CAPCO CENTER OF REGULATORY INTELLIGENCE

REGULATORY INTELLIGENCE BRIEFING

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CAPCO

THE FUTURE. NOW.

IN THIS ISSUE

EDITORIAL NOTE: SHIFTING INTO A NEW YEAR

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2018 was full of uncertainty and ambiguity, and 2019 is likely to continue this trend. Whether it is an enduring trade war between the U.S. and China, breakdown of international norms and alliances, uncertainty from a hard Brexit or President Donald Trump and his administration's response to multiple investigations, financial institutions will need to focus on interpreting and analyzing rapidly shifting events that will shape financial services in the new year. Adding to these challenges is the 2020 election for which several democrats, and perhaps even a few republicans, are taking steps to run for U.S. president. The campaign for president will focus on many anti-Wall Street and financial services-related themes such as breaking up banks, compensation, hiring practices and conduct risk.

HEADLINE VERSUS GENUINE RISK

The immediate challenge before financial institutions in 2019 will be the ability to determine whether news, speeches, legislation, rulemaking or even an event, is a mere headline risk or a genuine risk that requires responding quickly and refocusing resources engrossed in day-to-day risk management or business functions. This is particularly challenging when there was a broad slowdown in rulemaking at the beginning of the Trump's term, and financial institutions were able to refocus hiring from a significant increase in compliance functions to other business-related functions.

STATE-LEVEL CHANGES

Because of the perception of federal deregulation, in 2018 financial institutions became challenged with tracking state legislation that was a response from governors and attorneys general who expressed the need for state laws and regulations to address perceived gaps in federal examinations of business practices or laws that were not responding to a rapidly changing product environment. At Capco we are tracking over 200 hundred impacts at the federal and state levels. The velocity and volume of information requires financial institutions to determine which require attention, either as actual requirements, best practices or 'nice-to-knows.'

OVERLAPPING JURISDICTIONS

This is becoming particularly challenging as financial institutions operate in multiple states and jurisdictions, and increasingly serve customers who may or may not be U.S. and/or dual citizens. We have seen these issues arise under the new EU General Data Protection Regulation (GDPR), but also under localized data and privacy proposals such as San Francisco's Privacy First Policy and Chicago City Council's Personal Data Collection and Protection Ordinance. We continue to expect states and local governments to step in and address perceived gaps in laws and regulations for financial services and products, which will require financial institutions to finetune their surveillance programs for regulatory changes down to the county and municipal levels.

POLITICAL SHIFTS

With democrats gaining control of more state legislatures, gubernatorial offices and control of the U.S. House of Representatives, financial institutions will see a more challenging political environment where tracking changes to state laws and regulations will become even more important to maintaining strong compliance management systems. While state tracking will become more important in 2019, it does not imply that there should be less oversight for changes to federal laws and regulations that impact financial services. Rather, we expect increased tracking requirements at both the federal and state levels, ensuring regulatory change management programs can expediently determine impacts from each notification captured and remove noise from a rapidly shifting environment.

A NEED FOR BIPARTISANSHIP

At the federal level, with republicans maintaining control of the White House and Senate, we look to a Congress and presidential administration that must face not only policy disagreements with democrats controlling the legislative agenda in the House, but also a quickly changing economic and demographic environment. Public policymakers must understand emerging technologies and changes in consumer behaviors and preferences, while addressing gaps in public policies and regulations that fail to consider innovation. The Trump administration will have to find bipartisan agreement to help financial institutions clarify and stabilize traditional financial services laws, and help the U.S. compete against nations whose regulatory regimes encourage innovation and deployment of products and services that can better serve consumers.

AREAS FOR REFORM

While there will be challenges for financial institutions in responding to a divided government, there will be areas where democrats and republicans have expressed common priorities, including in the areas of reforms to anti-money laundering (AML)/Bank Secrecy Act (BSA), flood insurance, Fannie Mae and Freddie Mac (the Enterprises or GSEs) and legislation to enact new data privacy, cybersecurity and credit reporting standards. There has also been bipartisan discussion on laws to safe harbor financial institutions who service marijuana and marijuana-related businesses (MRBs), and to better define laws and regulatory expectations when firms buy, partner and build fintech to better serve customers.

NEW LEADERSHIP

Where we expect the most headline risk is in the U.S. House of Representatives. Congresswoman Maxine Waters (D-CA) will become Chair of the House Committee on Financial Services, and is expected to focus on issues ranging from consumer protection, fair housing and lending to presidential administration oversight. She is expected to particularly focus on the Consumer Financial Protection Bureau (CFPB) and the new CFPB Director Kathy Kraninger's approach to enforcement, rulemaking and interpreting and clarifying existing rules. Waters' focus will include a review of former Acting Director Mick Mulvaney's tenure at the CFPB, including reductions or rejections of penalties under Mulvaney and changes to authorities under the CFPB's organizational structure. The financial industry should expect Waters to be open to bipartisan legislation in areas such as flood insurance, fintech, marijuana banking and privacy.

OVERSIGHT HEARINGS

Where we do see headline risk that could turn into compliance risk is in the areas where Waters is expected to hold oversight hearings for business practices in sales, consumer lending and human resources. While financial institutions may technically comply with a regulation, the hearings and financial institutions' corresponding compliance management policies and procedures could create perception problems that turn into business and compliance problems. Waters is expected to hold hearings with CEOs from financial institutions that had technical compliance failures in these areas and is expected to ask what steps these institutions have taken to address technical or perceived failures. The hearings will not be limited to financial institutions but will also take the form of oversight hearings for each of the federal financial regulators to spotlight how they supervise and examine for these practices. Capco will be closely monitoring the statements and any formal regulatory interpretations or clarifications in response to these hearings, as well as what actions trickle down into the actual examination process.

TAKING ACTION IN 2019

With Congress and most state legislatures beginning their legislative sessions in January, Q1 of 2019 will be the best time for financial institutions to review their federal and state tracking programs and ensure they have an effective process to review changes their programs capture. As 2019 progresses, it will be particularly important to examine congressional hearings and state laws that focus on business practices that receive heightened scrutiny and map that back to their own institutions compliance management system and corresponding policies, procedures, controls and testing environment.

This month's RIB highlights the most impactful changes of 2018 and the most important areas for financial institutions to keep in mind as we move into 2019. Capco will continue to monitor these areas into the new year, providing actionable intelligence to keep your institution proactively informed.

2018

EGRRCPA IMPLEMENTATION

Perhaps the most impactful development for the financial services industry in 2018 has been the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), which Trump signed into law on May 24, 2018.

In response to questions from various stakeholders, the Federal Reserve Board (FRB), Federal Deposit Insurance Corporation (FDIC) and Office of the Comptroller of the Currency (OCC) issued an Interagency Statement regarding the impact of EGRRCPA, clarifying to financial institutions how the agencies would administer certain provisions of the Act. Some EGRRCPA provisions became effective upon enactment or soon thereafter, but in certain cases, agencies had to revise their regulations to reflect changes in the law. The Interagency Statement provided information on the positions agencies would take until the agencies amend their regulations to incorporate EGRRCPA's changes.

On October 2, 2018, a hearing before the Senate Committee on Banking, Housing, and Urban Affairs titled "Implementation of the Economic Growth, Regulatory Relief, and Consumer Protection Act" included witnesses:

- Comptroller of the Currency Joseph Otting;
- FRB Vice Chairman for Supervision Randal Quarles;
- FDIC Chairman Jelena McWilliams; and
- National Credit Union Administration (NCUA) Chairman J. Mark McWatters.

In his testimony, Otting described the progress the OCC, both independently and working with the other agencies, has made since the Interagency Statement. These areas included:

- **Thrift charter flexibility:** On September 10, 2018, the OCC issued a notice of proposed rulemaking (NPR) to implement a new section of the Home Owners' Loan Act added by section 206 of EGRRCPA. This proposal would allow a federal savings association with total consolidated assets of $20 billion or less to elect to operate as a "covered savings association," with the same rights and privileges (and subject to the same duties and restrictions) as a similarly located national bank, but retaining the association's charter and existing governance framework.

- **HVCRE:** Section 214 of EGRRCPA allows agencies to require an institution to assign a heightened risk weight to a high volatility commercial real estate (HVCRE) exposure only if it meets EGRRCPA's new definition of an HVCRE acquisition, development and construction loan. On September 18, 2018, the agencies jointly issued an NPR to implement the statutory definition.
- **Examination cycle:** On August 23, 2018, the agencies jointly issued interim final rules implementing changes to their examination cycles. Section 210 of EGRCCPA increases the asset threshold for 18-month examination cycle eligibility from institutions under $1 billion in total assets to those under $3 billion. The 18-month cycle, under the interim final rules, is now available to a larger number of qualifying 1- and 2-rated institutions.

- **High quality liquid assets (HQLA):** Section 403 of EGRRCPA directed the agencies to consider certain municipal obligations to be HQLA, including for the liquidity coverage ratio (LCR). The Interagency Statement explained that the agencies will not require an institution subject to the liquidity regulations to exclude municipal obligations believed to meet the statutory criteria for inclusion in HQLA from the definition of HQLA. On August 22, 2018, the agencies jointly issued interim final rules to implement this statutory provision.

- **Community bank leverage ratio:** On November 21, 2018, the agencies issued a request for comment on a proposal to change regulatory capital requirements for qualifying community banking organizations, as required by section 201 of EGRRCPA, which directs the agencies to develop a community bank leverage ratio (CBLR) of not less than 8 percent and not more than 10 percent for qualifying community banking organizations (with "CBLR" defined as the ratio of an institution's tangible equity to its average total consolidated assets, both as reported on the organization's applicable regulatory filing). Under the proposal, to determine eligibility, regulatory agencies will consider off-balance sheet exposure, trading assets and liabilities, total notional derivatives exposures and other factors as the agencies determine appropriate; and an institution must meet certain capital ratio requirements:

    - Less than $10 billion in total consolidated assets
    - Limited amounts of certain assets and off-balance sheet exposures
    - A community bank leverage ratio greater than 9 percent

  If an institution qualifies and chooses the proposed framework, it would not be required to calculate the existing risk-based and leverage capital requirements. Additionally, a firm that has a community bank leverage ratio greater than 9 percent would also be considered to have met the capital ratio requirements to be well capitalized for the agencies' prompt corrective action rules.

- **Asset threshold for short form Call Report:** For institutions with less than $5 billion in total consolidated assets, section 205 of EGRRCPA provides for reduced reporting requirements on Call Reports for Q1 and Q3. On November 7, 2018, The agencies issued a proposal to reduce reporting requirements for small depository institutions, such that only 63 percent of data items would be required in Q1 and Q3.

- **Periodic stress testing:** On December 28, 2018, the FDIC proposed a rule to revise the FDIC's requirements for stress testing by FDIC-supervised institutions, consistent with section 401 of EGRRCPA made. Specifically, the proposed rule would amend the FDIC's existing stress testing regulations to change the minimum threshold for applicability from $10 billion to $250 billion, revise the frequency of required stress tests by FDIC-supervised institutions and reduce the number of required stress testing scenarios from three to two.

- **Supplementary leverage ratio:** Under section 402 of EGRRCPA, the agencies are looking to revise the leverage ratio requirements applicable to the largest U.S. banking organizations.

In addition to the areas Otting mentioned for interagency review, Quarles discussed actions the FRB has taken toward implementing EGRRCPA provisions, including:

- Expanding eligibility of community banking firms for the Small Bank Holding Company Policy Statement, and for longer, 18-month examination cycles
- Giving bank holding companies below $100 billion in assets immediate relief from supervisory assessments, stress testing requirements and some additional Dodd-Frank Act prudential measures
- Implementing changes to liquidity regulation of municipal securities and capital regulation of HVCRE exposures

The FRB also announced two proposals under EGRRCPA on October 31, 2018, focusing on changes to applicability thresholds for regulatory capital and liquidity requirements and prudential standards for large bank holding companies and savings and loan holding companies. The proposals include:

- Relief from advanced approaches capital requirements;
- A reduced liquidity coverage ratio;
- Changes to the frequency of supervisory and company-run stress testing; and
- In some cases, the disclosure of the results.

McWilliams and McWatters added a few more areas in their testimonies, discussing efforts toward:

- **Appraisals for Residential Loans in Rural Areas:** Section 103 of EGRRCPA became effective immediately, exempting from the agencies' appraisal requirements certain loans secured by real property. The agencies are currently working on changes to existing regulations. At its September 2018 Board meeting, the NCUA Board proposed amendments to incorporate the EGRRCPA provisions.
- **Reciprocal Deposits:** Section 202, effective upon enactment, provides that reciprocal deposits will not be considered funds obtained, directly or indirectly, by or through a deposit broker under section 29 of the Federal Deposit Insurance Act, under certain circumstances. The June 30, 2018, Call Report Instructions reflected the reporting change from brokered to non-brokered treatment of specified reciprocal deposits. On September 12, 2018, the FDIC issued an NPR to conform its brokered deposit regulation to section 202.
- **Volcker Rule:** Section 203 of EGRRCPA amends section 13 of the Bank Holding Company Act to redefine "banking entity," which includes an insured depository institution or a company that controls an insured depository institution. Under EGRRCPA, the term "insured depository institution" does not include an institution
  - that functions solely in a trust or fiduciary capacity (subject to certain conditions) or
  - that does not have and is not controlled by a company that has
    - more than $10 billion in total consolidated assets and
    - total trading assets and trading liabilities that are more than 5 percent of total consolidated assets.

  Section 204 of EGRRCPA, effective on enactment, removes specific naming restrictions on covered funds, enabling hedge funds or private equity funds to share a name with a banking entity that is an investment adviser to the fund, under certain conditions.

  On December 18, 2018, the FDIC, FRB, SEC, OCC and Commodity Futures Trading Commission (CFTC) issued an NPR and requested comment on a proposal to amend regulations implementing section 13 of the Bank Holding Company Act (the Volcker Rule), to align regulations with sections 203 and 204 of EGRRCPA.
- **Member Business Lending (Loans for Non-primary Residences):** Section 105 of EGRRCPA changed the definition of a "member business loan" under the Federal Credit Union Act, addressing a statutory disparity in how certain residential real estate loans that credit unions and banks make are treated. The revised definition now excludes all extensions of credit fully secured by a lien on a one-to-four-family dwelling, irrespective of the borrower's occupancy status. These loans no longer count toward the aggregate member business loan cap the Federal Credit Union Act places on most federally insured credit unions. Effective upon enactment, the NCUA immediately issued a final rule to include the change in commercial and member business lending regulation. McWatters emphasized the NCUA's support for additional legislative action in this area, including an additional exemption for loans to small businesses.

On October 17, 2018, the CFPB published its Fall 2018 rulemaking agenda, which includes rulemaking initiatives aimed at implementing EGRRCPA provisions. The agency has already issued two rules relating to EGRRCPA:

- **An interim final rule that adjusts certain Fair Credit Reporting Act (FCRA) forms:**

  The interim final rule became effective on September 21, 2018, but the CFPB accepted comments until November 19, 2018. The new section requires that a consumer receives a new notice of rights whenever the consumer is required to receive a summary of rights required by FCRA section 609. The interim final rule amends the model forms in Appendices I and K (model summary of rights to obtain and dispute information in consumer reports and to obtain credit scores; and a model summary of rights of identity theft victims) to incorporate the new required notice, among other things.

The Summary of Consumer Rights includes the right to obtain a copy of a consumer report, the frequency and circumstances under which a consumer is entitled to receive a free consumer report, the right to dispute information in a consumer's file and the right to obtain a credit score. A consumer reporting agency must provide a Summary whenever it makes a written disclosure of information from a consumer's file or a credit score to the consumer.

- **An interpretive and procedural rule that clarifies aspects of HMDA:** This interpretive and procedural rule, issued September 7, 2018, implements and clarifies the requirements of section 104(a) of the EGRRCPA, which amended various HMDA provisions. The rule clarifies:
    - That as long as insured depository institutions and insured credit unions covered by a partial exemption under EGRRCPA report all data fields within any exempt data point for which they report data, they have the option of reporting exempt data fields;
    - That only loans and lines of credit that are otherwise HMDA-reportable count toward the thresholds for the partial exemptions;
    - Which of the data points the partial exemptions cover;
    - A designation for a non-universal loan identifier for partially exempt transactions for institutions that choose not to report a universal loan identifier; and
    - EGRRCPA's exception to the partial exemptions for negative Community Reinvestment Act (CRA) examination history.

  On October 30, 2018, the CFPB issued a revised version of the HMDA Small Entity Compliance Guide, to reflect EGRRCPA partial exemptions and this interpretive and procedural rule.

As additional efforts to follow directives under EGRRCPA, the CFPB added several new rulemaking initiatives to the agenda, including:

- A rulemaking to exempt certain creditors with assets of $10 billion or less from certain mortgage escrow requirements under the Dodd-Frank Act
- A rulemaking to develop standards for assessing consumers' ability to repay "Property Assessed Clean Energy" financing (PACE), which results in a tax assessment on a consumer's home and covers the costs of home improvements, often to increase energy efficiency.

HDMA CHANGES

Home Mortgage Disclosure Act (HMDA) saw many impactful developments in 2018. On January 1, 2018, new requirements went into effect including changes to the types of institutions subject to HMDA, the types of transactions subject to HMDA, data points required in HMDA collection and processes for reporting and disclosing data.

With EGRRCPA's passage, confusion reigned as to what HMDA reform would look like before the CFPB published a final rule with clarifications on August 31, 2018. On July 5, 2018, the CFPB, FDIC and OCC released statements clarifying EGRRCPA HMDA amendments.

The 2018 rule exempts small-volume lenders from the expanded reporting requirements (those that became effective on January 1, 2018) if certain conditions are met:

- For closed-end mortgage reporting, the institution must have originated fewer than 500 of such loans in each of the preceding two calendars years.
- For HELOCs, the institution must have originated fewer than 500 of such loans in each of the preceding two calendars years.
- The bureau also clarified that only those loans that would otherwise be HMDA-reportable count toward meeting the 500-loan threshold to qualify for the partial exemption.

A 2017 final HMDA rule had already temporarily raised the HELOC threshold from 100 to 500 loan originations. The CFPB-revised rule only temporarily raises the threshold to 500 for 2018 and 2019 for any HELOC reporting so it is possible EGRRCPA could not affect the 500-HELOC threshold until 2020.

Though the Loan Application Register (LAR) format has not and will not change, institutions that do not report information for certain data fields under HMDA's partial exemptions now enter exemption codes specified in the revised 2018 Filing Instructions Guide (FIG) released September 2018. Small creditors that receive a less than Satisfactory CRA rating, however, are required to file all 110 data fields. The CFPB released the 2019 FIG in October 2018.

Small creditors also became exempt from collecting, recording and reporting sections 5 and 6 of the Dodd-Frank Act and instead are now to only report the data as they did in 2017, with one caveat — age. Even though sections 5 and 6 have been removed, the requirement to report age continues, as listed in HMDA section (b)(4). Section 1094(3)(A)(i) of the Dodd-Frank Act amended HMDA section 304(b)(4) to require financial institutions to report an applicant's or borrower's age.

In 2018, the requirement to report the rate spread remains, though it is calculated differently than it was under the 2017 rules. Property type isn't collected in 2018, but was in 2017, and property location was reported differently.

On December 21, 2018, the CFPB issued final policy guidance describing modifications it intends to apply to the HMDA data reported by financial institutions before the data are made available to the public on the loan level.

January 1, 2019, marked the effective date for changes to enforcement provisions and additional amendments to reporting provisions. January 1, 2020 will mark the effective date for the quarterly reporting provision.

MARIJUANA BANKING

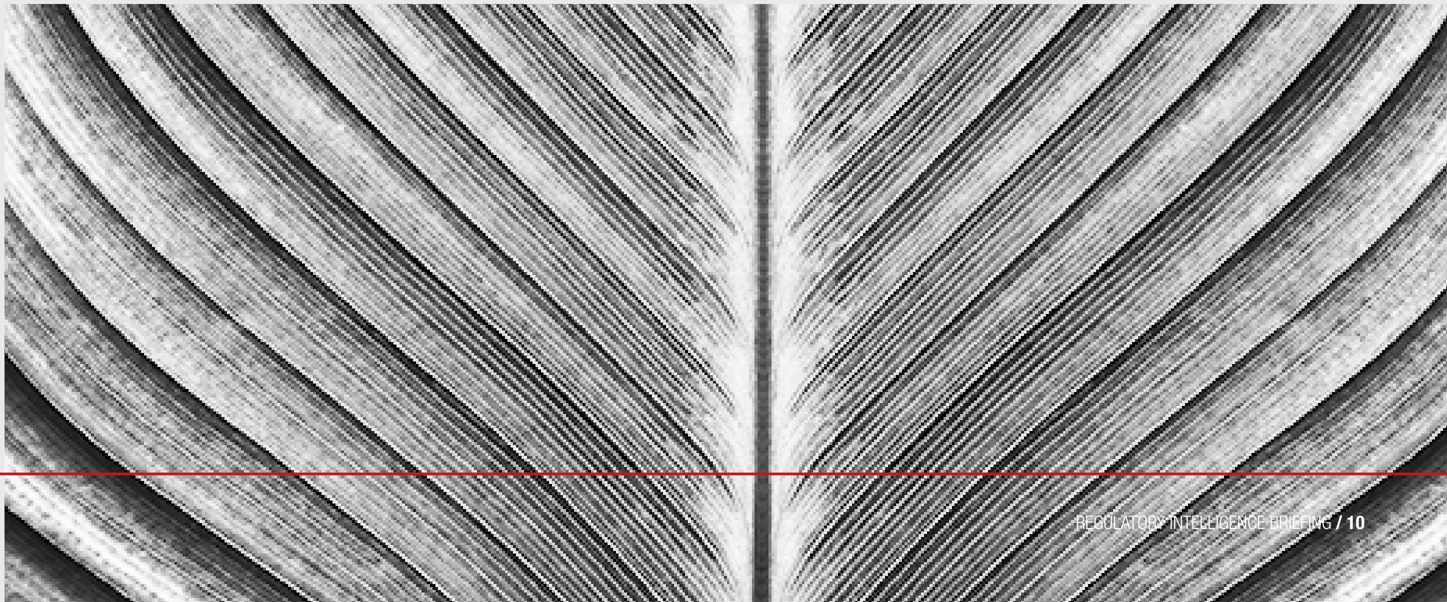
On January 4, 2018, former Attorney General Jeff Sessions issued a memo which rescinded the Cole memo and other previously issued nationwide guidance, and returned federal prosecution back to where the Department of Justice (DOJ) stood prior to the issuance of the Cole memo. Though the federal government never legalized marijuana, it had taken a relaxed approach toward enforcement where state law did not conflict with eight specific enforcement priorities. In effect, all Sessions did was reinforce the law was in place all along, but the message was clear that federal regulation easements were not on the horizon, and those in the industry stood less protected.

However, the Financial Crimes Enforcement Network (FinCEN) indicated that banking institutions should continue to follow its February 2014 guidance, "BSA Expectations Regarding Marijuana-Related Businesses," which clarifies expectations for financial institutions seeking to provide services to MRBs. The guidance sets forth how financial institutions can provide services to MRBs consistent with their BSA obligations and reporting requirements with federal and state law enforcement priorities.

On December 17, the Senate rejected legislation submitted by Senator Cory Gardner (R-CO) that would ease the cannabis industry's access to financial services by federally legalizing marijuana and allowing states to regulate their own medical and recreational cannabis markets. Though it did not pass, the amendment (included as part of a criminal justice reform bill) highlights the inconsistencies between laws at the federal level and the laws of certain states. After elections this year, 33 states and the District of Columbia currently have passed laws broadly allowing marijuana in some form (recreational and/or medical). Legislators continue discussions aimed at reconciling discrepancies.

On December 20, 2018, Trump signed into law the Agriculture Improvement Act of 2018 and removed hemp, a nonintoxicating variant of cannabis with lower THC levels than marijuana, from the Controlled Substances Act (CSA). Many believe this will allow the hemp industry to grow rapidly at a nation-wide level, as activities involving the plant are now federally legal, including producing, marketing and banking the crop and its products (largely cannabidiol (CBD)). Upon the Act's passage, the Food and Drug Administration (FDA) put out a statement regarding the regulation of cannabis.

It is important to note that marijuana remains an illegal substance under the CSA, and that any institution considering providing financial services to an MRB or an ancillary business consult with their legal counsel prior to engagement.



FINTECH

The financial services industry has similar regulatory sentiments across multiple fintech platforms: at the federal level, it seems regulators are both excited to explore the implications of new and innovative approaches, but also wary of the risks these uncharted territories may pose.

On December 3, 2018, the FRB, FDIC, FinCEN, NCUA and OCC issued a joint statement to encourage institutions to "consider, evaluate and, where appropriate, responsibly implement innovative approaches to meet their Bank Secrecy Act/anti-money laundering (BSA/AML) compliance obligations, in order to further strengthen the financial system against illicit financial activity." The statement provides certain examples of this type of innovation, including building or enhancing internal financial artificial intelligence (AI) units devoted to identifying complex and strategic illicit finance vulnerabilities and threats, through risk identification, transaction monitoring and/or suspicious activity reporting.

It is important to note two aspects of this joint encouragement toward AI and machine learning:

1. There is an emphasis on the fact that these AI units are internal, and not consumer-facing. Regulators have thus far been far more cautious regarding consumer-facing innovative products.
2. While the agencies stated they will work with institutions who wish to take more innovative approaches, there is no official sandbox.

In 2018, this type of caution at the federal level caused a few states to begin taking fintech regulation into their own hands. In March 2018, Arizona became the first state to enact a law that allows for establishing a fintech regulatory sandbox program, while Illinois proposed a similar program and six states sought to create a multi-state sandbox called "The New England FinTech Sandbox." Both Arizona and Illinois were also considering implementing programs to allow residents to pay their taxes in virtual currencies.

Continuing the trend of states taking action in fintech where federal action has stalled, Ohio recently launched Ohiocrypto.com, a website that allows businesses to pay taxes with cryptocurrencies. Ohio Treasurer Josh Mandel says that he hopes the new option will democratize finance and entice fintech-friendly developers to Ohio. The state is working with a third party to convert digital currencies to fiat currency, thus reducing the risk of cryptocurrency transactions by never actually holding them. The state also now legally recognizes data stored and transacted on a blockchain, so that electronic signatures secured through blockchain technology have the same legal standing as any other electronic signatures.

At the federal level, 2018 did see some movement in the fintech regulatory space. The OCC moved forward with their Special Purpose National Bank (SPNB) Charter for fintech firms, announcing in July that they would begin accepting applications. Backlash and legal battles continue, however, and on November 16, 2018, the OCC submitted a letter to the Southern District of New York court announcing the intent to dismiss a complaint brought by New York Department of Financial Services (NY DFS) for the second lawsuit the state agency has brought against the OCC. In its letter, the OCC reminded the court that no firm has yet applied for the SPNB Charter.

CORPORATE GOVERNANCE

2018 put corporate governance in the spotlight, with regulators paying particular attention to how financial institutions are ensuring corporate governance structures that appropriately mitigate risk and noncompliance. The OCC has taken on a role in this supervision process and reflects the current focus on the criticality of thorough corporate governance structures, stating "Corporate and risk governance is the framework in which all risks are managed at a bank as well as the oversight of the framework."

In a multi-year review of boards of directors' practices to support new guidance creation, the FRB found that "supervisory expectations for boards of directors and senior management have become increasingly difficult to distinguish." The agency also stated that "Greater clarity regarding these supervisory expectations could improve corporate governance overall, increase efficiency, support greater accountability, and promote compliance with laws and regulations."

Several enforcement actions in 2018 highlighted cracks in corporate governance. On December 18, 2018, for example, NY DFS announced fines totaling $15 million against a large U.K.-based institution and its New York branch for attempts by the bank's CEO to identify the author(s) of two whistleblowing letters. The NY DFS investigation found "shortcomings in governance, controls and corporate culture relating to [the bank's] whistleblowing function" and that "Several members of senior management failed to follow or apply whistleblowing policies and procedures in a manner that protected the CEO and the bank itself."

In fact, in the Security and Exchange Commission's (SEC) 2018 Annual Report to Congress – Whistleblower Program, the agency noted that 2018 has been a record-breaking year for the program, with the agency awarding more money to whistleblowers in 2018 than in all prior years of the program's existence combined.

And civil money penalties were not the only way in which regulators took action against institutions for corporate governance issues. After finding a large U.S. bank had not met corporate governance expectations, the FRB has disallowed the bank to increase its total consolidated assets to above December 31, 2017, levels until the bank created an acceptable plan — which it has thus far not successfully provided. Additionally, the FRB sent letters of disapproval to the bank's board, former CEO and a past independent director, demanding a larger focus on corporate governance from the individuals; and the bank agreed to replace four board members.

Another trending area of corporate governance is proxy activities. A recent public roundtable focused on key aspects of the proxy system, including proxy voting mechanics, the shareholder proposal process and the role and regulation of proxy advisory firms. Additionally, a group of Senators introduced legislation on November 14, 2018, that would require proxy advisors to register with the SEC and subject proxy advisors' policies on conflicts of interest to periodic SEC review. Moving into 2019, we may see more activity in this area.

ENFORCEMENT HIGHLIGHTS

CRI analysts monitor federal enforcement activity and identify trends from year to year. In 2018, the trend from previous years showed a general decrease in activity from the main banking authorities, with a larger drop at the CFPB and an increase in activity at the DOJ.

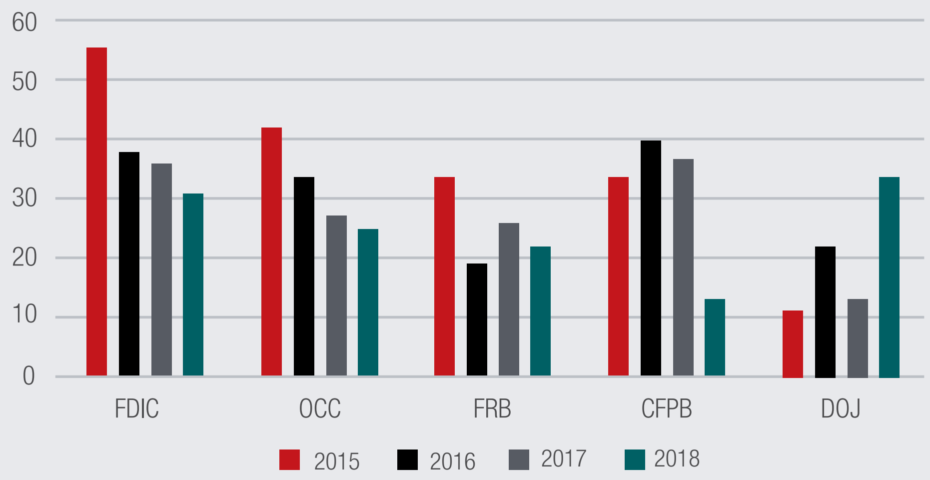
As we saw in 2017, the federal banking agencies, along with FinCEN and Office of Foreign Assets Control (OFAC), continued in 2018 to cite institutions for issues related to their BSA, AML and sanctions programs. The agencies remain focused on institutions that fail to implement and maintain effective, risk-based AML programs, with several consent orders calling for remediation of deficient programs. Other issues include oversight of compliance with U.S. economic sanctions and failure to file suspicious activity reports (SARs).

Another trend in 2018 included a focus on unfair, deceptive or abusive acts or practices (CFPB's UDAAP and the FTC's UDAP). While the CFPB's overall enforcement activity waned, the agency continued to rely on UDAAP as an impetus for action. In many cases, the root cause for action was a gap between what an institution told consumers it would do (in marketing and/or in disclosures) and the actual business practices in place within the institution. Regulators found issues related to credit card and annual percentage rate disclosures, overdraft treatments, consumer loan and deposit account add-on products, mortgage refinance products, prepaid products and deposit account processing.

Of note, the regulatory agencies made public enforcement actions against institutions of all sizes. While many of the larger, high-profile actions centered on large, global banks (with some fines up to $1 billion), others dealt with community banks and other entities connected to the financial services industry (including law firms, nonbank lenders, debt buyers and collectors and others). Some of the miscellaneous enforcement topics from 2018 included: fraud, foreign exchange price-fixing, London Interbank Offered Rate (LIBOR) manipulation, compliance with the Servicemembers Civil Relief Act (SCRA), bribery and False Claims Act violations in connection with HUD/FHA lending.

As the industry continues into the new year, Capco CRI will continue to monitor these and other emerging trends, especially as the leadership at the various agencies settles into a full year of managing their respective organizations.

ENFORCEMENT BY AGENCY 2015 – 2018



Data for 2018 is projected full-year data based on enforcement actions reported through December 31, 2018.

Totals may not reflect total number of actual enforcement actions due to certain actions filed jointly by multiple agencies.

Source: Research and analysis by the Capco Center of Regulatory Intelligence

TIMELINE FOR 2018

January 1
2018

Agencies Release Annual CRA Asset-size Threshold Adjustments

The FRB, FDIC and OCC announced the annual adjustment to the asset-size thresholds used to define "small bank," "small savings association," "intermediate small bank" and "intermediate small savings association" under CRA regulations.

January 1
2018

Agencies Finalize CRA Amendments

The FRB, FDIC and OCC amended their respective CRA regulations to conform to the CFPB's changes to Regulation C (HMDA).

January 1
2018

CFPB Finalizes Regulation B Amendments

The CFPB finalized amendments to Regulation B (ECOA) to help facilitate compliance with Regulation C (HMDA) and add flexibility for continued compliance with Regulation B. The section related to removing a reference to the "Uniform Residential Loan Application" is not effective until January 1, 2022.

January 1
2018

CFPB Updates HELOC Threshold in HMDA Rule

The CFPB finalized reporting requirements for banks and credit unions that issue HELOCs. On a temporary basis, financial institutions must report HELOCs if they made 500 or more such loans in each of the last two years (rather than the previously published threshold of 100).

January 1
2018

CFPB Final Rule on HMDA Data Reporting

The CFPB issued a final rule to amend HMDA mortgage data reporting requirements, including new reportable data fields and new requirements for small depository institutions to be exempt from reporting requirements. Most new requirements become effective on January 1, 2018, with other requirements effective between January 2017 and January 2020.

January 1
2018

Agencies Issue Supplementary Leverage Ratio Final Rule

The FRB, FDIC and OCC adopted a final rule to modify the definition of the denominator of the supplementary leverage ratio for consistency with recent changes agreed to by the BCBS. The revisions apply to all banking organizations subject to the advanced approaches risk-based capital rule. The rule became effective January 1, 2015, with certain provisions requiring compliance by January 1, 2018.

January 1
2018

Agencies Finalize Regulatory Capital Rules for Large Bank Holding Companies

FDIC, OCC and FRB adopted a final rule to strengthen the leverage requirements applicable to the largest, most systemically important banking organizations and their subsidiary insured depository institutions. The final rule only applies to U.S. top-tier bank holding companies with at least $700 billion in total consolidated assets or at least $10 trillion in assets under custody and any insured depository institution subsidiary. Some supplementary leverage ratio reporting began in 2015.

March 15
2018

Federal Court Updates Status of DOL Fiduciary Rule

On March 15, 2018, the U.S. Court of Appeals for the Fifth Circuit vacated the Department of Labor's (DOL) Fiduciary Rule. It is yet to be determined if any further appeals will take place. The DOL finalized an 18-month extension, from January 1, 2018, to July 1, 2019, of the special transition period for the Fiduciary Rule's Best Interest Contract (BIC) Exemption and the Principal Transactions Exemption. The rule also includes amendments to Prohibited Transaction Exemption 84-24.

TIMELINE FOR 2018 CONTINUED

April 19 2018

CFPB Takes Actions on Mortgage Servicing Rules

The CFPB updated the timing requirements for instances when mortgage servicers must transition to providing modified or unmodified periodic statements and coupon books in connection with a consumer's bankruptcy case. Additionally, the CFPB issued three rules with points requiring compliance by October 19, 2018, and April 19, 2018: a final rule with several non-substantive corrections to the 2016 mortgage servicing amendments; final rule to amend certain mortgage servicing provisions under Regulation X (Real Estate Settlement Procedures Act) and certain requirements under Regulation Z (Truth in Lending Act), addressing successors in interest, debtors in bankruptcy and cease communication requests under the Fair Debt Collection Practices Act (FDCPA); and an interpretive rule under the FDCPA to clarify the interaction between the FDCPA and specified mortgage servicing rules in Regulations X and Z, providing safe harbors for certain mortgage servicers.

May 11 2018

FinCEN Issues CDD Final Rule

FinCEN released a final rule on Customer Due Diligence (CDD Rule) under the BSA, including new requirements to identify and verify the identity of beneficial owners of legal entity customers. On September 28, 2017, FinCEN added a few technical corrections to the rule to eliminate confusion in terminology and to fix a reference to a training requirement that was inadvertently removed in the 2016 final rule.

June 1 2018

NCUA Issues Final Rule on Tailored Stress Tests

The NCUA announced a final rule to tailor stress test requirements to a covered credit union's size.

June 1 2018

CFPB Finalizes Amendment to KBYO Mortgage Disclosure Rule

The CFPB finalized an amendment to its Know Before You Owe (KBYO) Mortgage Disclosure Rule that addresses when mortgage lenders with a valid justification may pass on increased closing costs to consumers and disclose them on a Closing Disclosure.

June 1 2018

SEC Adopts Rules on Disclosure Requirements

The SEC adopted rules to modernize and enhance reporting and disclosure requirements related to information provided by registered investment companies. The effective dates are June 1, 2018, and June 1, 2019, depending on the fund's asset size.

June 5 2018

NCUA Announces Final Rule on One- to Four-unit Properties

The NCUA announced a final rule with a provision that federal credit unions no longer have to count loans made on any one- to four-unit family dwellings as "member business loans."

July 1 2018

FRB Finalizes Regulation CC Amendments on Electronic Checks

The FRB finalized Regulation CC (Availability of Funds and Collection of Checks) amendments to create a framework for electronic check collection and return, and to create new warranties for electronic checks.

September 1 2018

NCUA Approves Changes to Field-of-membership Rule

The NCUA amended its chartering and field-of-membership rules with respect to applicants for a community charter approval, expansion or conversion.

TIMELINE FOR 2018 CONTINUED

September 7 2018

CFPB Issues Rule to Implement and Clarify New HMDA Amendments

The CFPB issued an interpretive and procedural rule to implement and clarify the requirements of section 104(a) of EGRRCPA, which amended HMDA.

September 17 2018

CFPB Finalizes Regulation P Amendment

The CFPB finalized amendments to Regulation P (Gramm-Leach-Bliley Act) to implement legislation that allows financial institutions that meet certain requirements to be exempt from sending annual privacy notices to their customers.

October 1 2018

CFPB Finalizes Updates to KBYO Mortgage Disclosure Rule

The CFPB finalized updates to the KBYO rule to formalize guidance; provide greater clarity and certainty; and help facilitate compliance within the mortgage industry. The changes relate to tolerances for the total of payments calculation, housing assistance lending, cooperatives and privacy. The rule is effective October 10, 2017, with a mandatory compliance date of October 1, 2018.

December 21 2018

CFPB Adopts Policy Guidance related to Public Disclosure of HMDA Data

The CFPB adopted policy guidance related to the loan-level HMDA data that the CFPB plans to make available to the public beginning in 2019. The guidance outlines recommended modifications to the data intended to protect consumers' privacy, such as excluding certain fields and disclosing certain information with reduced precision (e.g., using age ranges instead of reporting exact ages).

2019

TIMELINE FOR 2019 IMPORTANT DATES

January 1 2019

FRB Finalizes Amendments to Regulation J

The FRB simplified Regulation J (Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers through Fedwire) to make it conform more closely with Regulation CC (Availability of Funds and Collection of Checks).

January 1 2019

FRB Finalizes Regulation CC's Liability Provisions

The FRB amended Regulation CC's existing liability provisions to include a presumption that a substitute or electronic check was altered instead of forged in certain cases of doubt.

January 1 2019

SEC Issues Final Rule on Internet Availability of Investment Company Shareholder Reports

The SEC adopted new rule 30e-3 under the Investment Company Act of 1940. Subject to conditions, new rule 30e-3 provides certain registered investment companies with an optional method to satisfy their obligations to transmit shareholder reports by making such reports and other materials accessible at a website address specified in a notice to investors. This rule is effective January 1, 2019, with select provisions effective on January 1, 2021, and January 1, 2022.

January 14 2019

SEC Adopts FAIR Act Rules to Promote Investment Funds Research

The SEC adopted rules and amendments in furtherance of the Fair Access to Investment Research (FAIR) Act's mandates to reduce obstacles to providing research on investment funds. The rule is effective January 14, 2019, with some provisions effective on May 1, 2020.

January 18 2019

SEC Adopts Rule regarding Disclosure of Order Handling Information

The SEC announced a final rule that will require broker-dealers to disclose to investors new and enhanced information about the way the broker-dealers handle investors' orders. This rule is effective January 18, 2019, with a compliance date of May 20, 2019.

January 28 2019

Agencies Finalize Rule on Examination Cycles

The FRB, FDIC and OCC adopted final rules to allow qualifying insured depository institutions with less than $3 billion in total assets to benefit from an extended 18-month on-site examination cycle.

February 1 2019

FRB Adopts New Rating System for Large Financial Institutions

The FRB finalized a new supervisory rating system for large financial institutions that is aligned with the core areas most important to supporting a large firm's safety and soundness and U.S. financial stability.

TIMELINE FOR 2019 CONTINUED

February 5 2019

FDIC Adopts Rule on Reciprocal Deposit Treatment

The FDIC adopted a rule on the treatment of reciprocal deposits, to conform the FDIC's current regulations with recent changes to section 29 of the Federal Deposit Insurance Act. The rule is effective 30 days after publication in the Federal Register.

April 1 2019

CFPB Extends Effective Date for and Amends Prepaid Rule

The CFPB finalized updates to its prepaid rule, including a delay in the overall rule's effective date to April 1, 2019. The main amendments to the rule relate to error resolution requirements, account registration and protections for when a card is set up electronically in a digital wallet. The CFPB also issued a final rule to increase consumer protections for prepaid account users.

April 1 2019

FRB Adopts Revisions to Regulatory Capital Rules regarding CECL Methodology

The FRB, OCC and FDIC approved a rule to revise its regulatory capital rules to address and provide an option to phase in the regulatory capital effects of the new accounting standard for credit losses, known as the "Current Expected Credit Losses" (CECL) methodology.

May 31 2019

Congress Reauthorizes NFIP

Congress approved, and Trump signed, legislation to extend the National Flood Insurance Program's (NFIP) authorization until May 31, 2019.

July 1 2019

SEC Adopts Final Rules for Disclosure of Hedging Policies

The SEC approved final rules to require companies to disclose, in proxy or information statements for the election of directors, any practices or policies regarding the ability of employees or directors to engage in certain hedging transactions with respect to company equity securities. The rule has a compliance ate of July 1, 2019 or July 1, 2020.

August 19 2019

CFPB Finalizes Payday Loan/Debt Trap Rule

The CFPB finalized a rule on payday, vehicle title and certain other high-cost installment loans. The rule looks to stop payday debt traps by requiring lenders to determine upfront whether people can afford to repay their loans and curtailing lenders' repeated attempts to debit payments from a borrower's bank account.

September 20 2019

NACHA Announces Rules to Expand Same Day ACH Capabilities

NACHA announced the approval of three rules that will expand the capabilities of Same Day ACH for all financial institutions and their customers. The rules cover the daily operating window, the threshold and the speed of availability for these transactions. The rules will become effective between September 20, 2019, and September 18, 2020.

December 31 2019

Foreclosure Protections Extended for Service Members

Trump signed into law the National Defense Authorization Act for Fiscal Year 2018, which extended until the end of 2019 a one-year foreclosure protection period following active duty.

AGENCY AGENDAS

COMMODITY FUTURES TRADING COMMISSION (CFTC)

Approved a supplemental NPR for **Regulation Automated Trading**, planning a series of risks controls, transparency measures, and other safeguards to enhance the security and reliability of automated trading on all designated contracts markets (DCMs). *Set to be finalized June 2019.*

Approved the **Indemnification** Final Rule, repealing section 21(d) of the Commodity Exchange Act (CEA), introduced through the Dodd-Frank Act. This rule requires domestic and foreign regulators to agree, in writing, to abide by CEA confidentiality requirements and to indemnify the Swap Data Repository (SDR) and the CFTC for any expenses arising from litigation relating to the information provided by the SDR. *Became effective August 13, 2018.*

FEDERAL RESERVE BOARD (FRB)

Amending **Regulation CC (Availability of Funds and Collection of Checks)**, which implements the funds-availability and disclosure provisions of the Expedited Funds Availability Act (EFAA). Regulation CC was implemented to address concerns about the lengths of holds banks were placing on checks deposited by their customers, and was intended to address the issue of delayed availability of funds by banks. *Final rulemaking stage.*

Implementing **Regulation LL (Savings and Loan Holding Companies)** to modify regulations that transferred responsibility for supervision of Savings and Loan Holding Companies (SLHCs) and their non-depository subsidiaries from the Office of Thrift Supervision (OTS) to the FRB. This rulemaking also includes **Regulation MM (Mutual Holding Companies)**; will collect all current OTS regulations that are applicable to SLHCs; and will help determine when a company or natural person acquires control of a saving association or SLHC under the Home Owner's Loan Act or the Change in Bank Control act. *Final rulemaking stage.*

Implementing **Regulation YY (Single Counterparty Credit Limits for Large Banking Organizations** to establish an upper single-counterparty credit limit for bank holding companies and foreign banking organizations with $250 billion or more in total consolidated assets, and additional large institutions. *Became effective on October 5, 2018.*

Implementing **Source of Strength (Section 610 Review)** rules that require that bank holding companies, savings and loan holding companies and other companies that directly or indirectly control an insured depository institution serve as a source of strength for the insured depository institution. *Notice given November 2018, and draft expected by December 2019.*

Proposing providing a reduced reporting requirement for the first and third reports of condition for depository institutions that have less than $5 billion in total consolidated assets and satisfy other criteria determined by the agencies **(Short Form Call Reports (Docket No: R-1618))**. *Notice given November 2018, next action date not determined.*

AGENCY AGENDAS CONTINUED

SECURITIES AND EXCHANGE COMMISSION (SEC)

Adopted **Regulation A** to provide an exemption for reporting companies from registration for offerings of securities up to $50 million in a 12-month period. EGRRCPA mandates the amendments, which will enable companies that are subject to the reporting requirements of section 13 or 15(d) of the Securities Exchange Act to use Regulation A. *Introduced December 19, 2018.*

Considering re-proposing rule amendments to implement section 951 of the Dodd-Frank Act, which requires companies to conduct a separate shareholder advisory vote to approve the compensation of executives **(Reporting of proxy votes on executive compensation and other matters**). *Proposed rulemaking stage.*

Considering **offering reform for business development companies under the small business credit availability act and closed-end funds**, by proposing amendments to existing rules and/or proposing new rules to implement section 803 of the Small Business Credit Availability act and section 509 of the EGRRCPA, which requires the SEC to enact rules permitting closed-end funds that are listed on an exchange or make periodic repurchase offers to use the SEC's offering and proxy rules that are available to other reporting companies, subject to conditions the SEC deems appropriate. *Proposed rulemaking stage.*

Adopted new rule permitting registered **investment companies to transmit periodic reports to their shareholders by making the reports accessible on a website** and satisfying certain other conditions. *Effective on January 1, 2019.*

Amending the **Securities Act Rules Under the Fair Access to Investment Research Act of 2017**, which directs the SEC to establish and implement a "safe harbor" for certain investment fund research reports published by brokers and dealers. *Effective in September 2019.*

Amended, jointly with other financial regulators, section 619 of the Dodd-Frank Act (Volcker Rule). The rule regards **prohibitions and restrictions on proprietary trading and certain relationships with hedge funds and private equity funds.** Became final in September 2018.

Prescribed **reporting and recordkeeping requirements for security-based swap (SBS) dealers and SBS swap participants** pursuant to section 764 of the Dodd-Frank Act, including rules that limit the activities of non-bank security-based swap dealers and major security-based swap participants. Finalized September 2018.

Adopted Rule of Practice 194, for **applications by SBS dealers or major SBS participants for statutorily disqualified associated persons to effect or be involved in effecting SBSs**. *Finalized December 2018.*

Proposing rules that would require the application of specific **risk mitigation techniques for uncleared SBSs**. The proposal would establish requirements for SBS dealers and major participants with respect to, among other things, reconciling outstanding security-based swaps with applicable counterparties on a periodic basis, engaging in certain forms of portfolio compression exercises, as appropriate, and executing written security-based swap trading relationship documentation with each of its counterparties prior to, or contemporaneously with, executing a security-based swap transaction. *Further action expected March 2019.*

AGENCY AGENDAS CONTINUED

Proposing **new Form CRS (relationship summary); amendments to form ADV; and required disclosures in retail communications and restrictions on the use of certain names or titles.** The changes would require registered investment advisers and registered broker-dealers to provide a brief relationship summary to retail investors to inform them about the relationships and services the firm offers; the standard of conduct and the fees and costs associated with those services; specified conflicts of interest; and whether the firm and its financial professionals currently have reportable legal or disciplinary events. Retail investors would receive a relationship summary at the beginning of a relationship with a firm, and would receive updated information following a material change. *Further action expected in 2019 to draft the rule.*

Proposing a new rule to streamline and enhance the regulatory framework applicable to funds that invest in other funds **("fund of funds" arrangements**). *Further action expected in 2019 to draft the rule.*

Conducting a **Transaction Fee Pilot for National Market System (NMS) stocks** to study the effects that transaction-based fees and rebates may have on, and the effects that changes to those fees and rebates may have on, order routing behavior, execution quality and market quality more generally. *Further action expected in 2019 to draft the rules.*

Amendments applicable to broker-dealer financial responsibility, and confirmation of transactions. Such amendments relate to section 939A of the Dodd-Frank Act, which requires the Commission **to remove certain references to credit ratings** from its regulations and to substitute such standards of creditworthiness as the SEC determines to be appropriate. *Proposed rulemaking stage.*

Re-proposing a new rule designed to enhance the regulation of the **use of derivatives by registered investment companies**, including mutual funds, exchange-traded funds, closed-end funds and business development companies. *Draft expected by September 2019.*

Considering adopting new rules and rule amendments to allow certain **exchange-traded funds** to operate without first obtaining exemptive orders from the SEC. *Final action expected September 2019.*

Proposed rules to require annual meeting proxy statement disclosure of whether employees or members of the board of directors are permitted to engage in transactions to hedge or offset any decrease in the market value of equity securities granted to the employee or board member as compensation, or held directly or indirectly by the employee or board member **(disclosure of hedging by employees, officers and directors).** *Final action expected by April 2019.*

AGENCY AGENDAS CONTINUED

SMALL BUSINESS ADMINISTRATION (SBA)

Considering amending **small business size standards and creating alternative size standards for 7(a)**, certified development company (CDC) loans under title V of the Small Business Investment Act (504) **and disaster loan programs** including for Business Loans and economic injury disaster loans (EIDL). *Comment period closed May 21, 2018, and final NPR was expected December 2018.*

Reviewing **small business size standards for transportation and warehousing; information; finance and insurance; real estate and rental and leasing** as part of the SBA's second five-year review of size standards under the Jobs Act. *Final notice of proposed rulemaking was expected December 2018.*

Streamlining and modernizing 504 loan program corporate governance requirements including changes to: board makeup and membership; loan portfolio balance; Multi-State requirements; outside-Area of Operation loans; Premier Certified Lenders Program; inter-CDC assistance. *Final NPR in November 2018.*

Streamlining and modernizing the 7(a), microloan, and 504 loan programs to reduce unnecessary regulatory burden, including removing regulations related to programs that are either no longer in effect or have not been funded for many years; and clarifying factors the SBA will consider when seeking the appointment of a receiver and the scope of the receivership with respect to certain firms. *Final NPR in November 2018.*

DEPARTMENT OF THE TREASURY (TREASURY)

Implementing **Section 42 Average Income Test** under the Consolidated Appropriations Act of 2018. These developments are known as the average income test. A project may be a "qualified low-income housing project" if 40 percent or more of the residential units in such project are both rent-restricted and occupied by individuals whose income does not exceed an average imputed income limitation equal to or less than 60 percent of area median income (AMI), based on designated imputed income limitations. Part of the 2018 omnibus spending bill, the Average Income Test is available for "elections made" after the law's enactment (March 23, 2018). *Final NPR set for December 2019.*

BEST INTEREST RULEMAKING

On April 18, 2018, the SEC proposed a package of rulemakings and interpretations related to investment professionals and their relationship with retail investors. Specifically, the package consisted of:

- **Regulation Best Interest:** requires broker-dealers to act in the best interest of the retail customer at the time the recommendation is made. The proposed allows broker-dealers to discharge this obligation if it satisfies the
  1. disclosure obligation
  2. care obligation and
  3. conflict of interest obligation.
- **Investment Adviser Interpretation:** reaffirms and clarifies certain aspects of the fiduciary duty an investment adviser owes to its clients.
- **Form CRS – Relationship Summary:** requires both broker-dealers and investment advisers to provide a relationship summary to clients highlighting key differences in the principal types of services offered; the legal standards of conduct that apply to each; the fees a customer might pay; and certain conflicts of interest that may exist.

During 2017 and through the first few months of 2018, there was speculation and uncertainty over whether the SEC was going to issue anything related to client best interest.

The impetus for an SEC response was the DOL issuing a revised Fiduciary Standard for retirement accounts, with portions of the rule taking effect in June 2017. The DOL "fiduciary rule," as it became known, required advisors to provide advice that aligns with clients' best interests, charge reasonable compensation and not make misleading statements. Other portions of the rule were set to take place later in the year explaining what advisers must do to meet the rule's requirements.

In March 2018, the Fifth Circuit issued a decision vacating the portion of the rule that was currently in effect, significantly minimizing the rule's impact. The DOL followed up by announcing they would no longer be enforcing the rule.

Even before the March 2018 ruling, the DOL appeared to be considering consulting with other federal agencies around the future of the rule. The SEC was expected to be a big contributor to those conversations.

However, with the proposed package released, the industry responded with over 2,500 comments by the August 7, 2018, deadline. Trade associations and other industry groups have been vocal about their concerns with the proposed package in its current state and are eagerly anticipating a final rule. The SEC Chairman Mark Clayton has deemed the best interest rules a priority in 2019, with the agency hoping to finish its work on the rule in 2019. If the final rules are similar to the proposed rules, the impact on broker-dealers, in particular, could be significant and firms will face tough decisions in complying with the rule.

LIBOR TRANSITION

For more than a decade the industry has questioned LIBOR reliability. Manipulation and instability finally led to the conclusion that industry participants should pursue and identify reliable alternative rates, and the UK Financial Conduct Authority (FCA) finally requested a full transition by the end of 2021.

On September 19, 2018, the FCA and UK Prudential Regulation Authority (PRA) published Dear CEO letters that they jointly sent to the CEOs of major UK-regulated banks and insurance companies, regarding their preparations for the transition from LIBOR to alternative risk-free rates (RFRs).The firms were asked to provide board-approved summaries of their assessments of key LIBOR discontinuation risks, together with details of planned actions to mitigate those risks, senior managers for applicable oversight and specific plans for transition implementation. It is clear that regulators expect firms to move away from all Interbank Offered Rate (IBOR) products.

Regional participants have formed working groups and committees over the past few years to explore alternative reference rates. These include the Alternative Reference Rate Committee (ARRC) in the U.S., the Sterling RFR Working Group from Bank of England and the EU's Eurodollar RFR Working Group, to name a few. Now, these groups are looking to capitalize on the success of their established alternative reference rates (ARR), with participant firms and exchanges accelerating their ARR timelines of deploying and trading new products, and ARR tenures for SOFR and SONIA are expected in 2019, which opens a large set of products and fixings for creation and trade.

Institutions should design and implement a full transition plan, defining the approach, tracking progress, aggregating reporting and allocating resources, as needed. A successful transition will require firms to have an intimate understanding of their IBOR use and exposure to legal entities, regions, business lines and the functional groups that support those business lines. Then, firms should look to design their new ARR products, offerings, services and strategies, by region. The target state of these items will inform application and process requirements. Market data and curve data will likely have its own set of requirements, per product and application.

Institutions should consider:

- **Regional regulatory requirements and concerns**
- **Vendor management**, to avoid new product failure. Firms should take the initiative and provide vendors with their requirements, expected product support and timelines to impacted applications, rather than waiting for vendors to provide ARR products and functionality.
- **Participation in industry associations, working groups and committees**, such ISDA, LSTA and LMA, as well as regional committees such as ARRC, Sterling RFR and EU RFR working groups, to manage industry expectations to align with their target state.

Once institutions have analyzed their positions and strategic objectives, they can make decisions whether to

- transition these items to new ARRs;
- re-securitize; or
- leave in place as an IBOR product.

Firms should monitor legacy IBOR products and positions for activity and should put triggers in place to provide feedback on rate movements outside of set risk tolerances. Contingency plans should also be in place for legacy positions that could have potentially adverse effects on the firm.

Firms that are proactive in their LIBOR transition will reap first-to-market benefits. Institutions that do not may find themselves in the position of playing catch-up, or worse, behind the specter of regulatory requirements, resource constraints, missed opportunities or even adverse impacts to their bottom lines.

DID YOU KNOW?

Capco has teams that can help with your institution's LIBOR transition, from impact assessment to target state design, implementation and testing. Contact michael.drews@capco.com to learn more.

GSE REFORM

We are likely to see many conversations in 2019 regarding if and when the Trump administration will end GSE conservatorship. One important development is a change in leadership, as Mark Calabria has been nominated to serve as the next FHFA Director, if confirmed, and will take over for Mel Watt, whose term expired January 6, 2019. The FHFA director is perhaps the most impactful role in potential GSE reform, which can generally take place through legislative or executive action.

A top Treasury official recently spoke at an industry conference acknowledging that the Trump administration is working to end the conservatorship of Fannie Mae and Freddie Mac. Specifically, he advocated for removing their charters from statute and having their operations overseen by the primary regulator (FHFA), allowing for more competition in the secondary market.

In June, the Office of Budget and Management issued a 132-page proposal that highlighted changes across the board, including a desire to end conservatorship. The plan aims to achieve four main goals through legislative and policy reform:

1. Increase competition
2. Increase transparency and accountability
3. Align incentives and reduce overlap
4. Provide more targeted assistance to those in need

Some potential options for GSE reform through the FHFA include:

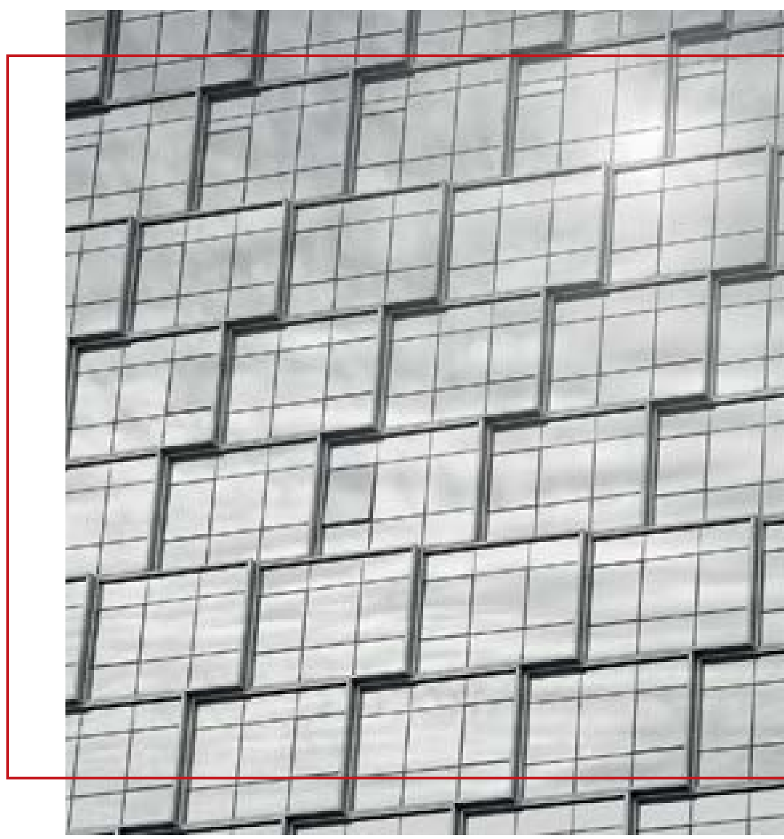
- Placing Fannie Mae and Freddie Mac in a receivership
- Exploring a common securitization platform
- Evaluating whether to continue insurance pilot programs (unlikely as the programs are considered too new by many to write off)

Legislatively, reform is not believed to be a part of Congress' plans following the midterm elections. The House Financial Services Committee has held multiple hearings throughout the second half of 2018 related to GSE reform, including:

- Oversight of the Federal Housing Finance Agency's role as conservator and regulatory of the Government Sponsored Entities (9/27/2018)
- A Failure to Act: How a Decade without GSE Reform Has Once Again Put Taxpayers at Risk (9/6/2018)

A hearing in the Senate Banking, Housing and Urban Affairs Committee has been delayed three times, from October to December and will likely take place in 2019.

While former Chair of the House Financial Services Committee Jeb Hensarling (R-TX) and John Delaney (D-MD) did draft a reform proposal, the bill was never formally introduced. The discussion draft included: strengthening the secondary mortgage market and improving borrow access to conventional loans through establishing "Ginnie Mae Plus"; creating a mortgage security market exchange and data repository; repealing Fannie Mae and Freddie Mac charters; and updating the regulatory structure related to housing finance system.



STRESS TESTING

COMMUNITY FINANCIAL INSTITUTIONS:

On November 21, 2018, the FRB, FDIC and OCC issued a request for comment on a proposal to change regulatory capital requirements for qualifying community banking organizations, as required by EGRRCPA. Section 201 of EGRRCPA, titled "Capital Simplification for Qualifying Community Banks," directs the agencies to develop a community bank leverage ratio (CBLR) of not less than 8 percent and not more than 10 percent for qualifying community banking organizations.

The proposal intends to relieve qualifying community financial institutions of specific regulatory burdens by providing an option for these institutions to calculate a CBLR, as opposed to using multiple measures of capital adequacy. Section 201 of the EGRRCPA defines the "CBLR" as the ratio of an institution's tangible equity to its average total consolidated assets, both as reported on the organization's applicable regulatory filing. EGRRCPA also states that an institution's risk profile may be the basis for preclusion from eligibility. To determine eligibility, regulatory agencies will consider off-balance sheet exposure, trading assets and liabilities, total notional derivatives exposures and other factors as the agencies determine appropriate.

LARGE BANKING ORGANIZATIONS:

On October 31, 2018, the FRB released two draft NPRs to tailor its enhanced prudential standards (EPS) in accordance with section 401 of EGRRCPA:

1. Tailoring EPS application relating to capital stress testing; risk management; liquidity risk management, liquidity stress testing and liquidity buffer requirements; and single-counterparty credit limits to U.S. bank holding companies and applying EPS as tailored to covered savings and loan holding companies (SLHCs)
2. Joint proposal with the OCC and FDIC, tailoring requirements under the agencies' regulatory capital rules, the liquidity coverage ratio (LCR) rules, and proposed net stable funding ratio (NSFR) rules.

The proposals revise the EPS application framework for large U.S. banking organizations, creating four categories based on covered firms' risks. Of note, Governor Brainard voted against the NPRs, saying that the proposals go beyond EGRRCPA provisions.

The NPRs also announce three forthcoming related rulemakings:

1. Adjust EPS for foreign banking organizations (FBOs), including intermediate holding companies of FBOs
2. Further incorporating the four categories, including aligning the Board's April 2018 proposed stress capital buffer (SCB) rule with biennial stress testing for certain firms
3. Joint work with the FDIC regarding resolution planning requirements for firms with $100-$250 billion in total assets

In a speech on November 9, 2018, FRB Vice Chairman for Supervision Randal Quarles stated that he expects the first SCB not to go into effect before 2020 and Comprehensive Capital Analysis and Review (CCAR) to remain in place in 2019 for firms with over $250 billion in assets or that are otherwise complex. Quarles also stated, however, that FRB is considering moving forward with certain aspects of the SCB proposal for CCAR 2019, such as assumptions related to balance sheet growth. Additionally, Quarles announced he will also ask the FRB to exempt firms with less than $250 billion in assets from the CCAR quantitative assessment and supervisory stress testing in 2019, to account for the every-other-year cycle included in the tailoring proposal.

BENEFICIAL OWNERSHIP

On May 11, 2018, FinCEN's CDD Rule went into effect. Leading up to this compliance date, FinCEN released guidance and FAQs to ensure financial institutions implemented programs in compliance with the new requirements.

On September 7, 2018, FinCEN granted permanent exceptive relief to covered financial institutions from the Beneficial Ownership Rule's requirement to identify and verify beneficial ownership information in the following scenarios: a rollover of a certificate of deposit; a renewal, modification or extension of a loan that does not require underwriting review or approval; a renewal, modification or extension of a commercial line of credit or credit card account that does not require underwriting review or approval; or a renewal of a safe deposit box rental. The exception applies if the original account originated prior to May 11, 2018, and does not apply to the initial opening of these accounts.

But, while congress considers a draft bill Counter Terrorism and Illicit Finance Act (CTIFA) the issue is again in the spotlight. The original version of the CTIFA required non-exempt U.S. companies to disclose their beneficial owners to FinCEN. But in June, Congress received a new version of the bill that removed the beneficial ownership provision. Instead, this version requires the U.S. Comptroller General" to submit a report evaluating the effectiveness of the collection of beneficial ownership information under the [CDD] regulation as well as the regulatory burden and costs imposed on financial institutions subject to it."

In a November 29, 2018, Senate Committee on Banking, Housing, and Urban Affairs hearing on "Combating Money Laundering and Other Forms of illicit Finance: Regulator and Law Enforcement Perspectives on Reform," Ranking Member Senator Sherrod Brown (D-OH) urged a revamping and strengthening of the beneficial ownership rules, in order to "shed[] once and for all the U.S. reputation of being a haven for anonymous shell companies." While most of the hearing focused on the particular monetary thresholds for SARs and Currency Transaction Reports (CTRs), the debate over beneficial ownership regulations is likely to continue, and we may see developments in the area in 2019.

DATA PRIVACY

2018 was a big year for data protection and the emphasis is likely to continue in 2019. Among the most important developments in 2018 were GDPR, which took effect in May 2018, and several high-profile data breaches across the country.

At the federal level, there have been many critics that the Federal Trade Commission (FTC) has been too lenient on large corporations in charge of handling consumer data. Some states have taken it upon themselves to pass unique legislation around data protection in addition to data breach legislation, which was a common topic across state legislatures in 2018. These include:

California (AB 375): provides consumers rights in relation to their personal information, including: requesting what their information is being used for; requesting the deletion of personal information; making disclosures about the information and the purposes it is used; and provide a right for the consumer to opt out of the sale of its personal information

Vermont (H. 764): regulates data brokers and data collectors in Vermont

Colorado (HB 18-1128): makes changes related to the handling of personally identifying information and required procedures and notifications if this information is breached, including: requiring a policy for the disposal of personally identifiable information; protecting personally identifiable information from unauthorized access; addressing breach notification; and requiring notice to the Colorado Attorney General within 30 days of any breach if certain requirements are met

Capco CRI will continue tracking state legislation and regulation regarding data privacy as we move into a new year.

ABOUT CAPCO

Capco is a global technology and management consultancy dedicated to the financial services industry. Our professionals combine innovative thinking with unrivalled industry knowledge to offer our clients consulting expertise, complex technology and package integration, transformation delivery, and managed services, to move their organizations forward. Through our collaborative and efficient approach, we help our clients successfully innovate, increase revenue, manage risk and regulatory change, reduce costs, and enhance controls. We specialize primarily in banking, capital markets, wealth and investment management, and finance, risk & compliance. We also have an energy consulting practice. We serve our clients from offices in leading financial centers across the Americas, Europe, and Asia Pacific.

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