



The Washington Report

Financial Services Regulatory Insight Center

The week ended October 20, 2017

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1. Safety and soundness

1.1 Basel Committee completes assessment of LCR implementation and releases progress report on Basel III implementation

On October 18, 2017, the Basel Committee on Banking Supervision (BCBS) published assessment reports on the implementation of the Liquidity Coverage Ratio (LCR) in four member countries (Australia, Brazil, Canada and Switzerland) completing its review of the implementation of the LCR for all member jurisdictions as part of its Regulatory Consistency Assessment Programme (RCAP). The BCBS noted that implementation of the LCR in all member jurisdictions has been assessed as either Compliant or Largely Compliant.

Also on October 18, the BCBS published its *Thirteenth progress report on adoption of the Basel regulatory framework* based on the information provided by members as part of the RCAP. This report focuses on implementation of the Basel III standards, and, among other things, indicates that of the 27 member jurisdictions:

- All have final risk-based capital rules, LCR regulations and capital conservation buffers in force;
- Twenty-six have issued final rules for the countercyclical capital buffers and for domestic systemically important banks (D-SIBs) frameworks;
- All that are home jurisdictions to global systemically important banks (G-SIBs) have final rules in force;
- Twenty-one have issued final or draft rules for margin requirements for non-centrally cleared derivatives; and
- Twenty-two have issued final or draft rules for monitoring tools for intraday liquidity management

[\[Press Statement-LCR\]](#) [\[Thirteenth Progress Report\]](#)

1.2 GAO legal decision states inter-agency leveraged lending guidance is subject to Congressional review

In response to a request from Senator Pat Toomey, the General Accountability Office (GAO) has issued a decision on whether the Interagency Guidance on Leveraged Lending, issued jointly by the Office of the Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation (the Agencies), is considered a rule for purposes of the Congressional Review Act (CRA). GAO concluded that the Interagency Guidance is a general statement of policy and is a rule under CRA, which must be submitted to the Congress for review. The guidance was released in 2013 but has not yet been submitted to Congress for review.

[\[GAO Decision\]](#)

1.3 Powell outlines Fed efforts in financial innovation and payments services

Federal Reserve Board Governor Jerome H. Powell delivered an address to the 41st Annual Central Banking Seminar on October 18, 2017 during which he discussed the role of the Federal Reserve in changing the delivery of retail banking and payments services through technological innovation.

Governor Powell discussed how banks have a key role in the design and safety of more efficient retail payment systems. He said "a collective and collaborative effort by all payment stakeholders will also be important as the United States works to achieve a payment system that has broad reach and can seamlessly integrate with other systems to transfer funds in a reliable, secure, and convenient manner."

Powell said the Federal Reserve supports technological innovation in the payments system and discussed how the central bank asked stakeholders to "come together in pursuit of a better payment system for the future--focusing on speed, security, efficiency, international payments, and collaboration." He noted that more than 300 stakeholders joined the Faster Payments Task Force with the mission to identify and assess alternative approaches for implementing a safe, ubiquitous, faster U.S. payments system and submitted 16 proposals that represented ideas ranging from centralized clearing and settlement to distributed networks.

Powell stated that there is more to be done to advance our collective vision of a ubiquitous, real-time, secure future payment system. He said the Federal Reserve reaffirmed its commitment to that vision in the paper, "Federal Reserve Next Steps in the Payments Improvement Journey," which outlines refreshed strategies and tactics that the Federal Reserve and the payment industry will employ to make improvements. In particular, Governor Powell noted that:

- A Governance Framework Formation Team has been established to develop, publish, and solicit public comment on a proposal for a governance framework.
- The Federal Reserve is considering providing settlement services in the real-time retail payments environment and plans to explore and assess the need for other related services or capabilities.
- The Federal Reserve will pursue two new efforts focused on security, including a study analyzing payment security vulnerabilities and work groups focused on

approaches for reducing the cost and prevalence of specific payment security vulnerabilities.

[\[Speech\]](#)

2. Enterprise and consumer compliance

2.1 CFPB releases Consumer Protection Principles for consumer-authorized financial data sharing

On October 18, 2017, the Consumer Financial Protection Bureau (CFPB) released a set of Consumer Protection Principles that are intended to highlight for the importance of consumer interests as more and more consumers authorize third party companies to access and use their personal financial data. The CFPB stated that while consumer-authorized access and use of consumer financial account data may foster innovation in the markets for financial products and services, such access must be designed and implemented to serve and safeguard consumers. The CFPB has identified nine consumer protection principles related to access, data scope and usability, control and informed consent, payment authorization, security, transparency in access, accuracy, dispute and resolution for unauthorized access, and efficient and effective accountability. They are intended to be read together and are not intended to alter, interpret, or otherwise provide guidance on existing statutes and regulations.

[\[Blog\]](#) [\[Press Statement\]](#) [\[Stakeholder Insights report\]](#)

2.2 President signs legislation expanding elder protections

On October 18, 2017, President Donald J. Trump signed into law the "Elder Abuse Prevention and Prosecution Act," which amends the Federal criminal code to include "email marketing" fraud in "telemarketing fraud" and expands the definition of telemarketing or email marketing to include measures to induce investment for financial profit, participation in a business opportunity, or commitment to a loan. This bill also establishes requirements for the Department of Justice with respect to investigating and prosecuting elder abuse crimes and enforcing elder abuse laws. It also adds health care fraud to the list of fraud offenses subject to enhanced penalties.

[\[Press Statement\]](#) [\[Elder Abuse Prosecution Act of 2017\]](#)

2.3 First annual review of the EU-U.S. Privacy Shield framework shows favorable results

The European Commission (EC) published its first annual report on the functioning of the EU-U.S. Privacy Shield on October 18, 2017. Overall the report showed that the Privacy Shield continues to ensure an adequate level of protection for

the personal data transferred from the European Union (EU) to participating companies in the United States. The report also contains recommendations for improvement.

The EU-U.S. Privacy Shield was adopted in July 2016 and became operational in August 2016. It is intended to protect the fundamental rights of anyone in the EU whose personal data is transferred to the United States for commercial purposes as well as to bring legal clarity for businesses relying on transatlantic data transfers. The EC committed to review the Privacy Shield annually to assess if it continues to ensure an adequate level of protection for personal data. This first report is based on meetings with all relevant U.S. authorities as well as input from a wide range of stakeholders, including reports from companies, NGOs, and independent data protection authorities from EU member states.

In response, the Acting Commissioner of the Federal Trade Commission issued the following statement: "We welcome the positive outcome of the first EU-U.S. Privacy Shield Annual Review. Enforcing international privacy frameworks such as Privacy Shield is an integral part of our Privacy and Data Security program, as highlighted in three recently announced Privacy Shield enforcement actions. We look forward to continuing to work with our European counterparts to ensure that the Privacy Shield remains a robust mechanism for protecting privacy and enabling transatlantic data flows."

[\[EU Press Statement\]](#) [\[FTC Press Statement\]](#) [\[Review Report\]](#)

2.4 Senate committee conducts hearing on consumer data security and credit bureaus

On October 17, 2017, the Senate Committee on Banking, Housing, and Urban Affairs held a hearing entitled "Consumer Data Security and the Credit Bureaus" during which witnesses testified on the legal authority of regulators to monitor the data security practices of credit reporting bureaus.

A witness from a research organization testified that the data security requirements for consumer-facing financial institutions do not extend to credit reporting agencies. He said the Consumer Financial Protection Bureau (CFPB) authorizations under Dodd-Frank do not include regulatory authority to establish data security guidelines.

A witness from an industry association testified that the Federal Trade Commission (FTC) has interpreted its unfair or

deceptive acts or practices (UDAP) authority in Section 5 of the FTC Act to cover enforcement for inadequate data security practices over credit reporting companies. He testified that while the FTC has issued guidance in this area, this authority is not codified in the law. He also testified that CFPB examination authority over credit reporting agencies does not include cybersecurity.

A witness from the Congressional Research Service noted that the CFPB does not engage in reviews of cybersecurity risks faced by credit reporting agencies and has never asserted authority in this areas. The Congressional Research Service recommends that Congress explicitly authorize the CFPB to examine CRAs for their adherence to the FTC safeguards rule.

[\[Senate hearing\]](#)

3. Capital markets and investment management

3.1 CFTC's LabCFTC releases primer on virtual currencies

On October 17, 2017, the Commodity Futures Trading Commission's LabCFTC released the first in a series of primers on financial technology (FinTech) innovation. A *CFTC Primer on Virtual Currencies* provides an overview of virtual currencies, including their potential uses and potential risks, as well as an outline of the CFTC's role and oversight.

[\[Press Statement\]](#) [\[Primer\]](#)

3.2 Director of LabCFTC outlines FinTech initiatives

On October 19, 2017, Daniel Gorfine, the Commodity Futures Trading Commission's (CFTC) Director of LabCFTC and Chief Innovation Officer, discussed the agency's approach to financial technology (FinTech) innovation and the LabCFTC initiatives at the 33rd Annual FIA Futures & Options Expo. Gorfine outlined the initiatives of the new LabCFTC, which he described as a way to help the agency cultivate a regulatory culture of forward thinking; become more accessible to emerging technology innovators; discover ways to harness and benefit from FinTech innovation; and become more responsive to changing markets.

Gorfine identified three characteristics common across many FinTech innovations: (1) the rapid pace of innovation and adoption; (2) the disintermediation of traditional functions or actors in the financial sector; and (3) convergence and increased technology between industry sectors. He stated that the disintermediation of traditional actors "will strain rules written for a different, analog era," and stated that "proper recognition of new actors in markets will necessitate regulatory consideration, though always with the careful balance of not prematurely stemming innovation."

Gorfine discussed the three core components of LabCFTC:

- "Guide Point," which is a dedicated point of contact for innovators to meet with the CFTC, learn about its regulatory framework, and obtain feedback;
- "CFTC 2.0," which fosters the understanding, testing, and potential adoption of new technology that can make the CFTC a more effective and efficient regulator; and
- "DigitalReg," which will help the CFTC identify and develop regulatory tools, approaches, and culture that promote market-enhancing innovation and satisfy key regulatory objectives.

He also discussed how the CFTC would implement its vision with initiatives around engagement with FinTech entities; a series of LabCFTC Primers, including the newly released primer on virtual currencies; innovation prize competitions under the Science Prize Competition Act; formal collaboration with international and domestic regulators similarly focused on facilitating market-enhancing innovation; an advisory committee; and a Technology Advisory Committee (TAC)

[\[Speech\]](#)

3.3 CFTC releases clearinghouse liquidity stress test results

On October 16, 2017, the Commodity Futures Trading Commission (CFTC) issued a report on recent liquidity stress tests of clearinghouses. The tests were designed and conducted internally by the CFTC to evaluate (1) whether clearinghouses could obtain in a timely manner the funds necessary to meet the settlement obligations resulting from the simultaneous default of two large clearing members, and (2) whether the need for multiple clearinghouses to generate

liquidity simultaneously might have systemic implications. The analysis used actual positions and collateral as of August 16, 2017; encompassed cleared futures, options, and interest rate swaps; and assumed the default of the same two systemically important clearing members at each clearinghouse.

The CFTC released the following key findings: (1) all clearinghouses demonstrated the ability to generate sufficient liquidity to fulfill settlement obligations on time; (2) the methods the clearinghouses used to generate funds included cash from maturing reverse-repurchase agreements, selling collateral, cash balances at a commercial bank, cash balances at a central bank, currency conversion, and repurchase agreements; and (3) the cumulative size of liquidity requirements would not impair the ability of each clearinghouse to meet its settlement obligations in instances in which multiple derivatives clearing organizations (DCOs) used the same methodology or the same firm to meet liquidity demands.

[\[Press Statement\]](#) [\[Report\]](#)

3.4 CFTC commissioner discusses CCP risk management

Commodity Futures Trading Commission (CFTC) Commissioner Brian Quintenz addressed the Federal Reserve Bank of Chicago's Fourth Annual Conference on CCP Risk Management on October 17, 2017 during which he discussed the CFTC's oversight of derivatives clearing organizations (DCOs), DCO access to Federal Reserve Bank accounts, recovery and resolution planning, central counterparty (CCP) systemic risk, and the supplementary leverage ratio (SLR).

Quintenz discussed the CFTC's three primary methods by which it oversees DCOs and the overall clearing process: (1) review of DCO applications and rule changes, (2) examinations of DCOs for compliance with the statute and regulations, and (3) daily risk surveillance.

He discussed how the CFTC and Federal Reserve Board work together to provide access to Federal Reserve Bank deposit accounts for systemically important DCOs and their customers. He said this was a critical tool in mitigating systemic risk, as it protects DCOs and their customers from the risks of commercial banks and provides a reliable source of liquidity. He recommended that access to Federal Reserve Bank accounts should be expanded to all DCOs regardless of a systemically important designation.

In discussing recovery and resolution planning, Commissioner Quintenz explained that although the probability of default is low, DCOs and regulators must plan for extreme circumstances given that the continuity of these critical services is crucial to maintaining financial stability. He discussed DCO requirements for recovery plans and noted

that they are a critical input in regulators' contingency planning to address the event that a DCO's recovery plan fails. He noted that the CFTC has been actively working with the Federal Deposit Insurance Corporation (FDIC) on DCO resolution plans and said the CFTC's experience and expertise in the oversight of both DCOs and their clearing members make it well-positioned "to create the right incentives, ensure the continuity of critical payment and settlement services in the event of a crisis, and mitigate or avoid systemic impact of a DCO failure."

Quintenz discussed how clearinghouses diversify risk among their members and noted that a larger and more diverse membership would reduce systemic risk through effective risk mutualization. The market, however, is increasingly concentrated; the futures commission merchant (FCM) marketplace has declined from 100 CFTC-registered entities in 2002 to 55 at the beginning of 2017.

Quintenz attributed the reduced number of clearinghouses to the increased capital costs and targeted as an example the Supplementary Leverage Ratio, a requirement to maintain five percent of assets for loss absorption to supplement risk-based capital requirements. He described how the SLR is a requirement for large banks that is also being applied to swaps clearing, as bank-owned FCMs that hold cash margin for their clearing clients must also set aside the SLR capital. He said this reflects a fundamental misunderstanding of central clearing, ignores the risk reducing purpose of margin by viewing margin as risk-enhancing, reduces profits causing some banks to leave the DCO business, and poses a significant barrier to resolution.

"[I]n the next crisis, because of the SLR, there may not be FCMs willing and/or able to take on non-defaulting customers," he said. "That would severely limit a DCO's options in the middle of a stress event, and it could force the fire-sale liquidation of positions, further roiling markets." Quintenz provided two recommendations to reduce capital costs: (1) exclude customer cash collateral held at a DCO from a bank's leverage calculation; and (2) have customer collateral held at a DCO reduce a bank's potential future exposure.

[\[Press Statement\]](#)

3.5 FINRA requests comment on two arbitration proposals

The Financial Industry Regulatory Authority (FINRA) on October 18, 2017 issued two Regulatory Notices requesting comment on two arbitration proposals: (1) a proposal to expand the options available to investors when filing a claim in arbitration against an inactive firm or associated person, and (2) a proposal related to compensated non-attorney representatives that provide public investors an alternative to representation by attorneys in disputes between investors and broker-dealers.

Expand arbitration options: Regulatory Notice 17-33 proposes amendments to FINRA's arbitration rules to allow customers to withdraw an arbitration claim, amend pleadings, postpone hearings, and receive a refund of filing fees in situations in which a firm or associated person is no longer in business either at the time the claim is filed or during a pending arbitration.

Non-attorney representatives: Regulatory Notice 17-34 seeks responses to questions related to forum users' experiences

with non-attorney representatives (NAR firms). FINRA is conducting a review of the efficacy of continuing to allow compensated NAR firms to represent customers in arbitration.

[\[Press Statement\]](#) [\[Regulatory Notice 17-33\]](#) [\[Regulatory Notice 17-34\]](#)

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