The Washington Report

Americas FS Regulatory Center of Excellence

The week ended September 9, 2016

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Contents

1. Safety and soundness

1.1 Federal Reserve finalizes policy for determination of the countercyclical capital buffer

On September 8, 2016, the Federal Reserve Board (Federal Reserve) released a final policy statement under Regulation Q (Capital Adequacy of Bank Holding Companies, Savings and Loan Holding Companies, and State Member Banks) describing the implementation framework for the Countercyclical Capital Buffer (CCyB). The CCyB applies to banking organizations with more than $250 billion in assets or $10 billion in on-balance-sheet foreign exposures, and to any depository institution subsidiary of such banking organizations (collectively, these banking organizations are commonly referred to as advanced approaches banks). It supplements the minimum capital requirements and other capital buffers under Regulation Q. It can be increased or decreased as vulnerabilities in the financial system rise or recede, subject to a 2.5 percent cap.

The policy statement outlines the types of factors the Federal Reserve will consider when implementing the CCyB. These include: (i) leverage in the financial and nonfinancial sectors; (ii) maturity and liquidity transformation in the financial sector; and (iii) asset valuation pressures.

The CCyB requirement will be activated when the Federal Reserve determines that systemic vulnerabilities are "meaningfully above-normal." Changes to the CCyB will be subject to public notice and comment before any action is taken. Currently, the CCyB is set at zero. The policy takes effect on October 14, 2016. [Press Statement] [Policy Statement]

1.2 FFIEC releases updated Information Security booklet as part of its Information Technology Examination Handbook

On September 9, 2016, the Federal Financial Institutions Examination Council (FFIEC) issued a revised "Information Security" booklet, which is part of the FFIEC's Information Technology Examination Handbook. The revised booklet addresses various factors necessary to assess the level of security risks facing a financial institution's information systems. It provides an overview of information security operations, including the need for effective threat identification, assessment, and monitoring in addition to effective incident identification, assessment, and response. The booklet also contains updated examination procedures to help examiners measure the adequacy of an institution's culture, governance, information security program, security operations, and assurance processes. [FFIEC Press Statement] [Information Security Booklet]

1.3 BCBS oversight body endorses direction of regulatory reforms

On September 11, 2016, the Group of Central Bank Governors and Heads of Supervision (GHOS), the oversight body of the Basel Committee on Banking Supervision (BCBS), released a progress report regarding post-crisis regulatory reforms to reduce excessive variability in Risk-Weighted Assets (RWAs). The GHOS endorsed again the direction of BCBS reforms and reaffirmed that the BCBS should "focus on not significantly increasing overall capital requirements."

As a part of this announcement, Mario Draghi, Chairman of the GHOS and European Central Bank President, stated that finalizing the BCBS's post-crisis reforms would complete Basel III and help restore confidence in banks' risk-weighted capital ratios. [Press Statement]

1.4 Agencies release report on permissible activities and investments of banking entities

On September 8, 2016, the Federal Reserve Board (Federal Reserve), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) released a joint report to the Congress and the Financial Stability Oversight Council presenting the results of their study on the permissible activities and investments of banking entities. The report was required by Section 620 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which directed the agencies to review and provide recommendations on the:

- Types of activities and investments permissible for banking entities under state and federal law;
- Risks, including operational, managerial, or reputational risks, associated with such activities or investments;
- Activities undertaken to mitigate such risks;
- The potential for the activities or investments to have a negative effect on the safety and soundness of banking entities or the U.S. financial system;
- The "appropriateness" of banking entities conducting such activities or investments; and
- Additional restrictions needed to address risks to safety and soundness.

Each agency prepared a section of the report containing analyses and recommendations relative to the banking entities it supervises. Some of the key recommendations include:

- The Federal Reserve recommended Congress repeal special exemptions that permit certain firms (particularly industrial loan companies and grandfathered unitary savings and loan holding companies) to operate free of activity restrictions and/or outside of the prudential framework applicable to other banking entities.
- The FDIC identified potential areas for "enhancement, reconsideration, and clarification" in its policies and procedures. In particular, the FDIC indicated that it plans to review activities related to investments in other financial institutions and other equity investments as well as to re-evaluate prudential standards and filings regarding mineral rights, commodities, or other non-traditional activities. No timeframe for the review process was specified in the report.
- The OCC indicated that it would:
  - Issue a proposed rule to prohibit federal banking entities from holding asset-backed securities that hold bank-impermissible assets;
  - Address concentrations of mark-to-model assets and liabilities with a rulemaking or guidance;
  - Clarify minimum prudential standards for certain national bank swap dealing activities;
  - Consider providing guidance on clearinghouse memberships;
  - Clarify regulatory limits on physical hedging;
  - Address the authority of national banks to hold and trade copper; and
  - Incorporate the Volcker Rule into the OCC's investment securities regulations. [Press Statement] [Report]

As noted in Section 3.1 below, the OCC acted to implement one of its recommendations by proposing to prohibit banks and thrifts from dealing and investing in industrial or commercial metals.

2. Enterprise and consumer compliance

2.1 Enforcement actions

The Federal Trade Commission (FTC), the Consumer Financial Protection Bureau (CFPB or Bureau), and the Office of the Comptroller of the Currency (OCC) announced the following enforcement actions in the past week:

- The CFPB entered into a Consent Order with a national bank to address findings that the employees of the bank opened approximately 1.5 million deposit accounts that may not have been authorized by consumers; applied for more than 500,000 credit card accounts that may not have been authorized by consumers; requested and issued debit cards without consumers' knowledge or consent; and created false email addresses to enroll consumers in online banking services without the consumers' knowledge or consent. The CFPB further found that bank employees engaged in these improper sales practices to satisfy sales goals and earn financial rewards under the bank's incentive compensation program. The CFPB concluded these practices violated the unfair, deceptive, or abusive acts or practices provisions of the Consumer Financial Protection Act and imposed a fine of $100 million against the bank. It also required the bank to pay restitution to harmed customers. The bank agreed to the Consent Order without admitting or denying the CFPB's findings.

  The CFPB's action was coordinated with the OCC and the City and County of Los Angeles, California. The OCC separately assessed a $35 million civil money penalty against the bank and ordered it to pay restitution to customers harmed by its unsafe and unsound practices. The OCC's Consent Order also required the bank to establish an enterprise-wide sales practices risk management and oversight program to detect and prevent unsafe or unsound sales practices. The City and County of Los Angeles separately required the bank to pay a $50 million penalty for these practices.
- The FTC announced the resolution of two separate actions taken by the agency as part of Operation Collection Protection, a federal, state, and local initiative directed toward deceptive and abusive collection practices. In one case, the FTC obtained a stipulated order banning the defendants from debt collection activities, prohibiting them from misrepresenting materials facts about any financial-related products or services, and prohibiting them from profiting from consumers' personal information and failing to dispose of it properly. The final order imposes a judgment of more than $4.4 million. The defendants were alleged to have demanded payment of payday and other loans without verifying the debt and despite consumers' dispute of the

debt. They also were alleged to have impersonated law enforcement, accused people of bank fraud, and falsely threatened to sue.

In the second case, the FTC obtained a stipulated order banning the defendants from debt collection activities and from debt brokering or otherwise trading in consumer information regarding debt. The order also prohibits the defendants from profiting from consumers' personal information and failing to dispose of it properly, and imposes a judgment of approximately $27 million, which will be partially suspended upon the surrender of all of their frozen funds. The defendants allegedly sent alarming and deceptive text messages to consumers without identifying themselves as debt collectors. They also were alleged to have harassed the consumers' friends, family, and employers.

3. Capital markets and investment management

3.1 OCC proposes rule to prohibit banks and thrifts from dealing and investing in industrial or commercial metals

On September 8, 2016, the Office of the Comptroller of the Currency (OCC) issued a proposed rule seeking to prohibit national banks and federal savings associations (collectively, banks) from dealing and investing in "industrial or commercial metals." Under the proposal, "industrial or commercial metals" would mean metal, including alloys, in a physical form primarily suited to industrial or commercial uses, such as copper cathodes.

If finalized in its current form, the proposal would supersede a prior OCC determination (Interpretive Letter 693) permitting national banks to trade copper cathodes. However, other authorities that permit banks to hold industrial or commercial metal for purposes distinct from dealing and investing would not be changed by the proposal (e.g., metal acquired through loan foreclosure).

The proposed rule implements one of the recommendations in the OCC's report to Congress and the Financial Stability Oversight Council on the permissible activities and investments of banking entities. The report was required by Section 620 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and was delivered by the OCC in a joint report with the Federal Reserve Board and the Federal Deposit Insurance Corporation on September 8, 2016. [Press Statement] [Proposed Rule]

The OCC's report on the permissible activities and investments of banking entities was separately covered above, in the Safety and Soundness section.

3.2 CFTC signs MOU with Mexican supervisory authorities

On September 6, 2016, the Commodity Futures Trading Commission (CFTC) signed a Memorandum of Understanding (MOU) with the Comisión Nacional Bancaria y de Valores (CNBV), Mexico's national banking and stock commission, which is an independent agency of the Secretariat of Finance and Public Credit of Mexico with executive powers over the Mexican financial system, and with Banco de México, Mexico's central bank. The MOU aims to increase cooperation and facilitate information exchange regarding the supervision and oversight of central counterparties and trade repositories operating on a cross-border basis in the United States and Mexico. [Press Statement] [Memorandum of Understanding]

3.3 CFTC adopts final rules for systems safeguards testing

The Commodity Futures Trading Commission (CFTC) adopted two final rules on September 8, 2016 that enhance system safeguards testing requirements for registered entities. One rule covers designated contract markets, swap execution facilities, and swap data repositories. The second rule covers derivatives clearing organizations.

The final rules enhance and clarify existing requirements relating to cybersecurity testing and system safeguards risk analysis by, among other things, specifying and defining five types of cybersecurity testing considered to be essential to a sound system safeguards program. The five types of testing include 1) vulnerability testing, 2) penetration testing, 3) controls testing, 4) security incident response plan testing, and 5) enterprise technology risk assessment. The final rules also address internal reporting and review of testing results, and remediation of vulnerabilities and deficiencies. In addition, for specified registrants (based on trading volume), the final rules tighten standards particularly with respect to minimum frequency requirements for conducting certain types of cybersecurity testing and specific requirements for certain tests to be performed by independent contractors.

Each of the final rules will become effective upon publication in the Federal Register. Compliance dates for individual provisions vary throughout the one year period from the effective date. [Press Statement] [DCO Final Rule] [DCM, SEF, SDR Final Rule]

3.4 CFTC approves comparability determination for certain uncleared swaps with Japan

On September 8, 2016, the Commodity Futures Trading Commission (CFTC) released a Notice of Comparability Determination for Margin Requirements for Uncleared Swaps under the Laws of Japan. The notice states that the CFTC has determined, with one exception, that the margin requirements for uncleared swaps under the laws and regulations of Japan are comparable to margin requirements under the Commodity Exchange Act and CFTC regulations. The one exception relates to the treatment of inter-affiliate swaps. The comparability determination will become effective upon publication in the Federal Register and will apply to margin requirements for certain swap dealers and major swap participants registered with the CFTC. [Press Statement] [Final Rule]

3.5 House passes Investment Advisers Modernization Act of 2016

On September 9, 2016, the House of Representatives passed the Investment Advisers Modernization Act (H.R. 5424). The Bill amends the Investment Advisers Act of 1940 and directs the Securities and Exchange Commission (SEC) to amend its rules that apply to investment advisers. Specifically, the Bill seeks to update rules pertaining to advertising, custody, recordkeeping, brochure delivery, and assignment of advisory contacts that apply particularly to private equity firms and private investment funds. The provisions of the bill however, do not apply to advisory services provided to registered investment companies. [Congress.gov]

4. Alternative finance

4.1 House passes Accelerating Access to Capital Act of 2015

On September 8, 2016, the House of Representatives passed a package of measures under the 'Accelerating Access to Capital Act of 2015.' The Bill consists of the following three bills to help small businesses access capital easily:

- H.R. 2357, the Accelerating Access to Capital Act: Simplifies the Securities and Exchange Commission's (SEC's) registration regime for smaller companies.
- H.R. 4850, the Micro Offering Safe Harbor Act: Amends the Securities Act of 1933 to exempt certain small businesses from registration requirements if the following requirements are met: (i) each investor has a substantive pre-existing relationship with an owner; (ii) there are 35 or fewer purchasers, and (iii) the aggregate amount raised from all securities offerings does not exceed $500,000 during the 12-month period preceding the 'micro offering' transaction.
- H.R. 4852, the Private Placement Improvement Act: Increases the use of private placement offerings for companies to raise capital. It directs the SEC to revise Regulation D to ensure that small businesses do not face complicated and unnecessary regulatory burdens when attempting to raise capital through Regulation D offerings. Regulation D contains three rules providing exemptions from registration requirements, allowing some companies to offer and sell their securities without having to register the securities with the SEC. [Congress.gov]

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