The Washington Report

Americas FS Regulatory Center of Excellence

The week ended September 16, 2016

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1. Safety and soundness

1.1 OCC proposes framework for resolution of uninsured national banks

The Office of the Comptroller of the Currency (OCC) published a notice of proposed rulemaking on September 13, 2016, establishing a framework for placing non-depository uninsured national banks (i.e., trust banks) into receivership. As of May 2016, 52 uninsured national banks are supervised by the OCC, all of which are trust banks. The National Bank Act (NBA) grants the OCC broad authority to choose a receiver for uninsured national banks. In contrast, the NBA and Federal Deposit Insurance Act specify the Federal Deposit Insurance Corporation as receiver for insured banks and savings associations. The framework in the proposed rule describes the:

- Appointment of a receiver and required federal notice;
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The proposal would not apply to federal savings associations. Nor would it apply to branches of foreign banks.

The OCC proposal indicates that the initiative holds implications for the Alternative Finance (FinTech) sector. Consequently, it expressly requests comment on whether the application of the NBA framework to FinTech banks raise any unique considerations. It also requests comment on the technical details of the proposed receivership process.

Comments on the proposed rule will be accepted through November 14, 2016. [Press Statement] [Proposed Rule]

1.2 OCC releases FY 2017 supervisory plan

On September 14, 2016, the Office of the Comptroller of the Currency (OCC) released its bank supervision plan for 2017 highlighting the following priority objectives:

- Commercial and retail loan underwriting;
- Business model sustainability and viability;
- Operational resilience;
- Bank Secrecy Act/anti-money laundering (BSA/AML) compliance management; and
- Change management to address new regulatory requirements.

The supervisory priorities apply to the National Risk Committee, Large Bank Supervision, Midsize and Community Bank Supervision, Compliance and Community Affairs, the supervision of technology service providers, and the Office of the Chief National Bank Examiner. Large Bank Supervision will develop and execute individually approved FY 2017 supervisory strategies for each large bank, federal branch, or federal agency.

Specific areas of focus include:

- Compliance and operational risk management;
- Cybersecurity;
- Third-party risk management;
- Information security, data protection, and information technology risk management;
- Model risk management;
- Stress testing;
- Recovery planning;
- Anti-money laundering and terrorist financing risks, as well as the impact of BSA/AML strategies on financial inclusion;
- Reviewing commercial and retail credit underwriting practices for leveraged loans, auto loans, loans to nondepository financial institutions, and certain commercial real estate loan sectors that have experienced higher growth and weakening underwriting standards;
- Horizontal risk assessments of shared national credit;
- Effective, timely, and consistent guidance for matters requiring attention and enforcement actions. [Press Statement] [FY 2017 Plan]

1.3 BCBS publishes Basel III monitoring exercise results

On September 13, 2016, the Basel Committee on Banking Supervision (BCBS) published the results of its latest Basel III monitoring exercise, which reviews the progress made by banks in implementing the standards. Key takeaways include:

- As of December 31, 2015, all large internationally active banks (banks with Tier 1 capital of more than 3 billion euro, referred to as "Group 1 banks") met the fully phased-in minimum Basel III Common Equity Tier 1 (CET1) requirement of 4.5 percent, as well as the target level of 7 percent (plus the surcharges on global systemically important banks (G-SIBs)).

- Group 1 banks continue to reduce their capital shortfalls with respect to Tier 1 and total capital target levels.
- Group 2 banks (all banks other than Group 1 banks) experienced a shortfall of $218.5 million with respect to the CET1 target level of 7 percent. However, no Group 2 banks experienced capital shortfalls in minimum CET1 levels. .
- The vast majority of the Group 1 banks (eighty five percent) and Group 2 banks (eighty three percent) reported a Liquidity Coverage Ratios (LCRs) that met or exceeded 100 percent. The target Basel III LCR was set at 60 percent in 2015. It, increased to 70 percent in 2016 and will continue to rise each year to reach 100 percent in 2019.
- The vast majority of Group 1 banks (eighty percent) and Group 2 banks (eighty seven percent) reported a Net Stable Funding Ratio that met or exceeded 100 percent. [Press Statement]; [Basel III Monitoring Report]

1.4 Committee on Payments and Market Infrastructure to review security measures in wholesale payment systems

On September 16, 2016, the Bank for International Settlements Committee on Payments and Market Infrastructures (CPMI) announced the establishment of a task force to assess the security of wholesale payment systems involving banks, financial market infrastructures, and other financial institutions. The task force will work with central banks globally to review the level of security measures currently in place at each stage of the payments process. The review builds on the CPMI's work in the areas of cyber security and operational risk, as well as its ongoing work testing and strengthening the payments infrastructure. [Press Statement]

2. Enterprise and consumer compliance

2.1 FDIC releases guide and online resources for community bankers on affordable mortgage programs

The Federal Deposit Insurance Corporation (FDIC), on September 15. 2016, published a guide and launched an online resource center to help community bankers understand various single-family housing support products offered by federal agencies and government-sponsored enterprises and compare various programs. The guide describes programs supporting home purchase, refinance, manufactured housing, and some home improvements. The materials seek to facilitate comparison of various government programs, evaluate Community Reinvestment Act implications, and identify steps for program participation.

The published guide is the first in a three part series. The second and third publications will focus on resources available from state housing finance agencies (Part II) and Federal Home Loan Banks (Part III). They will be posted to the online resource center, the Affordable Mortgage Lending Center, later in 2016. [Press Statement] [Affordable Mortgage Lending Guide, Part I] [Resource Center]

2.2 FTC seeks public comment on the Disposal Rule

The Federal Trade Commission (FTC) seeks public comment on its rule regarding the Disposal of Consumer Report Information and Records, commonly referred to as the "Disposal Rule." The rule implements part of the Fair and Accurate Credit Transactions Act of 2003 (FACTA). It requires certain persons who have consumer report information for a business purpose to dispose of it properly and take reasonable measures to protect the information from unauthorized access.

The request for public comment is part of an ongoing systematic review of all FTC rules and guides. The FTC specifically seeks comment on:

- the economic impact and benefits of the Disposal Rule; possible conflicts with state, local or other federal laws; and its effect on any technological or other industry changes; and
- whether the definition of "consumer information" should be expanded to include aggregate information or information that can be reasonably linked to an individual.

The comment period will be open through November 21, 2016. [Press Statement] [Request for public comment]

2.3 Enforcement action

The Consumer Financial Protection Bureau (CFPB or Bureau) has entered into a consent order with a for-profit secondary education institution regarding CFPB allegations that the institution engaged in deceptive acts and practices in violation of the Consumer Financial Protection Act regarding statements about the cost of its institutional private student loans. The

Bureau alleges the institution deceived students about the actual or typical monthly payments required under the student loan obligations, thus preventing them from knowing the true cost of the loans. Under the consent order, the institution agreed, without admitting or denying the CFPB's allegations, to discharge all outstanding debt for its institutional private student loans and to refund all principal and interest payments previously made – a total of approximately $23.5 million in relief and refunds. The institution must also pay a civil penalty of $8 million.

3. Capital markets and investment management

3.1 SEC undertakes initiative to conduct supervisory examinations of registered investment advisers that employ individuals with a disciplinary history

On September 12, 2016, the Securities and Exchange Commission (SEC) Office of Compliance Inspections and Examinations (OCIE) released a Risk Alert announcing a new initiative to examine the supervision practices and compliance programs of registered investment advisers that employ individuals with a history of disciplinary events in the financial sector. The examinations will assess the advisers' business and compliance practices. It will particularly assess practices relating to supervision of high risk individuals.

Advisers will be identified for examination under this initiative based on a variety of factors, including disciplinary information reported on Form ADV, information from other legal actions not required to be reported on Form ADV (such as private civil actions), and information from SEC enforcement actions where individuals were barred or suspended from certain financial industries.

The examinations will focus on:

- The effectiveness of registered advisers' compliance programs and oversight practices regarding hiring processes, ongoing reporting obligations, and complaints handling;
- Disclosures made in an adviser's Form ADV and brochure relating to regulatory, disciplinary, and other actions;
- Full and fair disclosure of all material facts and conflicts of interest, especially regarding financial arrangements initiated by supervised persons with a history of disciplinary events; and
- Marketing materials, including advertisements, pitch-books, website postings, and public statements to identify any conflicts of interest or risks associated with supervised persons with a history of disciplinary events. [SEC Risk Alert]

3.2 Enforcement actions

The Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA) announced the following enforcement actions in the past week:

- The SEC charged a foreign firm for failing to disclose properly the nature and extent of credit risk associated with its investments in certain debt instruments. The company was found to have multiple disclosure failures and insufficient internal accounting controls which prevented investors from discerning the risks arising from the company's investments. The company consented to the SEC's cease-and-desist order and agreed to pay a penalty of $1.25 million without admitting or denying the SEC's findings.
- FINRA charged a firm for failing to supervise adequately the activity in its customers' brokerage accounts. According to FINRA findings, the firm failed to supervise the transmittal of funds from customer brokerage accounts and failed to detect a conversion and transfer of more than $370,000 from five customer brokerage accounts by one of its registered representatives. Further, the firm failed to identify or investigate red flags associated with third-party wire requests, which highlighted that funds were being transmitted to a business bank account of the representative. The firm agreed to pay a civil penalty of $850,000 to settle charges. It has separately and previously paid restitution, including interest and fees, to harmed customers, and barred the registered representative.

4. Financial crimes

4.1 FinCEN issues advisory to financial institutions on e-mail compromise fraud schemes

On September 6, 2016 the Financial Crimes Enforcement Network (FinCEN) issued an advisory to financial institutions to help them guard against a growing number of e-mail fraud schemes. In these schemes, the perpetrator compromises the e-mail account of their victim and misappropriates funds by sending fraudulent wire transfer instructions to the victims' financial institution. These email compromise fraud schemes target both financial institutions' commercial customers (business email compromise (BEC)) and individual customers (e-mail account compromise (EAC)).

The advisory provides a list of "red flags", developed in consultation with the Federal Bureau of Investigation (FBI) and the U.S. Secret Service (USSS), which financial institutions may use to identify and prevent these types of fraudulent schemes. FinCEN also notes that these transactions are often irrevocable, making it important to identify fraudulent transaction payment instructions before payments are issued. FinCEN states that a multi-faceted transaction verification process can help to guard against BEC and EAC fraud. [Press Statement] [FinCEN Advisory]

5. Alternative finance

5.1 Comptroller outlines policy and regulatory questions regarding marketplace lending

Thomas J. Curry, Comptroller of the Currency, discussed various marketplace lending risks and policy concerns at the Marketplace Lending Policy Summit 2016 on September 13, 2016. He indicated rapid growth is underway in consumer loans originated by marketplace lenders: nearly $29 billion was originated in 2015 from a base of $5 billion in 2013. He also cautioned, that the surge in demand may be challenged if the credit cycle becomes less favorable.

Comptroller Curry identified four policy and regulatory questions regarding marketplace lending:

1. Do new techniques, technologies, and products raise concerns about compliance with existing laws and regulations? Comptroller Curry emphasized that new companies and companies deploying new technologies should understand and ensure that their products and services comply with existing laws and regulations.
2. Are existing laws and regulations adequate, or do they need to be expanded to include new types of companies and new types of delivery channels?
3. Do innovative activities, products, or services present a need for entirely new regulations or laws to protect the public's interest or prevent risks to the financial system?
4. Should innovation be regulated and, if so, "who" should be responsible for such regulation? Is there a need for a new federal charter for FinTech firms?

He indicated these questions will help guide the OCC's efforts to assess whether, and under which conditions, FinTech firms might be permitted to apply for a specialized federal banking charter. Finally, Comptroller Curry indicated that the OCC's Innovation Framework Development Team continues to work on a framework to enable the OCC to assess and promote responsible innovation. [Curry Speech]

5.2 OCC Proposes Framework for Resolution of Uninsured National Banks

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This item was also covered under the Safety and Soundness section.

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