The Washington Report

Americas FS Regulatory Center of Excellence

The week ended October 7, 2016

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1. Safety and soundness

1.1 Federal Reserve Board task forces to review proposals for faster payments system

Two national task forces established by the Federal Reserve Board (Federal Reserve) have begun to review and discuss nineteen (19) specific proposals and preliminary assessments regarding potential approaches for a faster U.S. payments system. One task force will focus on faster payment capabilities, the other will work to enhance payment system security. The review results will be presented in two parts.

The first review report is expected to be released in January 2017. It will provide: (i) a description of the process undertaken to identify and assess faster payments solutions; (ii) explanation of gaps in the current payments landscape; (iii) identification of opportunities for improvements; and (iv) an outline of the benefits of a faster payments system.

The second review report is expected to be released in mid-2017. It will: (i) include a discussion and assessment of specific proposals; (ii) provide models of what a faster payments system could look like and show how each proposal measures up against the various effectiveness criteria; (iii) identify strategic measures that would be important for successful development of faster payments systems; and (iv) recommend industry actions to advance implementation and adoption of these measures.

The task forces are composed of 500 members, including representatives from financial institutions, consumer groups, payment service providers, financial technology firms, businesses, government agencies, and other interested parties. [Press Statement]

1.2 Federal Reserve and FDIC publish public portions of targeted submissions for the resolution plans of eight institutions

On October 4, 2016, the Federal Reserve Board (Federal Reserve) and the Federal Deposit Insurance Corporation (FDIC) posted the public portions of the required "targeted submissions" relating to resolution plans submitted by eight systemically important domestic banking institutions.

In April 2016, the agencies jointly determined that the 2015 resolution plans for five of these eight institutions were not credible in facilitating an orderly resolution under the U.S. Bankruptcy Code. In the cases of the remaining three institutions, the agencies identified weaknesses in their 2015 resolution plans. The deadline for providing "targeted submissions" by all eight banks regarding remediation plans was set for October 1, 2016.

Portions of those remediation plans have now been posted publicly. Where the agencies jointly identified "deficiencies" in an institution's 2015 resolution plan, the "targeted submission" contains a description of the deficiencies identified as well as the steps the institution has taken to remediate the deficiency. Where "shortcomings" in an institution's 2015 resolution plan were identified, the remediation plan contained a description of the issue and the actions the institution has taken or is taking to remediate the issue. "Shortcomings" must be addressed by the time an institution's 2017 resolution plan is submitted. Most of the institutions also included additional information regarding their efforts to execute on their 2015 resolution plans as well as to improve and enhance their resiliency and resolvability. [Joint Press Statement]

1.3 Comment period to close soon on OCC proposed rule mandating contractual stay requirements for qualified financial contracts

The Office of the Comptroller of the Currency (OCC) released Bulletin 2016-31 on October 3, 2016, outlining a proposed rule published on August 19, 2016, that would require a "covered bank" to ensure that its qualified financial contracts (QFC): 1) contain a contractual stay-and-transfer provision analogous to the statutory stay-and-transfer provision imposed under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act and in the Federal Deposit Insurance Act; and ii) limit the exercise of default rights based on the insolvency of an affiliate of the covered bank. "Covered banks" would include:

- National banks and federal savings associations that are subsidiaries of a global systemically important bank holding company designated as such pursuant to the Federal Reserve Board's Regulation YY (Enhanced Prudential Standards);
- National banks and federal savings associations that are subsidiaries of a global systemically important foreign banking organization pursuant to Regulation YY; and
- Federal branches and agencies (including any U.S. subsidiary of a federal branch or agency) of a global systemically important foreign banking organization pursuant to Regulation YY.

The proposed rule would also make conforming amendments to the OCC's capital adequacy and liquidity risk measurement standards.

The OCC's proposed rule is substantially identical to the proposed rule issued by the Federal Reserve Board on May 3, 2016, and would complement and work in tandem with the

Federal Reserve's rule. The OCC's proposed rule is open for comments through October 18, 2016. [OCC Bulletin 2016-31] [Proposed Rule]

1.4 U.S. and European resolution authorities to hold second exercise to enhance coordination on cross-border resolution

Senior officials representing resolution authorities in the United States and Europe announced the second planned exercise on cross-border resolution coordination on October 10, 2016. The first such exercise was conducted in 2014. A similar staff-level exercise occurred earlier this year.

The FDIC will host the exercise, which is expected to include representatives from the Federal Reserve Board, the Office of the Comptroller of the Currency, the Securities and Exchange Commission, the Commodity Futures Trading Commission, and the Federal Reserve Bank of New York.

Expected participants from Europe include senior officials from HM Treasury, the Bank of England, the U.K. Prudential Regulation Authority, the Single Resolution Board, the European Commission, and the European Central Bank. [Press Statement]

1.5 OFR Working Paper analyzes the interconnectedness of the global financial market

On September 27, 2016, the Office of Financial Research (OFR) published a Working Paper entitled "*Interconnectedness in the Global Financial Market.*" The paper analyzes statistical measures of interconnectedness across nearly 4,000 stocks from 15 countries. The results show that during stable times, stocks experience correlated movements within, but not across, regions. In times of stress, stocks tend to move in unison globally. However, even during stress periods, some countries retain a high level of autonomous behavior. The analysis is based on network theory, which the authors suggest provides a framework to present, quantify, and monitor interconnectedness in the global financial system both at a single point in time and its evolution over time. [Working Paper]

1.6 BCBS Secretary General outlines revisions to the Basel capital framework to be completed by year-end

William Coen, Secretary General of the Basel Committee on Banking Supervision (BCBS), spoke at the Annual Meeting of the Institute of International Finance on October 7, 2016. He indicated that the revisions seek to reduce excessive variability in risk-weighted assets with a focus on outliers. The proposals are not intended to increase overall capital requirements, though he acknowledged some "outlier banks" will experience increased capital due to the revisions.

The package of proposals address:

- Standardized approach for credit risk;
- Internal ratings-based approaches;
- Operational risk;
- Output floor;
- Leverage ratio;
- Global systemically important bank surcharge; and
- Credit valuation adjustment risk.

[Coen Speech]

2. Enterprise and consumer compliance

2.1 Agencies release revised examination procedures for the Military Lending Act

The Federal Reserve Board (Federal Reserve) issued Consumer Affairs Letter 16-6 on September 29, 2016, to distribute interagency examination procedures for the Military Lending Act (MLA) developed by the Federal Financial Institutions Examination Council's (FFIEC) Task Force on Consumer Compliance. The new exam procedures reflect amendments to the July 2015 Department of Defense (DOD) regulations implementing the MLA. Among other things, these amendments extended the protections of the MLA to a wider range of closed-end and open-end credit products, including credit cards, provided to active duty servicemembers and their dependents. The MLA now applies to all consumer credit other than home-secured credit, and loans secured by motor vehicles or other consumer goods. In addition, the amendments limit the interest rate on such loans to a Military Annual Percentage Rate (MAPR) of 36 percent, which includes finance charges, credit insurance premiums or fees, add-on products sold in connection with the credit extended, and other fees such as application or participation fees.

Compliance with the final amendments is required beginning October 3, 2016, except for credit card accounts, which must comply with the final amendment beginning October 3, 2017. The DOD may extend the compliance date for credit cards by one year.

The Federal Reserve, Office of the Comptroller of the Currency, and the Consumer Financial Protection Bureau have all released revised MLA examination procedures based on the FFIEC

interagency procedures. [MLA Exam Procedures] [Federal Reserve] [OCC] [CFPB]

2.2 CFPB issues a final rule extending comprehensive consumer protections to prepaid accounts

On October 5, 2016, the Consumer Financial Protection Bureau (CFPB or Bureau) issued a final rule regarding prepaid accounts under Regulation E (which implements the Electronic Fund Transfer Act), and Regulation Z (which implements the Truth in Lending Act). The final rule strengthens federal consumer protections for prepaid account users by creating tailored provisions governing disclosures, limited liability, error resolution, and periodic statements. In addition, the final rule requires prepaid card issuers to post on their websites the prepaid account agreements they offer to the general public. With a few exceptions, issuers must also submit all agreements to the CFPB, which intends to post them on a public, Bureau-maintained website at a future date. The rule also regulates overdraft credit features that may be offered in conjunction with prepaid accounts.

The rule applies to traditional prepaid cards, including general purpose reloadable cards. It also applies to mobile wallets, person-to-person payment products, and other electronic prepaid accounts that can store funds. Other prepaid accounts covered by the new rule include: payroll cards; student financial aid disbursement cards; tax refund cards; and certain federal, state, and local government benefit cards such as those used to distribute unemployment insurance and child support. Gift cards are specifically excluded.

The rule becomes effective October 1, 2017. The requirement to submit prepaid account agreements to the Bureau will take effect on October 1, 2018. Issuers must submit all of the prepaid account agreements that they offer as of October 1, 2018, to the Bureau no later than October 31, 2018. [Press Statement] [Final Rule]

2.3 CFPB releases results of Project Catalyst pilot program on savings tools and prepaid cards

In early 2015, American Express launched a pilot program to encourage approximately 540,000 prepaid card users to set money aside in a non-interest bearing savings "wallet" that was separated from funds used for regular transactions. The company undertook the pilot program in collaboration with the Consumer Financial Protection Bureau (CFPB or Bureau) through the CFPB's Project Catalyst initiative. The goal was to understand better how to promote savings among consumers, especially those who may be low-income and economically vulnerable.

In conjunction with the program, the company tested four strategies to promote savings to customers who had not previously enrolled in the savings feature. These strategies included: i) encouragement by email, ii) encouragement by direct mail, iii) promotional incentives, and iv) automatic transfers. The pilot program ran for three months and the usage of the savings wallet was tracked for an additional nine months.

The CFPB released results from the pilot on September 29, 2016. The results indicate that offering customers a $10 incentive was highly effective at encouraging enrollment in the savings feature. The promotional incentive gave customers $10 on their prepaid card in exchange for depositing $150 into the savings wallet by a specified date. For consumers who continued to use the savings feature, balances generally did not decrease even after they stopped receiving emails about saving. Nine months after the pilot program ended, the company conducted a voluntary survey of all participants that had enrolled in a savings feature as well as a random subsample of participants that had not enrolled. The survey results showed that those offered an incentive were 20 percent less likely to use a payday loan or paycheck advance service in the past year compared to the control group. Some customers also reported changes in their financial behavior.

The CFPB notes that the results of the pilot program may not translate to other prepaid card users or other similar products offered by different industry participants. They also suggest that incentivizing prepaid card customers to save, and providing an opportunity for them to do so by using a savings feature that earmarks funds for saving, could provide tangible financial benefits to consumers. The Project Catalyst initiative is designed to encourage consumer-friendly developments in markets for consumer financial products and services, [Press Release] [CFPB Blog Post] [Study Results]

2.4 Enforcement action

The Federal Trade Commission (FTC) announced the following enforcement actions in the past week:

— The FTC obtained a U.S. District Court Order granting the FTC's Motion for Summary Judgment against an individual and several companies involved in a payday lending scheme (the defendants) that deceived consumers and illegally charged them undisclosed and inflated fees in violation of Section 5 of the FTC Act. The defendants falsely claimed they would charge borrowers the loan amount plus a one-time finance fee but, instead, made multiple withdrawals from consumers' bank accounts and charged a new finance fee each time, without disclosing the true costs of the loan to the consumers. The court order imposed a $1.3 billion judgment against the defendants, representing the difference between what consumers actually paid on the loans and what they were told they would have to pay. It also (i) banned them from the consumer lending business, (ii) prohibited them from misrepresenting material facts about any good or service, and (iii) prohibited them from engaging in illegal debt collection practices.

— The FTC filed a complaint charging nine auto dealerships and their owners (the Defendants) with using a wide range of deceptive and unfair sales and financing practices. The complaint is the FTC's first action against an auto dealer for using deception or other unlawful pressure tactics to coerce consumers who have signed contracts into accepting a different deal. The Defendants were also charged with adding extra, unauthorized charges for aftermarket products and services ("add-ons") into car deals financed by consumers. In doing so, the complaint alleges that the Defendants violated the Truth in Lending Act/Regulation Z, and the Consumer Leasing Act/Regulation M, for failing to disclose clearly the required credit information and lease information in their advertising. The case is ongoing.

3. Capital markets and investment management

3.1 CFTC signs MOU with U.K. Financial Conduct Authority to enhance supervision of cross-border regulated swap dealers

On October 6, 2016, the Commodity Futures Trading Commission (CFTC) announced that it signed a Memorandum of Understanding (MOU) with the Financial Conduct Authority (FCA) of the United Kingdom covering the derivatives-related activities and conduct of the 20 firms registered with the CFTC as swap dealers. The MOU enhances bilateral cooperation and exchange of information regarding supervision and oversight regarding: protecting customers; fostering the integrity of and maintaining confidence in financial markets; and reducing systemic risk. [Press Statement] [Memorandum of Understanding]

3.2 FINRA publishes ATS block-size trade data

On October 3, 2016, the Financial Industry Regulatory Authority (FINRA) began publishing monthly information on block-size trades in all National Market System (NMS) stocks occurring on alternative trading systems (ATSs). This is the most recent step in FINRA's ATS transparency initiative which seeks to provide additional transparency to over-the-counter (OTC) trading in equity securities. In June 2014, FINRA began publishing the trade volume for equity securities executed on an ATS. In April 2016, FINRA began publication of non-ATS OTC equity volume by member firm and security.

The statistics for ATS block-size trades are aggregated across all NMS stocks for a period of one month. They are published no earlier than one month following the end of the month for which trading was aggregated. The current report reflects ATS trades during August 2016. FINRA has defined block-size trades using share-based and dollar-based thresholds as well as thresholds that include both shares and dollar amounts. [Press Statement]

3.3 CFTC extends time-limited no-action relief to swap execution facilities from certain "block trade" requirements

On October 7, 2016, the U.S. Commodity Futures Trading Commission's (CFTC) Division of Market Oversight (Division) issued No-Action Letter 16-74 to extend until November 15, 2017, existing time-limited no-action relief to Swap Execution Facilities (SEFs) from certain requirements in the definition of "block trade" in the CFTC regulations.

CFTC Regulation Section 43.2 defines a "block trade" as, among other things, a publicly reportable swap transaction that occurs away from the registered SEF's trading system or platform. Previously issued CFTC No-Action Letter 14-118 provided that the Division would not recommend enforcement action against a SEF that has rules and/or procedures that provide for the use of a SEF trading system or platform to facilitate the execution of block trades for swaps that are intended to be cleared, provided certain conditions were met. No-Action Letter 14-118 was subsequently extended to November 15, 2016, by No-Action Letter 15-60.

The relief is subject to the following conditions:

— The block trade is not executed on the SEF's Order Book functionality, as defined in Section 37.3(a)(3);

— The SEF adopts rules pertaining to cleared blocks that indicate that the SEF is relying on the relief provided in the no-action letter and that requires each cleared block trade executed on a non-Order Book trading system or platform to comply with the other requirements in the block trade definition in Section 43.2;

— The Futures Commission Merchant completes the pre-execution credit check pursuant to Section 1.73 at the time the order for a block trade enters the SEF's non-Order Book trading system or platform; and

— The block trade is subject to void ab initio requirements where the swap is rejected on the basis of credit. [Press Statement] [No-Action Letter 16-74]

3.4 Enforcement actions

The Securities and Exchange Commission (SEC) recently announced the following enforcement actions:

— The SEC charged a global financial services firm with misrepresenting a key performance metric of its wealth management business. An SEC investigation revealed that the firm had moved away from its publicly disclosed method for determining net new assets (NNA. While the firm's disclosures stated that it assessed assets individually based on each client's intentions and objectives, it occasionally took an undisclosed results-driven approach to determining NNA in order to meet certain targets established by senior management. The firm admitted to wrongdoing and agreed to pay a penalty of $90 million to settle charges. The former chief operating officer of the firm's private banking division agreed to settle charges with the SEC and agreed to pay civil money penalties of $80,000, without admitting or denying the charges.

— The SEC charged the former Chief Executive Officer (CEO) of a microcap company and a boiler room operator (the Defendants) with defrauding seniors and others by pressuring them to invest in penny stock companies and promising lucrative profits. The complaint alleges that the Defendants sold the stocks based on misrepresentations that investor funds would be used for research and development and no sales commissions would be paid out of investor funds. However, the complaint alleges that the Defendants misappropriated approximately 90 percent of the nearly $20 million raised from investors, diverting the funds to enrich themselves and to pay sales commissions to agents. The Defendants agreed to partial settlements of the SEC charges without admitting or denying the allegations. They also agreed to be barred from future penny stock offerings. Finally, the CEO agreed to being barred from serving as an officer or director of a public company. Financial sanctions have not yet been set.

4. Financial crimes

4.1 OCC issues guidance regarding risk re-evaluation of foreign correspondent accounts

On October 5, 2016, the Office of the Comptroller of the Currency (OCC) issued guidance to national banks, federal savings associations, and federal branches and agencies (collectively, banks) regarding periodic evaluation of their correspondent accounts for foreign financial institutions (foreign correspondent accounts). The Guidance references multiple areas where a bank needs to have an audit trail to support its account retention or rejection decisions at various inflection points throughout the internal decision-making process and subsequent communications process with affected clients. It also identifies factors that a bank should consider and document in order to mitigate the risk of client retention, particularly in situations where account closure could decrease access to financial services for "an entire group of customers…or an entire geographic location."

In addition to having established policies and procedures for conducting risk assessments for foreign correspondent accounts, the guidance outlines the OCC's supervisory expectation that banks should periodically engage in a risk re-evaluation of these accounts. Specific factors that should be considered in the risk reevaluation process include: the risks present in the foreign financial institutions' business and markets, as well as the anticipated account activity and the supervisory regime of the geographic location in which the foreign financial institution is licensed. Foreign financial institutions should be given an opportunity to provide sufficient and transparent information to allow banks to make informed risk assessment decisions.

The OCC believes the following best practices should govern account retention and termination processes:

— Establishment and maintenance of an effective governance function that includes review of the risk reevaluation method, and monitors the appropriateness of employee recommendations regarding foreign correspondent account retention or termination.

— Communication of foreign correspondent account termination decisions regularly to senior management.

— Communication with foreign financial institutions, in order to obtain and consider specific mitigating information these institutions may provide, and to provide the foreign correspondent accountholder with sufficient time to establish alternative banking relationships before its accounts are terminated, unless doing so would be contrary to law or pose an additional risk to the bank, national security, or reveal law enforcement activity.

— Documentation of a clear audit trail of the reasons and method used for account closure. [OCC Bulletin 2016-32]

4.2 FinCEN charges gaming company for violations of the anti-money laundering provisions

On October 3, 2016, the Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) assessed a $12 million civil money penalty against a gaming technology provider for "egregious and systemic" violations of the anti-money laundering (AML) provisions of the Bank Secrecy Act (BSA). FinCEN's assessment was made concurrent with the U.S. Attorney's Offices for the Eastern District of New York and District of Nevada's announcement of a non-prosecution agreement with the company. In that settlement, the company agreed to a forfeiture of $6 million and a criminal fine of $10.5 million to settle possible criminal charges.

Regulators alleged that the gaming technology provider willingly failed to implement and maintain an effective anti-money laundering program, failed to report certain suspicious activity, failed to report certain transactions involving currency in amounts greater than $10,000, and failed to keep accurate records as required by the BSA and its implementing regulations. This includes failing to keep required records on its highest-volume patron who placed more than $300 million in wagers between 2010 and 2013.

4.3 SEC settles charges with hedge fund and its executives for violations of FCPA

The Securities and Exchange Commission (SEC) announced that it had reached a settlement with an institutional alternative asset manager to address charges that the firm violated the Foreign Corrupt Practices Act (FCPA). The settlement requires the firm to pay nearly $200 million in disgorgement and interest, and the SEC reached separate settlements with the firm's Chief Executive Officer (CEO), who will pay nearly $2.2 million in disgorgement and interest, and Chief Financial Officer (CFO), who was not required to make a monetary payment. The company separately expects to enter into a deferred prosecution agreement with the Department of Justice in a parallel criminal proceeding and to pay a criminal penalty of $213 million.

The SEC detected the misconduct as part of a proactive investigation into the way financial services firms obtain investments from sovereign wealth funds overseas. The SEC identified in its subsequent investigation that the company used intermediaries, agents, and business partners to pay bribes to high-level government officials in Africa. According to the SEC order, some of the illicit payments were made to induce investment in the company's funds. Other payments were made to secure mining rights to natural resources and to influence government officials. The SEC found the firm's books and records did not accurately describe the true purposes for which managed investor funds were used. The SEC also found that the firm's internal controls were inadequate to detect or prevent the payment of bribes.

5. Alternative finance

5.1 CFPB releases results of Project Catalyst pilot program on savings tools and prepaid cards

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opportunity for them to do so by using a savings feature that earmarks funds for saving, could provide tangible financial benefits to consumers. The Project Catalyst initiative is designed to encourage consumer-friendly developments in markets for consumer financial products and services. [Press Release] [CFPB Blog Post] [Study Results]

This item was also published under the Enterprise and Consumer Compliance section.

5.2 Federal Reserve Governor Brainard gives speech on distributed ledger technology

Federal Reserve Board (Federal Reserve) Governor Lael Brainard spoke at the Institute of International Finance Annual Meeting on October 7, 2016. She focused her speech on the implications of distributed ledger technology for payments, clearing, and settlement purposes. She stated that distributed ledger technology may represent the most significant development in many years in the areas of payments, clearing, and settlement and that the Federal Reserve is paying close attention.

She indicated that the agency is particularly interested in ensuring that this new technology is developed and deployed in a safe and sound manner, with a thorough understanding and management of the associated risks. In the payments, clearing, and settlement arena, these risks include settlement, operations, and cybersecurity, as well as money laundering and terrorist financing.

Governor Brainard underscored the importance of identifying and tracking identities and country identifiers associated with reporting suspicious activity regarding cross-border payments. She identified the importance of improvements in cryptographic security as well as policy considerations regarding system resiliency, governance and the role of licensing to ensure proper oversight.

The Federal Reserve has established a working group to analyze financial innovation across the range of its responsibilities in supervision, consumer protection, financial stability, and information technology. A research paper on the group's key findings is expected to be published later this year. [Governor Brainard speech]

6. Brexit

6.1 CFTC signs MOU with U.K. Financial Conduct Authority to enhance supervision of cross-border regulated swap dealers

On October 6, 2016, the Commodity Futures Trading Commission (CFTC) announced that it signed a Memorandum of Understanding (MOU) with the Financial Conduct Authority (FCA) of the United Kingdom covering the derivatives-related activities and conduct of the 20 firms registered with the CFTC as swap dealers. The MOU enhances bilateral cooperation and exchange of information regarding supervision and oversight regarding: protecting customers; fostering the integrity of and maintaining confidence in financial markets; and reducing systemic risk.

This item was also published under the Capital Markets and Investment Management section.

6.2 OFR Financial Markets Monitor report finds impact of UK Brexit vote subsides

On October 6, 2016, the Department of the Treasury's Office of Financial Research (OFR) released its Financial Markets Monitor report for the third quarter of 2016. The report analyzes the impact of the UK referendum to exit the European Union (EU), commonly referred to as the "Brexit vote," on the global financial markets. The OFR report states that investor risk appetite "quickly recovered" from the initial shock of the Brexit vote, but cautions that the ultimate financial and political effects will depend on final terms that have yet to be negotiated. The following key developments for the third quarter of 2016 are highlighted in the report:

- Global risky assets recovered most of the losses triggered by the UK referendum. The recovery was attributed to the absence of severe market dislocations after the vote, expectations for easier policy from major central banks, and continued stability in China's economy and markets. Consequently, many economists upgraded their 2017 growth forecasts for the UK from recession to low, positive growth.
- Political stability returned quickly in the UK with Theresa May becoming prime minister within a month after David Cameron resigned.
- Emerging markets attracted capital from overseas investors during the third quarter, as interest rates in advanced economies remained at historically low levels.
- Assets in prime money market funds fell more than 40 percent in 2016 in anticipation of U.S. money market reforms scheduled to go into effect on October 14, 2016. Divestments by prime funds increased short term U.S. dollar borrowing rates.

The report also highlighted that uncertainty remains about how and when the UK would exit the EU. The new government has signaled that it will trigger Article 50, the procedure to formally exit the EU, sometime in 2017. The OFR reports that "most experts doubt that trade and financial agreements can be negotiated for an orderly exit within the two years allowed under Article 50" and indicates that an extension would require approval from the other EU members, presenting another political risk to economic confidence in the UK and Europe. [OFR Review Brief]

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