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The Washington Report

Americas FS Regulatory Center of Excellence

The week ended August 25, 2017

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1. Safety and soundness

1.1 Federal Reserve chair Janet Yellen offers perspectives on regulatory reform, financial stability, and commitment to improvements as needed

Federal Reserve Board Chair Janet Yellen spoke before a symposium sponsored by the Federal Reserve Bank of Kansas City on August 25, 2017 on the topic of financial stability. She stated that although post-crisis reforms have made the financial system "substantially safer," the scope and complexity of financial regulatory reforms "demand that policymakers remain alert to both areas for improvement and unexpected side effects." "The Federal Reserve is committed individually, and in coordination with other U.S. government agencies through forums such as the FSOC [Financial Stability Oversight Council] and internationally through bodies such as the Basel Committee on Banking Supervision and the FSB [Financial Stability Board], to evaluating the effects of financial market regulations and considering appropriate adjustments," she said.

Chair Yellen highlighted two areas affected by the regulatory reforms: credit availability and market liquidity. With regard to credit availability, she stated the Federal Reserve was "examining additional steps to reduce unnecessary complexity in regulations affecting smaller banks" as a means to address increased availability of small business credit. She suggested that mortgage lending issues were affected by multiple factors that interact with broader challenges related to the domestic housing financial system. These factors include: market perceptions of risk, changes in the practices of the government-sponsored enterprises, changes in technology and the entry of nonbank lenders, changes in consumer protection regulations, and changes in capital and liquidity requirements.

With regard to market liquidity, she said "There may be benefits to simplifying aspects of the Volcker rule" and to "reviewing the interaction of the enhanced supplementary leverage ratio with risk-based capital requirements." She cautioned, however, that the new regulatory framework has made dealers more resilient to shocks, such that any adjustments to the regulatory framework "should be modest and preserve the increase in resilience at large dealers and banks associated with the reforms put in place in recent years."

[Yellen Speech]

1.2 Federal banking agencies propose extension of certain capital rule transitions

On August 22, 2017, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of Comptroller of the Currency issued a joint notice of proposed rulemaking that would extend the current transitional capital treatment for certain regulatory capital deductions and risk weights for banking organizations not subject to the agencies' advanced approaches capital rules. If finalized as proposed, the rule would prevent the implementation of the fully phased-in requirements for these items on January 1, 2018.

In particular, the proposed rule would extend the current regulatory capital treatment for:

- Mortgage servicing assets;
- Deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks;
- Significant investments in the capital of unconsolidated financial institutions;
- Non-significant investments in the capital of unconsolidated financial institutions; and
- Common equity tier 1 minority interest, tier 1 minority interest, and total capital minority interest exceeding the capital rules' minority interest limitations.

Banking organizations that are not subject to the advanced approaches capital rules are generally those with less than $250 billion in total consolidated assets and less than $10 billion in total foreign exposure. Firms that are subject to the advanced approaches rules would not be affected by this proposal and would remain subject to the fully phased-in requirements for these exposures beginning on January 1, 2018.

Comments on the proposal will be accepted through September 25, 2017. The agencies expect to soon issue a separate proposal to simplify the regulatory treatment of the items for which the extension is being proposed.

[FRB Press Statement] [Notice of Proposed Rule]

1.3 Federal Reserve seeks public comment on proposal to produce reference rates based on repo transactions secured by Treasuries

The Federal Reserve Board (Federal Reserve) released a notice and request for comment on August 24, 2017 to announce that the agency is considering producing and publishing three new reference rates based on overnight repurchase agreement (repo) transactions secured by U.S. Treasury securities. The rates would be produced by the Federal Reserve Bank of New York in cooperation with the Office of Financial Research. As outlined in the notice, the most comprehensive of the rates, which would be called the Secured Overnight Financing Rate (SOFR), would be a broad measure of overnight Treasury financing transactions and was selected by the Alternative Reference Rates Committee as its recommended alternative to U.S. dollar LIBOR. The second proposed rate would be based solely on triparty repo data and would be called the Tri-party General Collateral Rate (TGCR). The third rate, to be called the Broad General Collateral Rate (BGCR) would be based on the triparty repo data.

Comments will be accepted throughout a sixty-day period following publication in the Federal Register.

[Press Release] [Notice]

1.4 OCC publishes a new booklet on substantial asset changes for the Comptroller's Licensing Manual

The Office of the Comptroller of the Currency (OCC) issued a new booklet entitled, "Substantial Asset Changes, Including Changes in Charter Purpose," that is part of the Comptroller's Licensing Manual. The booklet incorporates key policies and requirements under 12 CFR 5 for filings by a national bank or federal savings association pertaining to a substantial asset change. In general, a bank must submit an application and obtain OCC approval before engaging in a substantial asset change or change in charter purpose. This booklet discusses what constitutes a substantial asset change, including a change in charter purpose, and when a filing with the OCC is required.

[Bulletin] [Substantial Asset Change Booklet]

1.5 FDIC releases Quarterly Banking Profile for the second quarter of 2017 showing revenue and earnings growth

The Federal Deposit Insurance Corporation (FDIC) released its Quarterly Banking Profile for the second quarter of 2017 on August 22, 2017. The report finds that commercial banks and savings institutions insured by the FDIC reported aggregate net income of $48.3 billion in the second quarter of 2017, up $4.7 billion (10.7 percent) from a year earlier. The FDIC states the increase in earnings was mainly attributable to a $10.3 billion (9.1 percent) increase in net interest income and a $654 million (1 percent) increase in noninterest income. Of the 5,787 insured institutions reporting second quarter financial results, 63.4 percent reported year-over-year growth in quarterly earnings. The proportion of banks that were unprofitable in the first quarter fell to 4.1 percent from 4.6 percent a year earlier.

[Press Statement]

2. Enterprise and consumer compliance

2.1 CFPB temporarily increases the HMDA reporting threshold for open-end lines of credit

The Consumer Financial Protection Bureau (CFPB or the Bureau) issued a final rule amending its Regulation C, which implements the Home Mortgage Disclosure Act (HMDA). Under the final rule, the threshold for collecting and reporting data about open-end lines of credit would temporarily increase from 100 to 500 open-end lines of credit for calendar years 2018 and 2019. Only financial institutions that meet the threshold for two consecutive years would be required to collect data in the following calendar year. This amendment was originally proposed by the CFPB in July 2017.

The final rule also addresses a number of clarifications, technical corrections, and adjustments originally proposed by the CFPB in April 2017. These amendments include: clarification of certain key terms, such as "temporary financing" and "automated underwriting system;" transition rules for reporting certain loans purchased by financial institutions; and the availability of a geocoding tool to use in reporting the census tract of a property.

The final rule is generally effective beginning January 1, 2018, though certain provisions are subject to a delay. The CFPB also provided an Executive Summary of the final rule provisions.

[Press Statement] [Final Rule] [Executive Summary]

2.2 FFIEC issues new HMDA transaction testing guidelines for examiners

On August 23, 2017, the members of the Federal Financial Institutions Examination Council (FFIEC) announced the release of new FFIEC Home Mortgage Disclosure Act (HMDA) Examiner Transaction Testing Guidelines (Guidelines) for all financial institutions that report HMDA data. The Guidelines will apply to the examination of HMDA data collected beginning in 2018 and reported beginning in 2019. In light of new data fields that will be required beginning January 2018, the transaction testing procedures:

- Establish transaction testing guidelines based on a statistical sampling methodology.
- Provide direction to examiners in determining error rates for expanded data fields,
- Establish error rate thresholds for determining when an institution is expected to correct and resubmit reported data.

The Guidelines represent a joint effort by the Consumer Financial Protection Bureau, the Federal Deposit Insurance

Corporation, the Federal Reserve Board, the National Credit Union Administration, and the Office of the Comptroller of the Currency to provide uniform guidelines across all federal HMDA supervisory agencies. These agencies are all members of the FFIEC.

[FFIEC HMDA Guidelines]

2.3 OCC issues guidance on higher-loan-to-value lending in communities targeted for revitalization

On August 21, 2017, the Office of the Comptroller of the Currency (OCC) issued Bulletin 2017-28 providing guidance to national banks and federal savings associations (together, banks) on prudent higher-loan-to-value (LTV) mortgage lending in distressed communities for purposes of revitalization. The guidance applies to OCC-supervised institutions interested in establishing a program for originating higher-LTV loans in communities targeted by governmental entities for revitalization. The Bulletin provides guidance regarding the circumstances under which banks may establish a program to originate certain higher-LTV loans along with the OCC's supervisory considerations regarding such programs. In particular, the guidance interprets existing regulations, and sets out principles for managing risks associated with the origination of owner-occupied residential mortgage loans where the LTV ratio at origination exceeds 100 percent. At least annually, the OCC will assess the extent to which banks' programs collectively contribute to the revitalization of eligible communities and whether banks are adequately controlling the risks associated with originating higher-LTV loans.

[Press Statement] [Bulletin]

2.4 OCC proposes rule to increase appraisal threshold for commercial real estate transactions

On August 23, 2017, the Office of the Comptroller of the Currency (OCC) issued Bulletin 2017-29 to remind institutions of it previously released interagency notice of proposed rulemaking that would increase the appraisal threshold for commercial real estate transactions from $250,000 to $400,000. This threshold is above the transaction value for which banks must obtain appraisals that adhere to Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act and its appraisal rules. The rule proposes that banks be required to obtain evaluations in lieu of Title XI appraisals for transactions covered by the commercial real estate threshold exemption. The proposal would also make a conforming technical change to the requirement for the use of certified appraisers for certain transactions.

The proposed rule was originally published jointly by the OCC, the Federal Reserve Board, and the Federal Deposit Insurance Corporation on July 31. 2017. Comments will be accepted by each of the agencies through September 29, 2017.

[OCC Bulletin]

2.5 Enforcement action

The Consumer Financial Protection Bureau (CFPB) has announced that it entered into a Consent Order with two affiliated depository banks charged with violating the Equal Credit Opportunity Act (ECOA) and its implementing regulation, Regulation B, by providing products and services to consumers in certain U.S. territories that the CFPB found to be inferior to the products and services, including credit terms, conditions, servicing, and collections practices, offered to consumers in the fifty U.S. states. The CFPB also found that the banks did not offer certain services to consumers with a Spanish language preference though offers were made to other consumers. The CFPB estimates that, in total, more than 220,000 consumers were affected by these practices.

The banks consented to the CFPB's findings without admitting or denying the findings of fact or conclusions of law. The CFPB notes that the banks self-identified and reported these policies and practices to the CFPB, have discontinued the practices, have proactively worked with the CFPB to remediate disparities, and voluntarily provided approximately $95 million in remediation to harmed consumers. Based on these actions, the CFPB states that it has not imposed civil penalties on the two banks, but has required them to reserve an additional $1 million for purposes of providing redress to harmed consumers that have not been fully compensated, as required by the Consent Order.

3. Capital markets and investment management

3.1 FINRA introduces new electronic form for compliance with FINRA Rule 6432

On August 24, 2017, the Financial Industry Regulatory Authority (FINRA) released Regulatory Notice 17-26 to announce that it had adopted a new electronic Form 211 for compliance with FINRA Rule 6432 (Compliance with the Information Requirements of the Securities Exchange Act Rule 15c2-11). FINRA member firms may voluntarily use the new electronic Form 211 beginning September 11, 2017 but are required to use the electronic Form 211 in place of the current paper form beginning October 23, 2017.

[Regulatory Notice]

3.2 Enforcement actions

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

- The SEC charged an investment adviser with defrauding two clients by deceiving them about the investment advisory fees they were paying. The advisor allegedly sent false and misleading emails, deceptive fee reports, and other fabricated documents to the clients resulting in the clients actually paying $1.2 million more in management fees than represented. The investment adviser received $900,000 of incentive-based compensation based on the fees paid by the clients as a result of the deception. The SEC has charged the adviser with violating and aiding and abetting violations of the anti-fraud provisions of the Investment Advisers Act of 1940.
- A hedge fund advisory firm has agreed to pay more than $4.7 million to settle the SEC's charges the firm failed to establish, maintain, and enforce policies and procedures reasonably designed to prevent the misuse of inside information, including information about confidential government decisions. The firm consented to the SEC's order finding that it violated Section 204A of the Investment Advisers Act of 1940 and agreed to pay disgorgement of more than $700,000, interest of nearly $100,000, and a penalty of more than $3.9 million.

Contact us

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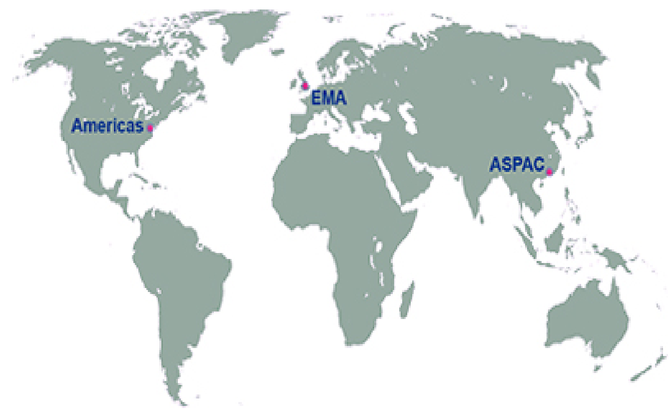

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