KPMG

The Washington Report

Americas FS Regulatory Center of Excellence

The week ended September 1, 2017

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1. Safety and soundness

1.1 Federal Reserve Governor Powell outlines supervisory expectations for large bank boards

In a speech on August 30, 2017 before the Large Bank Directors Conference, Federal Reserve Board Governor Jerome Powell outlined the Federal Reserve's recently released corporate governance proposal to distinguish the responsibilities of large bank boards of directors (boards) from the responsibilities of senior management and refocus the supervisory expectations for large bank boards on their "core" responsibilities. He said the Federal Reserve does "not intend these reforms will lower the bar for boards or lighten the loads of directors," bur rather will "enable directors to spend less board time on routine matters and more on core board responsibilities: overseeing management as they devise a clear and coherent direction for the firm, holding management accountable for the execution of that strategy, and ensuring the independence and stature of the risk management and internal audit functions. These were all areas that were found wanting in the financial crisis, and it is essential that boards get these fundamentals right."

[Powell Speech]

1.2 Federal Reserve finalizes rule on qualified financial contracts and GSIBs

The Federal Reserve Board approved a final rule on September 1, 2017 that establishes restrictions on the qualified financial contracts (QFCs) - such as derivatives contracts and repurchase agreements - of U.S. global systemically important banking organizations (GSIBs), the subsidiaries of any U.S. GSIB (other than insured depository institutions), and the U.S. operations of foreign GSIBs. The final rule requires the QFCs of GSIBs to contain contractual provisions that recognize the automatic stay of termination provisions and transfer provisions applied in resolutions under Title II of the Dodd-Frank Act and the Federal Deposit Insurance Act. It also prevents QFCs of GSIBs from allowing the exercise of default rights that could spread the bankruptcy of one GSIB entity to its solvent affiliates.

The final rule complements the Federal Reserve's final rule on total loss-absorbing capacity (TLAC), long-term debt, and clean holding company requirements for U.S. GSIBs and the U.S. intermediate holding companies of foreign GSIBs. The final rule will become effective 60 days after publication in the Federal Register though compliance with the rule will be subject to a phase-in schedule. GSIBs are required to conform their QFCs with other GSIBs beginning January 1, 2019 (the first day of the calendar quarter immediately following one year after the effective date of the rule) and July 1, 2019 for QFCs with most other financial counterparties. Additionally, GSIBs have two years (until January 1, 2020) to conform QFCs with community banks and all other counterparties.

[Press Statement] [Final Rule]

1.3 FDIC Supervisory Insights features examinations findings related to liquidity risk and BSA/AML

On August 30, 2017, the Federal Deposit Insurance Corporation (FDIC) issued the summer 2017 edition of its Supervisory Insights. Two articles are highlighted in the current issue: i) "Community Bank Liquidity Risk: Trends and Observations from Recent Examinations," which emphasizes the importance of liquidity risk management and describes contingency funding strategies to help community banks mitigate potential stress; and, ii) "The Bank Secrecy Act: A Supervisory Update," which offers an overview of the BSA/Anti-Money Laundering (AML) examination along with trends in supervision and enforcement as well as examples of failures in BSA/AML compliance programs identified by FDIC examiners.

[Press Statement]

1.4 Regulatory response to Hurricane Harvey

The Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Conference of State Bank Supervisors issued a joint supervisory statement on August 26, 2017, in connection with Hurricane Harvey, committing regulatory assistance to affected institutions subject to their supervision. The agencies said banks should work constructively with borrowers in communities affected by Hurricane Harvey and that "prudent efforts to adjust or alter terms on existing loans in affected areas should not be subject to examiner criticism." With respect to regulatory reporting requirements, the agencies stated institutions affected by Hurricane Harvey that expect to encounter difficulty meeting the agencies' reporting requirements should contact their primary federal regulatory agency, adding that they do not expect to assess penalties or take other supervisory action against institutions that take reasonable and prudent steps to comply if those institutions are unable to fully satisfy those requirements because of the effects of Hurricane Harvey.

[Joint Statement]

See additional discussion under the Enterprise and Consumer Compliance section.

2. Enterprise and consumer compliance

2.1 CFPB announces annual threshold adjustments to TILA regulations for certain credit transactions

The Consumer Financial Protection Bureau (CFPB or the Bureau) issued a final rule amending the official interpretations of Regulation Z, the implementing regulation to the Truth-in-Lending Act (TILA), to adjust the dollar amounts of certain thresholds applicable to consumer credit transactions during calendar year 2018. The amendments are based on changes in the Consumer Price Index as of June 1, 2017. They include thresholds related to: the minimum interest charge and safe harbor penalty fees under TILA and the Credit Card Accountability Responsibility and Disclosure Act (CARD Act); the total loan amount and points and fees dollar trigger for high-cost mortgages under the Home Ownership and Equity Protection Act (HOEPA); and the maximum points and fees for qualified mortgages under the Dodd-Frank Wall Street Reform and Consumer Protection Act. This final rule is effective January 1, 2018.

[Press Statement] [Final Rule]

2.2 CFPB provides "financial toolkit" for consumers affected by Hurricane Harvey

In a September 1, 2017 blog post, the Consumer Financial Protection Bureau (CFPB or Bureau) outlined steps that consumers affected by Hurricane Harvey, or other natural disasters, should take to secure their home and finances. The guidance includes practical steps, such as contacting insurance, credit card, and utility companies to guidance related to forbearance and insurance settlements. It also included warnings about the potential for consumer frauds.

The Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency separately released guidance encouraging depository institutions to consider all reasonable and prudent steps to assist customers in communities affected by the storm, consistent with safe-and-sound banking practices, including waiving fees, increasing ATM cash limits, easing credit card limits, allowing loan customers to defer or skip payments, and delaying the submission of delinquency notices to credit bureaus. Further they encouraged the use of non- documentary verification methods permitted by the Customer Identification Program requirement of the Bank Secrecy Act for affected customers who cannot provide standard identification documents.

[CFPB Blog Post] [FDIC Guidance]

2.3 Enforcement actions

During the past week, the Federal Trade Commission (FTC) announced the following enforcement actions:

— The FTC filed a complaint against the operators of a debt collections operation that the FTC alleges used intimidation and deception in violation of the Fair Debt Collection Practices Act (FDCPA) and the FTC Act to collect debts from consumers that the consumers did not owe or that the defendants had no right to collect. The FTC further alleges the defendants illegally disclosed purported debts to third parties, failed to disclose that they were debt collectors calling to collect a debt and that any information consumers provided could be used for that purpose, and failed to send consumers legally required written notices with the debt amount and the creditor's name, giving consumers an opportunity to dispute the debt. Harmed consumers reportedly paid more than $2.1 million as a result of the debt collectors' actions. A federal court has temporarily halted the scheme and frozen the company's assets at FTC's request.

— The FTC reached a settlement with the final defendant in a debt collection scheme that the FTC alleges made false threats, contacted third-parties to pressure debtors, charged made-up fees, sent deceptive text messages claiming that non-existent payments were declined, and failed to identify themselves as debt collectors. A settlement with the other defendants in the case was reached in September 2016. The settlement order imposes a $9.39 million judgment against the defendant though it will be suspended due to the defendant's inability to pay. The order also bans the individual from debt collection activities or trading in consumer information regarding debt.

3. Capital markets and investment management

3.1 BIS working paper looks at capital controls and foreign exchange liquidity

On August 31, 2017, the Bank for International Settlements (BIS) published Working Paper No. 659, "Effects of capital controls on foreign exchange liquidity," which introduces a theoretical model showing that, if capital controls are modelled as entry costs, fewer investors will enter an economy. In contrast, the model shows that if capital controls are modelled as transaction costs, they can reduce the effective spread. The authors conclude that these results imply that capital controls are effective in reducing the implicit cost component of foreign exchange (FX) market liquidity but can also have a negative structural effect on the FX market by making it more vulnerable to order flow imbalances.

[Publication] [Working Paper]

3.2 FINRA Investor Alert addresses risks of initial coin offerings

On August 31, 2017, the Financial Industry Regulatory Authority (FINRA) issued an investor alert warning of potential risks to investors when participating in initial coin offerings, or "ICOs." An ICO involves the creation and distribution of virtual coins or tokens by a company to raise capital. Gerri Walsh, FINRA's Senior Vice President for Investor Education says, "ICOs involve new technologies and products that are highly technical and can be used by con artists as an opportunity to dupe investors." Considerations highlighted by the alert include: whether the ICO is subject to the federal securities laws; the professional background of the individuals involved in the ICO; the terms and conditions of the ICO; and the company's business plan as well as the steps it has taken to protect its platforms and products from possible protocol breakdowns, hacking, malware and fraud.

[Press Statement]

3.3 DOL proposes to extend the transition period for certain exemptions under the Fiduciary Rule for eighteen months

The Department of Labor's (DOL) Employee Benefits Security Administration has published a proposed rule that would extend the special transition period of the Best Interest Contract (BIC) Exemption and Exemption for Principal Transactions (associated with the DOL's Fiduciary Rule) for a period of eighteen months, which would end the transition period on July 1, 2019 rather than the currently scheduled January 1, 2018. DOL is also proposing to delay the applicability of certain amendments to Prohibited Transaction Exemption 84-24 for the same period. DOL states the primary purpose of the proposed amendments is to give the agency time to consider possible changes and alternatives to these exemptions. The present transition period runs from June 9, 2017, to January 1, 2018 while the new transition period would end on July 1, 2019. The proposed amendments to these exemptions would affect participants and beneficiaries of plans, Investment Retirement Account (IRA) owners and fiduciaries with respect to such plans and IRAs. Comments on the proposal are requested no later than September 15, 2017.

[Proposed Rule]

4. Insurance

4.1 IAIS publishes survey report on supervisory capacity building and development needs

The International Association of Insurance Supervisors (IAIS) periodically conducts surveys to identify the key challenges relevant to insurance supervisors and the most significant areas where development is needed to meet those challenges, as well as to assess the effectiveness of various tools that might be used to further the development of supervisors. On August 30, 2017, the IAIS published a report on its most recent Supervisory Capacity Building and Development Needs Survey, which was conducted in September 2016. Forty-five jurisdictions completed the assessment, representing approximately one-third of the IAIS membership. The survey findings have been segmented into three categories: institutional information (indicating a focus on macroprudential supervision); staffing and professional development (expected primarily in supervisory staff); and promotion of capacity building resources (such as the Insurance Core Principles and the Financial Stability Institute).

[Press Statement] [Survey Report]

5. Alternative finance

5.1 BCBS publishes consultative document on FinTech

The Basel Committee on Banking Supervision (BCBS) released a consultative document on August 31, 2017, entitled "Sound practices: Implications of Fintech developments for banks and bank supervisors." The paper assesses how technology-driven innovation in financial services may affect the banking industry and the activities of supervisors in the near to medium term. BCBS states the rapid adoption of enabling technologies and the emergence of new business models pose an increasing challenge to incumbent banks in almost all the scenarios considered as part of the assessment. The following supervisory issues, along with observations and recommendations, are addressed in the paper:

- The overarching need to ensure safety and soundness and high compliance standards without inhibiting beneficial innovation in the banking sector;
- Key risks for banks related to Fintech developments, including strategic/profitability risks, operational, cyber, and compliance risks;
- Implications for banks of the use of innovative enabling technologies;
- Implications for banks of the growing use of third parties, via outsourcing and/or partnerships;
- Cross-sectoral cooperation between supervisors and other relevant authorities;
- International cooperation between banking supervisors;
- Adaptation of the supervisory skillset;
- Potential opportunities for supervisors to use innovative technologies;
- The relevance of existing regulatory frameworks for new innovative business models; and
- Key features of regulatory initiatives set up to facilitate Fintech innovation.

The BCBS requests on this document by October 31, 2017.

[Publication] [Consultative Document]

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