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# Safety & Soundness

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## Federal Reserve Revises Surveillance Program

On December 10, 2015, the Federal Reserve Board (Federal Reserve) issued Supervision and Regulation (SR) Letter 15-16 to announce that it has revised its safety-and-soundness surveillance program for state member banks (SMBs) and top-tier bank and savings and loan holding companies (HCs). The Federal Reserve highlights the following two key improvements:

- New risk classification algorithms (“Outlier Metrics”) that are intended to provide examiners and supervisory staff with early signals of an institution’s risk-taking; and
- A new early-warning model for HCs that is intended to complement the existing early-warning model for financial weaknesses at SMBs. [\[SR 15-16\]](#)

## OCC Credit Underwriting Survey Highlights an Easing of Standards

The 21<sup>st</sup> *Annual Survey of Credit Underwriting Practices* released by the Office of the Comptroller of the Currency (OCC) on December 9, 2015, indicated an easing of underwriting standards within commercial and retail loan products for the 95 banks and federal savings associations surveyed. The OCC states this trend reflects similar trends identified between 2005 and 2007 in advance of the financial crisis. Examiners noted that banks eased underwriting standards and increased levels of credit risk in response to competitive pressures and increasing market liquidity. Examiners also noted increasing exceptions to banks’ loan policies, primarily in commercial products and to a lesser degree in retail products. The OCC suggests that increasing policy exceptions and easing of underwriting standards increase portfolio risk and result in less resilient portfolios during times of stress. The Survey Report cautions boards of directors and senior management to carefully consider the impact of eased underwriting standards on the quality and volatility of performance in their loan portfolios. [\[Press Statement\]](#) [\[Survey\]](#)

## Basel Committee Releases Second Consultative Document for Credit Risk

The Basel Committee on Banking Supervision (Basel Committee) published a second consultative document on *Revisions to the Standardized Approach for Credit Risk* on December 10, 2015. The document is a part of the Basel Committee’s effort to ensure simplicity and comparability of bank capital structures by reducing variability in risk-weighted assets across banks and jurisdictions. The document differs from the Basel Committee’s first consultative document on this topic, released in December 2014, in a number of ways, including:

- Reintroducing the use of external credit ratings for exposures to “banks and corporates,” as well as alternatives for jurisdictions that do not allow the use of external ratings for regulatory purposes.
- Modifying the proposed risk weighting of real estate loans, with the loan-to-value ratio as the main risk driver.
- Doing away with the use of debt service coverage ratio as a risk driver and instead requiring an assessment of a borrower’s ability to pay, as a key underwriting criterion.
- Proposing to categorize all exposures related to real estate under the same asset class and applying higher risk weights to real estate exposures where repayment is materially dependent on the cash flows generated by the property securing the exposure.
- Proposing exposures to multilateral development banks, retail and defaulted exposures, and off-balance sheet items.

In response to the release of the Basel Committee’s consultation, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency released a joint statement indicating that they will consider the proposals with the goal of developing a stronger and more transparent risk-based capital framework for

large institutions in the U.S. though any changes to the U.S. risk-based capital rules would be subject to a notice and comment period. Comments on the proposal are being accepted by the BCBS through March 11, 2016.

[\[Basel Press Statement\]](#) [\[Consultative Document\]](#)

## FSB Publishes Papers of Enhance Disclosure Task Force

On December 7, 2015, the Financial Stability Board (FSB) published two reports and a statement from the Enhanced Disclosure Task Force (EDTF): [\[Press Statement\]](#)

- The *2015 Progress Report on Implementation of the EDTF Principles and Recommendations* is the EDTF's fourth report on the implementation of the EDTF recommendations. It covers 40 global or domestic systemically important banks and reflects their self-assessment on the extent to which the EDTF recommendations have been implemented. In this report, 82 percent of the covered banks believe they have fully implemented the recommendations. [\[Progress Report\]](#)
- The EDTF report on the *Impact of Expected Credit Loss Approaches on Bank Risk Disclosures* highlights issues with the implementation of new accounting standards on expected credit loss (ECL) and changes banks will need to make to their financial disclosures with the implementation of the new ECL standards. [\[Impact of ECL\]](#)
- The EDTF *statement on the disclosure of emergency liquidity assistance* under the EDTF disclosure recommendations allows that firms would not need to explicitly disclose emergency central bank liquidity support. [\[EDTF Statement\]](#)

## House Committee Conducts Oversight Hearing of Financial Stability Oversight Council

The House Committee on Financial Services conducted an oversight hearing of the Financial Stability Oversight Council (Council) on December 8, 2015. Eight of the Council's ten voting members provided testimony. Committee Chairman Jeb Hensarling released a statement indicating the witnesses were questioned about the Council's ability to designate insurers and financial companies as "systemically important," adding that "Of all of the Council's activities, none generates more controversy than its designation of non-bank financial institutions as 'systemically important financial institutions.'" He noted a key takeaway from the hearing was the need for greater transparency in the Council's publicly released meeting minutes.

## Legislative Actions

The House Committee on Financial Services passed the following bills on December 9, 2015:

- [H.R. 3791](#): which would increase the consolidated asset threshold from US\$1 billion, to US\$5 billion under the Federal Reserve's Small Bank Holding Company Policy Statement. [\[Press Statement\]](#)

# Enterprise & Consumer Compliance

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## Enforcement Actions

The Consumer Financial Protection Bureau (CFPB or Bureau) announced on December 7, 2015, that it had filed a federal complaint against a debt collection firm to address the CFPB's findings the firm violated the *Fair Debt Collection Practices Act*, the *Fair Credit Reporting Act*, and the prohibitions against unfair, deceptive, or abusive acts or practices of the *Consumer Financial Protection Act*. The firm had purchased a portfolio of old debt that it continued to collect and report

on, despite having learned that the portfolio contained fraudulent, paid, or settled debts. The CFPB's proposed consent order would require the firm to refund \$743,000 to consumers that paid debts that were disputed but the firm did not verify and pay a \$1.85 million in civil monetary penalty. In addition, the firm would be required to overhaul its debt collection practices, cease collecting and reporting on disputed debts, review, for a period of five years, original account-level documents verifying a debt before collecting it in certain instances, and also for a period of five years, cease reselling purchased debt.

## Legislative Actions

The House Committee on Financial Services passed the following bills on December 9, 2015:

- [H.R. 2205, the Data Security Act of 2015](#): which is intended to strengthen consumer protection against identity theft and fraud. It directs individuals, corporations or non-governmental entities that interact with sensitive consumer financial or other non-public data, to develop an information security plan to protect consumers' personal information.
- [H.R. 3700, the Housing Opportunity through Modernization Act of 2015](#): which is intended to promote greater efficiency in existing housing assistance programs and modernizes outdated rules and regulations. [\[Press Statement\]](#)

# Capital Markets and Investment Management

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## SEC Proposes New Derivatives Rules for Registered Funds

On December 11, 2015, the Securities and Exchange Commission (SEC) proposed a new rule to enhance the regulation of the use of derivatives by registered investment companies, including mutual funds, exchange-traded funds (ETFs) and closed-end funds, as well as business development companies. The proposed rule would limit funds' use of derivatives and require them to put risk management measures in place to ensure better investor protection. Funds would be required to comply with one of two alternative portfolio limitations designed to limit the amount of leverage the fund may obtain through derivatives and certain other transactions. Funds would also be required to manage the risks associated with their derivatives transactions by segregating certain assets to enable the fund to meet its obligations even under stressed market conditions. A fund that engages in more than the limited amount of derivatives transactions, or that uses complex derivatives would be required to establish a formalized derivatives risk management program. Comments on the proposal will be accepted for 90 days following publication in the *Federal Register*. [\[Press Statement\]](#) [\[Proposed Rule\]](#)

## CFTC Extends Time-Limited No-Action Relief from Certain Recordkeeping Requirements

The U.S. Commodity Futures Trading Commission's (CFTC) Division of Swap Dealer and Intermediary Oversight and Division of Market Oversight jointly issued a no-action letter. CFTC Staff Letter No. 15-65, on December 8, 2015, extending the relief previously provided in CFTC Staff Letter No. 14-147 (Letter 14-147), which is set to expire on December 31, 2015. The letter provides that commodity trading advisors that are registered with the CFTC and are members of designated contract markets or swap execution facilities, are not required to record oral communication. It also provides that market participants covered by the rule will not be required to link records of oral and written communications that lead to the execution of a transaction with any particular transaction. This no-action relief is effective immediately. [\[Press Statement\]](#) [\[CFTC Letter No. 15-65\]](#)

## FINRA Introduces New Trade Submissions Category

The Financial Industry Regulatory Authority (FINRA) issued Regulatory Notice 15-51 on December 8, 2015, to announce that it is introducing a new category of trade submissions – “clearing-only, non-regulatory reports” – that firms can use to submit to clearing those OTC transactions in equity securities that have been previously reported through a FINRA facility. Clearing-only, non-regulatory reports cannot be used for regulatory reporting purposes. As such, firms can only use these reports where their regulatory reporting obligations to FINRA have been satisfied through other submissions (tape reports or non-tape reports). The new trade submission category will become effective February 1, 2016. [\[Notice 15-51\]](#)

## IOSCO Publishes Hedge Fund Survey Report

On December 11, 2015, the International Organization of Securities Commissions (IOSCO) published its 3<sup>rd</sup> survey report on hedge funds entitled *IOSCO Hedge Fund Survey*, which provides an overview of the hedge fund industry as of September 30, 2014. Nearly 1,500 hedge fund managers and advisers were surveyed about the markets they operate in, their trading activities, leverage, funding, and counterparty information. IOSCO highlights the following survey findings:

- Hedge fund assets under management registered a 34 percent increase since the September 2012 survey and stood at \$2.6 trillion. This growth is mainly attributed to changes in asset values, net inflows, and fund structures;
- The hedge fund industry is largely concentrated in the U.S., U.S. dollar-based, and predominantly invested in North American assets;
- The use of equity-based strategies remains the most popular amongst hedge funds;
- Financial leverage is used by hedge funds across all jurisdictions, except in Japan;
- Reported data suggests there is no significant liquidity mismatch in hedge funds; and
- Hedge funds are aware of the market liquidity of their portfolios and can generally manage investor redemptions.

[\[Press Statement\]](#) [\[IOSCO Hedge Fund Survey\]](#)

## Enforcement Actions

The Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) announced the following enforcement actions in the past week:

- The SEC announced a series of enforcement actions against attorneys across the country that charged them with offering EB-5 investments (which is the government’s Immigrant Investor Program) despite not being registered to act as brokers. (Foreign investors in the EB-5 program may seek a path to U.S. residency by investing in a specific project that creates or preserves at least 10 U.S. jobs.) The attorneys allegedly received commissions for selling, recommending, and facilitating EB-5 investments, and have been charged for disregarding the relevant securities laws and regulations. Without admitting or denying the SEC’s findings, the attorneys and firms agreed to cease and desist from acting as unregistered brokers, and also paid civil penalties.
- The CFTC Issued an Order filing and simultaneously settling charges against an individual and his two companies for making false statement to the CFTC in their notices of exemption from registration. The Order also settles charges that the two of the Respondents engaged in foreign currency solicitation fraud, and one operated as a Commodity Trading Advisor without being registered with the CFTC. The Order imposes permanent trading and registration bans on the Respondents, bars them from any commodity-related activities, and requires them to jointly pay a \$70,000 civil monetary penalty.

## Legislative Actions

The House Committee on Financial Services passed the following bills on December 9, 2015:

- [H.R. 2187, the Fair Investment Opportunities for Professional Experts Act](#): which would amend the definition of an accredited investor in order to expand the pool of potential investors and enhance the ability of small and mid-sized business to raise capital.

- [H.R. 3784, the SEC Small Business Advocate Act of 2015](#): which would establish the Office for Small Business Capital Formation and the Small Business Advisory Committee within the SEC to help fulfill a part of the SEC's mission to facilitate capital formation.
- [H.R. 4168, the Small Business Capital Formation Enhancement Act](#): which would require the SEC to respond to any findings and recommendations put forth by the SEC's Government-Business Forum on Small Business Capital Formation. [\[Press Statement\]](#)

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