory obligations concerning any high-risk brokers they may employ. These proposals would:

- Require firms to adopt heightened supervisory procedures for brokers while a statutory disqualification request is under FINRA's review or the broker is appealing a hearing panel decision;
- Increase FINRA's statutory disqualification application fee for individuals and enact a new fee for firms;
- Require firms to disclose on BrokerCheck if they are subject to existing requirements for recording all telephone conversations with customers due to having a specified percentage of registered representatives who were formerly employed by a disciplined firm; and
- Revise the guidelines for reviewing FINRA examination waiver requests in cases where the broker has a history of past misconduct.

[Press Statement]

3.2 FINRA proposes rule to reduce the delay for TRACE data sets

The Financial Industry Regulatory Authority (FINRA) filed a proposal with the Securities and Exchange Commission (SEC) on May 12, 2017, that would amend Rule 7730 to reduce the delay from 18 months to six months for Historic TRACE Data Sets relating to corporate and agency debt securities. If the SEC approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following the SEC's approval. The effective date will be no later than 120 days following publication of the Regulatory Notice.

[Press Statement] [Proposed Rule]

3.3 SEC approves FINRA amendments to FINRA on T+2 settlement cycle

On May 9, 2017, the Financial Industry Regulatory Authority (FINRA) published Regulatory Notice 17-19 summarizing the Securities and Exchange Commission's (SEC) February approval of the amendments to FINRA rules needed to shorten the standard settlement cycle from T+3 to T+2 for U.S. secondary market transactions in equities, corporate and municipal bonds, unit investment trusts and financial instruments. The shorter cycle is intended to reduce credit, market, and liquidity risk, and, as a result, systemic risk for U.S. market participants. The amendments, which become effective September 5, 2017, revise settlement provisions in the following FINRA rules:

— Rule 2341 (Investment Company Securities)
— Rule 11140 (Transactions in Securities ''Ex-Dividend,'' ''Ex-Rights'' or ''Ex-Warrants'')
— Rule 11150 (Transactions ''Ex-Interest'' in Bonds Which Are Dealt in ''Flat'')
— Rule 11210 (Sent by Each Party)
— Rule 11320 (Dates of Delivery)
— Rule 11620 (Computation of Interest)
— Rule 11810 (Buy-In Procedures and Requirements)
— Rule 11860 (COD Orders)

[Press Statement] [Notice]

3.4 Enforcement Actions

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

— On May 10, 2017, the SEC announced that it had ordered a financial services firm to refund advisory fees or mutual fund sales charges to clients who were overcharged. The SEC alleged that the financial services firm had overbilled more than 2,000 clients approximately $50 million due to miscalculations and billing errors, collection of excess fees by recommending more expensive share classes when less expensive were available, and failure to provide the paid for services. Without admitting or denying the SEC's findings, the company consented to the order and agreed to refund advisory fees of nearly $50 million plus an additional $13.7 million in interest and $30 million in civil money penalties. Further, the company agreed to directly refund an additional $3.5 million to advisory clients who invested in third-party investment managers and investment strategies that underperformed while going unmonitored.

4. New administration updates

4.1 Trump issues executive order on cybersecurity of Federal networks and critical infrastructure

U.S. President Donald Trump issued an executive order on May 11, 2017 that aims to strengthen the cybersecurity of Federal networks and critical infrastructure. The President will hold heads of executive departments and agencies (collectively, agency heads) accountable for managing cybersecurity risks to their enterprises. Further, the U.S. will manage cybersecurity risk as an executive branch enterprise.

The order requires the agency heads to immediately use the National Institute of Standards and Technology (NIST) Cybersecurity Framework for risk management and to provide within 90 days a risk management report to the Department of Homeland Security (DHS) and the Office of Management and Budget (OMB) on the implementation of the framework and risk management strategies employed by the department or agency. The report must document the agency heads' risk mitigation and acceptance choices including strategic, operational, and budgetary considerations. The DHS and OMB will report to the President on whether the agencies risk management reports are appropriate and sufficient to manage the cybersecurity risk to the executive branch enterprise in the aggregate.

The order further mandates investigation and reporting by various agencies on federal policies for the owners and operators of critical infrastructure. It requires agencies to support market transparency, improve resilience against botnets and other automated, distributed threats, assess electricity disruption incident response capabilities, and evaluate the cybersecurity risks facing the defense industrial base.

Finally, the order aims to develop cybersecurity workforce training.

[Press Statement]

Contact us

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