The Washington Report

Americas FS Regulatory Center of Excellence

The week ended August 18, 2017

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1. Safety and soundness

1.1 Federal agencies jointly issue guidance on capital treatment of centrally cleared derivatives contracts

On August 14, 2017, the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation jointly issued guidance on the regulatory capital treatment of variation margin requirements for certain centrally cleared, settled-to-market derivative contracts. The guidance responds to recent changes in the rulebooks of some central counterparties resulting in variation margin being considered a settlement payment rather than collateral. Previously, variation margin that was transferred to cover the exposure from marking contracts to market value was considered collateral. However, for the central counterparties that revised their rulebooks, such variation margin for centrally cleared derivatives contracts is now considered a settlement payment for the exposure, with title to the payment transferring to the receiving party.

The agencies' guidance provides that, to determine whether variation margin may be considered settlement of outstanding exposure under their regulatory capital rules, an institution should use "accounting and legal analysis" to evaluate whether the:

— Variation margin payment settles any outstanding exposure on the contract;

— Terms are reset and the fair value of the contract is zero upon payment;

— Ownership of the variation margin has transferred;

— Transferor of the variation margin has relinquished all legal claims to the variation margin, and

— Payment of the variation margin constitutes settlement under the central counterparty's rulebook as well as any other applicable agreements governing the derivative contract, and applicable laws or regulations.

[Joint supervisory guidance]

2. Enterprise and consumer compliance

2.1 CFPB issues reports on student loan repayment and employer-sponsored repayment assistance programs

On August 16, 2017, the Consumer Financial Protection Bureau's (CFPB or Bureau) Office of Financial Research released the results of a study on student loan repayment behavior in which it found key changes in the way that consumers borrow and repay student credit. In conducting the study, the CFPB analyzed more than 1 million anonymized student loan borrowers' credit reports and looked at groups of borrowers who began repaying loans from 2002 to 2014. The Bureau analyzed each group's repayment experience through 2016 and identified key changes in the way consumers borrow and repay student debt.

Specifically, the Bureau found:

— <u>More student loan borrowers are leaving school owing more:</u> Since 2002, the percentage of borrowers owing $20,000 or more at the start of repayment has more than doubled (from 20 percent to more than 40 percent), and the percentage of borrowers owing $50,000 or more has tripled (from 5 percent to 16 percent).

— <u>The age of student loan borrowers when they start repayment is increasing:</u> Since 2003, the percentage of borrowers starting repayment older than 34 years old has doubled (from 25 percent to nearly 50 percent) and the percentage of consumers beginning repayment under the age of 25 has decreased (from 30 percent to 15 percent).

— <u>More borrowers are not paying down their loan balances after five years in repayment:</u> The percentage of borrowers who are not paying down their loan balances has nearly doubled (from 16 percent in 2008 to 30 percent in 2016), which the CFPB explains means that even if borrowers are making payments, those payments are not enough to cover the interest on their loans.

— <u>A significant number of those borrowers that are not reducing their loan balances are delinquent:</u> Despite increases in the availability income-driven repayment plans, 60 percent of borrowers who are not paying down their balances five years into repayment are delinquent on their loans.

In addition to the student loan repayment report, the CFPB released the results of a second, related study on student loan repayment assistance programs. The CFPB notes that employers are increasingly offering student loan repayment as an employee benefit. In many cases, the programs rely on third parties to administer the payments, which are sent directly to student loan servicers.

The report highlights issues identified by student loan borrowers as well as feedback from employers providing student loan repayment benefits to borrowers. It features a series of recommendations to student loan servicers, policymakers, and administrators of student loan repayment programs designed to address identified concerns (e.g., servicing roadblocks, accessibility, tailoring) and promote future growth and innovation to assist consumers with student debt.

Finally, in an August 18, 2017 blog post, the CFPB announced the release of updated information supporting an earlier report released in January 2017 on student loan debt held by Americans aged 60 and older in each of the fifty states, the District of Columbia, and Puerto Rico. The CFPB summarizes that the updated data show the number of older Americans with student loan debt is increasing as is the amount of student loan debt that they hold.

[Press Statement]
[CFPB report on student loan repayment]
[CFPB report on repayment assistance programs] [Blog]
[Blog - older Americans]

2.2 Enforcement action

The Consumer Financial Protection Bureau (CFPB) announced that it had filed a complaint and a proposed settlement against a private equity firm that allegedly aided the predatory lending scheme perpetrated by a for-profit post-secondary education institution that was previously subject to a CFPB enforcement action. The CFPB alleges the firm enabled the college to make high-cost private loans to the students so that it would seem as if the school was making enough outside revenue to meet the requirements for receiving federal student aid dollars. The Bureau's proposed settlement seeks $183.3 million in loan forgiveness and reduction for approximately 41,000 students.

3. Capital markets and investment management

3.1 IOSCO issues report on recommendations to improve transparency of corporate bond markets

On August 14, 2017, the Board of the International Organization of Securities Commissions (IOSCO) published a consultation report, entitled *Regulatory Reporting and Public Transparency in the Secondary Corporate Bond Markets*. The report sets forth seven recommendations that update IOSCO's 2004 report on *Transparency of Corporate Bond Markets*, including recommendations that regulatory authorities have sufficient information to perform their regulatory functions effectively. In addition, the report recommends that regulatory authorities look at how they might enhance pre-trade transparency in corporate bond markets and implement regimes that require post-trade transparency, taking into account the potential impact of pre- and-post trade transparency on market liquidity. The comment period for the report will close on October 16, 2017.

[Press Statement] [Consultation Report]

3.2 FINRA proposes Rule 11140 clarification

The Financial Industry Regulatory Authority (FINRA) proposed a rule change on August 17, 2017, that would address the application of Rule 11140 (Transactions in Securities 'Ex-Dividend', 'Ex-Rights' or 'Ex-Warrants') as it relates to establishing ex-dividend dates in connection with the implementation of the T+2 settlement cycle, which goes into effect on September 5, 2017. FINRA is proposing to refrain from establishing September 5, 2017 as an ex-dividend date for "regular" and "large" distributions in order to avoid confusion around the proper settlement date that would occur from the transition from the T+3 settlement cycle to the T+2 settlement cycle. As proposed, September 7, 2017 would be the first record date to which the new ex-dividend date determination would be applied for "regular" distributions. FINRA states that for "large distributions" it would advise issuers to not set September 1, 2017 as the payable date and, should an issuer set a payable date as September 1, 2017, FINRA would interpret the ex-dividend date to be September 6, 2017.

FINRA has submitted the proposed rule change to the Securities and Exchange Commission for approval and is seeking to obtain immediate effectiveness.

[Proposed Rule]

3.3 Enforcement actions

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

- The SEC announced insider trading charges against seven individuals to address the SEC's findings they traded on confidential information about impending mergers and acquisitions. Data analysis allowed the SEC's staff to uncover the illicit trading despite the traders' alleged use of shell companies, code words, and an encrypted messaging application to evade detection. The SEC's complaint charges the seven defendants with fraud and seeks permanent injunctions and the return of allegedly ill-gotten gains plus interest and penalties. In a parallel action, the U.S. Attorney's Office unsealed criminal charges against the same seven individuals.
- The SEC has entered into an Order with a wholly-owned U.S. subsidiary of a foreign bank to address the SEC's charges the subsidiary, an SEC-registered broker-dealer, violated federal securities laws by requesting the issuance of and receiving American Depositary Receipts (ADRs) without possessing the underlying foreign shares. The broker-dealer pre-released ADRs and lent them to counterparties without satisfying the proper requirements. To settle the charges, the broker-dealer has agreed to pay more than $18 million in disgorgement plus $2.3 million in interest as well as a $15 million penalty.
- FINRA expelled a broker-dealer from FINRA membership and barred its CEO from association with any FINRA member firm over a scheme that used manipulative trading to sell shares to customers at fraudulently inflated prices. FINRA also suspended one of the firm's representatives for a period of two years and required him to pay more than $18,000 in restitution to affected customers. In addition, the firm and its CEO were charged with failing to respond to numerous FINRA requests for documents and information, and FINRA found that the firm failed to maintain the required minimum net capital.
- The CFTC announced that a U.S. District Court entered a Consent Order against three individuals and their companies for fraudulently soliciting customers in connection with precious metals and diamonds transactions, misappropriating customer funds, and concealing their fraud with false account statements. The order requires them to pay more than $2.7 million in restitution to defrauded customers and an equal amount in civil monetary penalties. It also imposes a permanent trading and registration bans.

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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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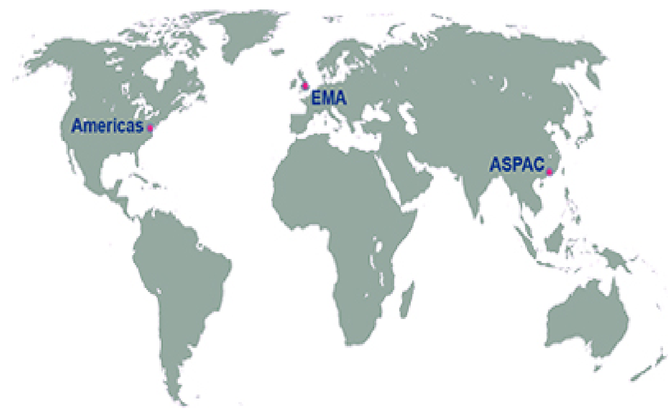

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