The Washington Report

Americas FS Regulatory Center of Excellence

The week ended June 9, 2017

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1. Safety and soundness

1.1 FDIC adopts supervisory guidance on model risk management

On June 7, 2017, the Federal Deposit Insurance Corporation announced the adoption of Supervisory Guidance on Model Risk Management (Guidance), as previously issued by the Federal Reserve Board (Federal Reserve) and the Office of the Comptroller of the Currency (OCC) though with technical modifications to make the guidance applicable to FDIC-supervised institutions.

The Guidance addresses the supervisors' expectations for model risk management, including model development, implementation, and use; model validation; and governance, policies, and controls. It also discusses how an effective model risk management framework should include:

- Disciplined and knowledgeable development that is well documented and conceptually sound;
- Controls to ensure proper implementation;
- Processes to ensure correct and appropriate use;
- Effective validation processes; and
- Strong governance, policies, and controls.

The Guidance uses the concept of "effective challenge" as a guiding principle for managing model risk and is intended to facilitate consistent model risk management expectations across the banking agencies and industry.

[Press Statement] [Financial Institution Letter 22-2017]

1.2 BCBS publishes revisions to annex on correspondent banking

On June 7, 2017, the Basel Committee on Banking Supervision (BCBS) published its final revisions to the annex on correspondent banking, which is part of the BCBS guidelines on the "Sound management of risks related to money laundering and financing of terrorism." The revisions have been made to annexes 2 (Correspondent banking) and 4 (General guide to account opening) and are intended to guide banks in the application of a risk-based approach to correspondent banking relationships. An updated list of risk indicators that correspondent banks should consider in their risk assessment is also included. The BCBS notes that the revisions to the annex support implementation of the Financial Action Task Force (FATF) standards in its October 2016 *Guidance on correspondent banking services*, and form part of the international initiative to assess and address the decline in correspondent banking as coordinated by the Financial Stability Board.

[Press Statement] [Guidelines]

1.3 BIS publishes FAQs on Basel III Liquidity Coverage Ratio

The Basel Committee on Banking Supervision (BCBS) issued a second set of frequently asked questions (FAQs) and answers on the Basel III Liquidity Coverage Ratio (LCR) on June 8, 2017. The FAQs are presented in combination with existing FAQs published by the BCBS in April 2014. The BCBS will continue to periodically update the FAQs to promote consistent global implementation of the LCR requirements.

[Press Statement] [FAQ]

1.4 House passes Financial CHOICE Act

On June 8, 2017, the U.S. House of Representative passed H.R. 10, the Financial CHOICE Act of 2017, which would change many provisions in the Dodd-Frank Act, including, among others:

- Repeal of the Volcker Rule;
- Repeal of the DOL Fiduciary Rule;
- Repeal of the Orderly Liquidation Authority and replacement with a new chapter in the U.S Bankruptcy Code;
- Elimination of the authority of the Financial Stability Oversight Council to designate nonbank financial companies as systemically important financial institutions;
- Exemption from the capital/liquidity/stress testing/resolution and recovery requirements for qualifying banking organizations (which would require a leverage ratio of at least 10 percent); and
- Significant modification to the structure and authorities of the Consumer Financial Protection Bureau.

H.R. 10 passed by a vote of 233-186, largely along partisan lines. The bill now goes to the U.S. Senate for consideration.

[Executive Summary] [Legislative Text]

1.5 OCC issues bulletin on shortening the settlement cycle for securities

On June 9, 2017, the Office of the Comptroller of the Currency (OCC) issued Bulletin 2017-22 to highlight actions all OCC-supervised banks and federal savings associations should take to prepare for the shortening of the regular settlement cycle for most U.S. securities transactions, which will take effect on September 5. 2017. As of that date, the settlement cycle for U.S. securities, including equities, corporate and municipal bonds, and unit investment trusts and financial instruments of these products, will change from the third business day after the trade date (T+3) to the second business day after the trade date (T+2).

Banks are expected to be prepared to meet the T+2 standards as of the effective date and should not enter into a contract for the purchase or sale of an affected security that provides for payment of funds or delivery of securities later than T+2 without express agreement by the parties at the time of the transaction. Bank management and the board of directors should employ effective change management processes and establish an appropriate project plan for implementation. Banks should also assess the preparedness of relevant third parties to meet the new settlement time frame.

[Bulletin 2017-22]

1.6 FDIC announces deadline for Summary of Deposits (SOD) survey

On June 7, 2017, the Federal Deposit Insurance Corporation (FDIC) issued Financial Institution Letter 21-2017 to remind insured depository institutions of the July 31, 2017 filing submission deadline for the FDIC's Summary of Deposits (SOD) survey. The SOD is an annual survey of branch office deposits as of June 30 for all FDIC-insured institutions, including insured U.S. branches of foreign banks. The FDIC has been gathering the SOD Survey responses using the Federal Financial Institutions Examination Council's (FFIEC's) Central Data Repository (CDR) since 2016. Before completing the survey, covered entities should review their current branch office information on the FDIC's BankFind website and submit any required corrections to the FDIC's Data Collection and Analysis Section before June 24, 2017.

[Financial Institution Letters]

2. Enterprise and consumer compliance

2.1 CFPB finds those lower-income areas more likely to become credit visible due to negative records

On June 7, 2017, the Consumer Financial Protection Bureau (CFPB or Bureau) Office of Research published a report entitled "CFPB Data Point: Becoming Credit Visible," which documents the results of a study on the transition to credit visibility. The study found how consumer credit histories differ based on the economic background when consumers transition out of credit invisibility and the means by which they do so. Key findings highlighted in the report include:

— Approximately 15 percent of consumers establish a credit history by non-loans such as a debt in collection or a public record. Consumers in lower-income neighborhoods are 240 percent more likely than those in higher-income areas to become credit visible due to negative records.

— Credit cards are the most common ways to establish credit visibility with 38 percent of consumers opting for it. Consumers in higher-income neighborhoods are 30 percent more likely than those in lower-income areas to use a credit card to become credit visible.

— Roughly 15 percent of consumers establish a credit history by relying on co-borrowers. Consumers in higher-income areas are 100 percent more likely than those in lower-income areas to rely on someone else to establish their credit.

— The percentage of consumers under the age of 25 who have used a student loan to establish credit visibility more than doubled between 2006 and 2016, increasing from roughly 10 percent to more than 26 percent .

[Press Statement] [Report]

2.2 CFPB encourages more transparent promotions for retail credit cards

On June 8, 2017, the Consumer Financial Protection Bureau (CFPB or the Bureau) announced that it had contacted a number of top retail credit card companies urging them to bring more transparency to their deferred-interest promotions. The CFPB focused on the companies' use of deferred interest as a means of attracting customers and encouraging purchases that may result in consumers facing high, retroactive interest charges after the promotional period ends. The CFPB suggests the companies consider using a zero-percent-interest promotion that is more transparent and carries less risk for consumers.

The Bureau also published a blog post on "How to understand special promotional financing offers on credit cards." The post discusses the difference between zero interest and deferred interest promotions, how deferred interest is calculated, and considerations when getting a card with a zero interest or deferred interest promotion.

[Press Statement] [Letter] [Blog post]

2.3 House conducts hearing on flood insurance reform

On June 7, 2017, the House Committee on Financial Services held a hearing entitled "Flood Insurance Reform: A Taxpayer's Perspective." Five witnesses, representing industry, conservation, and community organizations testified about proposed legislative reforms to the National Flood Insurance Program (NFIP). The six reform proposals address taxpayer protections; private market access; mitigation of high risk properties; flood mapping; consumer costs; and claims processing.

Some witnesses supported, among other things, increased private competition in the NFIP by removing prohibitions on insurers who participate in "Write Your Own" program for selling coverage outside of the NFIP. Witnesses also supported increased mitigation efforts in communities with large numbers of repetitive losses. Opponents of privatization argued that it has the potential to risk NFIP solvency and leave many without coverage, as insurance companies could leave the NFIP with only the riskiest properties. Witnesses also expressed concern that proposed sanctions on repeatedly flooded communities would leave many communities with the threat of being excluded from the NFIP. This problem, they said, would be furthered by the limited funding for mitigation nationwide.

[House committee hearing]

2.4 Enforcement Actions

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

- The CFPB filed an enforcement action against a mortgage servicer alleging the servicer violated the CFPB's servicing rules by not sharing information with borrowers about the process of applying for foreclosure relief and illegally beginning or continuing the foreclosure process when homeowners were actively seeking help to avoid foreclosure. The mortgage servicer agreed to the issuance of the Bureau's consent order without admitting or denying any of the CFPB's findings, as well as to stop its illegal practices and pay up to $1.15 million to harmed borrowers.
- At the request of the FTC and the Florida Office of the Attorney General, a federal district court judge issued orders against a group of entities for making illegal robocalls offering credit card interest rate reduction programs and then failing to provide the promised interest rate reductions or savings. The FTC's complaint also charged the defendants with making many calls to consumers whose phone numbers are on the FTC's National Do Not Call Registry along with several other violations of the FTC's Telemarketing Sales Rule and Florida's Telemarketing and Consumer Fraud and Abuse Act. The orders ban the entities from robocalling, telemarketing, and providing debt relief services in addition to a judgment of approximately $4.9 million. The monetary judgment is either entirely or partially suspended based on the defendants' inability to pay, but the entire amount will become due if they are found to have misrepresented their financial condition.

3. Capital markets and investment management

3.1 FINRA adopts rules on disruptive quoting and trading activity and expedited proceedings

On June 7, 2017, the Financial Industry Regulatory Authority (FINRA) issued Regulatory Notice 17-22 to announce the December 2016 adoption of rule changes pertaining to i) "Disruptive Quoting and Trading Activity," and ii) "Expedited Proceedings." The first rule change adopts new Supplementary Material .03 to Rule 5210 to define and prohibit two types of specific conduct that are deemed disruptive quoting and trading activity. These scenarios primarily include two patterns:

- A pattern in which (1) a party enters multiple limit orders on one side of the market at various price levels; (2) following the entry of the limit orders, the level of supply and demand for the security changes; (3) the party enters one or more orders on the opposite side of the market that are subsequently executed; and (4) following the execution, the party cancels the original limit orders.
- A frequent pattern in which (1) a party narrows the spread for a security by placing an order inside the national best bid and offer and (2) the party then submits an order on the opposite side of the market that executes against another market participant that joined the new inside market established by the party.

The second rule change amends the FINRA Rule 9800 procedural rules regarding temporary cease and desist orders against a respondent that engages in a frequent practice of disruptive quoting and trading activity. As amended, FINRA can issue, on an expedited basis, a permanent cease and desist order under which a respondent to the proceeding would be ordered to cease and desist from the prohibited activity under Supplementary Material or ordered to cease and desist from providing market access to a client engaged in the prohibited trading activity.

[Press Statement] [Regulatory Notice]

3.2 FINRA issues research on securitized-asset liquidity

On June 8, 2017, the Financial Industry Regulatory Authority (FINRA) Office of the Chief Economist posted a new Research Note on liquidity in structured products. The new analysis focuses on two categories of products: (1) Real-estate securities, including the mortgage-backed securities in residential housing (MBS) and commercial building (CMBS), collateralized mortgage products (CMO), and to-be-announced forward mortgages (TBA); and (2) Asset-backed securities (ABS) in credit cards, automobiles, student loans and other miscellaneous categories.

The research identified positive and negative market developments, some of which include the following:

- The number and volume of new issues of securitized assets decreased sharply after the financial crisis and have not yet rebounded to pre-crisis levels, while trading volumes are down for most but not all securitized asset categories.
- Despite the negative trends in issuance and trading volumes, market microstructure measures of liquidity do not show the same deterioration.
- Bid-ask spreads are down in every category except for autos.
- The price impact of trades has fallen in every security since 2012.
- The size of dealer networks has remained fairly stable, although interdealer trading has declined.
- The liquidity for real estate products is only weakly linked to that of the corporate bond market, with the exception of CMBS.
- The negative correlation between real estate products and several categories of ABS shows that there is no single common liquidity driver among structured products. This makes it difficult to ascribe the liquidity challenges in these markets to a single cause such as stronger regulatory burdens.

According the Chief Economist at FINRA, this analysis deepens and broadens FINRA's collective understanding of these markets, and contributes to informed decision making among securities firms, investors, issuers, and regulators. The research paper complements FINRA's previously released Research Note on corporate-bond liquidity.

[Press Statement] [Research Note] [Corporate Bond Liquidity]

3.3 Supreme Court limits SEC disgorgement to five years

On June 5, 2017, the U.S. Supreme Court ruled in a unanimous decision in *Kokesh v. SEC* that the five-year statute of limitations for U.S. Securities and Exchange Commission (SEC) civil penalty enforcement actions under 28 U.S.C. § 2462 also applies to its authority to require disgorgement of illegally obtained profits. The Court held that disgorgement constitutes a "penalty," as opposed to a remedial requirement, because it is seeks to redress a "wrong to the public" as opposed to an individual; it was sought "for the purpose of punishment, and to deter others from offending in like manner"; and disgorgement is not solely compensatory, as "some disgorged funds are paid to victims; other funds are dispersed to the United States Treasury."

[Kokesh v. SEC]

3.4 Republicans introduce two bills to repeal Department of Labor fiduciary rule

On June 8, 2017, Representative Phil Roe, member of the House Committee on Education and the Workforce, and Representative Peter Roskam, chairman of the Ways and Means Subcommittee on Tax Policy, introduced the Affordable Retirement Advice for Savers Act (H.R. 2823), which would repeal the Department of Labor fiduciary rule.

[Background] [Fact Sheet] [H.R. 2823]

Also, on June 8, 2017, Senator Johnny Isakson reintroduced the Affordable Retirement Advice Protection Act, originally introduced in February 2016, to stop implementation of the Department of Labor fiduciary rule.

The fiduciary rule became effective on June 9, 2017.

[Press Release] [S. 1321]

3.5 FINRA proposes rule change to adopt fee dispute resolution procedures

On June 9, 2017, the Financial Industry Regulatory Authority (FINRA) filed a proposed rule change with the Securities and Exchange Commission (SEC) to adopt FINRA Rule 6898 on "Consolidated Audit Trail (CAT) – Fee Dispute Resolution," which establishes the procedures for resolving potential disputes related to CAT fees. The rule change would require industry members to pay the CAT fees determined by the Operating Committee.

[Rule Filing] [Proposed Rule Change - SR-FINRA-2017-017]

3.6 Enforcement Actions

The Commodity Futures Trading Commission (CFTC) and the Financial Industry Regulatory Authority (FINRA) announced the following enforcement actions in the past week:

- The CFTC announced an enforcement action against a foreign exchange (forex) dealer and a brokerage firm that charges the forex dealer with providing services without being registered with the CFTC and fraudulently soliciting U.S. customers to trade leveraged foreign currencies. According to the complaint, the forex dealer accepted at least $1.5 million from the U.S. customers in connection with leveraged or margined forex transactions during September 2012 and September 2016. The enforcement action seeks restitution to defrauded customers, disgorgement of ill-gotten gains, a civil monetary penalty, permanent registration and trading bans, and a permanent injunction against future violations of federal commodities laws.

— A U.S. District Court entered a Statutory Restraining Order (SRO) against two individuals and a company owned by one of them freezing the defendants' assets and granting the CFTC the right to immediately inspect the defendants' business records. The SRO was granted in response to a CFTC complaint alleging the defendants fraudulently solicited more than $11 million from customers in connection with trading futures. The CFTC seeks full restitution to defrauded customers, disgorgement of ill-gotten gains, civil monetary penalties, permanent registration and trading bans, and a permanent injunction against future violations of federal commodities laws, as charged.

— A FINRA hearing panel barred a registered representative for selling $100 million in EB-5 investments promoted through the representative's private business and failing to disclose this activity to his employing firm. FINRA rules and the member firm's policy required the registered representative to disclose and obtain prior approval for all outside business activities.

4. Financial crimes

6.1 House conducts hearing on virtual currency and national security

On June 8, 2017, the House Committee on Financial Services Subcommittee on Terrorism and Illicit Finance conducted a hearing entitled "Virtual Currency: Financial Innovation and National Security Implications." Five witnesses, including representatives from a public policy group, an industry association, a former Department of Justice attorney, and two risk management software providers, provided testimony focusing on the use of virtual currency by terrorists and transnational criminal groups and the related policy considerations.

Their testimony revealed that governments are becoming increasingly aware of virtual currencies being used to fund illicit operations, raise money from sympathizers in crowdfunding operations, and pay for goods. Witnesses also noted that the record of transactions associated with blockchain technology can help law enforcement trace currency flows, but existing blockchain analysis tools will be challenged as new "cryptocurrencies" are developed to evade them.

One witness discussed how state-by-state regulation for FinTech firms, as opposed to a federal charter, limits visibility into payment networks. The witness recommended the creation of not only a federal FinTech charter but a new federal money transmission license as an alternative to state-by-state licensing. Witnesses also recommended coordination between public and private entities on mutually beneficial uniform legal, regulatory, and policy solutions for the management and oversight of virtual currencies and other payments systems. This includes working with foreign governments to establish internationally accepted methodologies and transparent requirements.

[Subcommittee hearing]

6.2 BCBS publishes revisions to annex on correspondent banking

On June 7, 2017, the Basel Committee on Banking Supervision (BCBS) published its final revisions to the annex on correspondent banking, which is part of the BCBS guidelines on the "Sound management of risks related to money laundering and financing of terrorism." The revisions have been made to annexes 2 (Correspondent banking) and 4 (General guide to account opening) and are intended to guide banks in the application of a risk-based approach to correspondent banking relationships. An updated list of risk indicators that correspondent banks should consider in their risk assessment is also included. The BCBS notes that the revisions to the annex support implementation of the Financial Action Task Force (FATF) standards in its October 2016 *Guidance on correspondent banking services*, and form part of the international initiative to assess and address the decline in correspondent banking as coordinated by the Financial Stability Board.

[Press Statement] [Guidelines]

This item was also covered under the Safety and Soundness heading.

6.3 Enforcement Actions

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

- The SEC charged a brokerage firm with violating the Securities Exchange Act and failing to comply with anti-money laundering laws. The SEC's complaint alleges the firm engaged in a practice of clearing transactions for microcap stocks that were used in manipulative schemes to harm investors and that it "routinely and systematically" failed to report suspicious activity in its Suspicious Activity Reports (SARs) that it flagged as suspicious.
- The Federal Reserve issued an order permanently barring two former employees of an institution-affiliated party of a state member bank who had established shell companies to commit money laundering, bank bribery and wire fraud affecting a financial institution. The two admitted to the conspiracy in their plea agreement and agreed to pay $5.1 million in restitution to the bank jointly and severally.
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Contact us

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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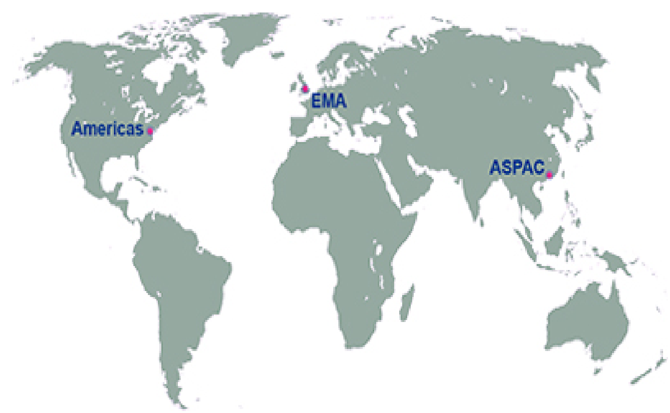

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