FIRMA Conference – New Orleans 2017

Regulator Panel

Office of the
Comptroller of the Currency
U.S. Department of the Treasury

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DEPARTMENT OF LABOR UNITED STATES OF AMERICA

FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION

Disclaimer - All

The views and opinions expressed in this presentation are those of the panelists, and do not necessarily represent those of the Board of Governors of the Federal Reserve, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, or Department of Labor.

Regulatory Update: Board of Governors of the Federal Reserve System

Presented by: Rebecca Zak

FIRMA Conference – Federal Reserve

- The Federal Reserve supervisory program is a 3 pronged approach:
  - Mandated examinations of state member banks and chartered trust companies.
  - Consolidated Holding Company Supervision
  - Systemic Risk
- Within this framework, the Federal Reserve places significant focus on the risk management and governance processes the firm has to meet regulatory requirements and expectations regarding asset wealth management business activities.

FIRMA Conference – Federal Reserve

- Supervisory Approach – Governance Beyond the Legal Entity
  - Holding Company Governance Reviews
  - Line of Business Reviews and Governance
  - Firm-Wide Compliance Programs
  - Mandated Examinations
  - Vendor Management
  - Recovery/Resolution
  - International Wealth Management Activities

Office of the Comptroller of the Currency

OCC Initiatives – Innovation and Fintech

- "Supporting responsible Innovation in the Federal Banking system: An OCC Perspective" (March 2016)
- "Recommendations and Decisions for Implementing a Responsible Innovation Framework" (October 2016)
- Established OCC Office of Innovation
- OCC recently established receivership framework for uninsured National Banks – currently limited purpose trust banks.
  - "Receivership for Uninsured National Banks" (12 CFR 51 – OCC Bulletin 2016-160)
- OCC published "Exploring Special Purpose National Bank Charters for Fintech Companies" for public comment, December 2016

Draft Licensing Manual Supplement for Evaluating Charter Applications From Financial Technology Companies

- Published March 15, 2017 (NR 2017-31) – 30 day comment period
  - Explains how the OCC will apply the licensing standards and requirements in existing regulations and policies to fintech companies applying for special purpose national bank charters.
- Guidance does not apply to a fintech that intends to engage in fiduciary activities and meets the requirements of a trust bank.
- Three guiding principles in implementing the charter.
  - Not allow “the inappropriate commingling of banking and commerce,”
  - Not to sanction “products with predatory features”
  - Not to facilitate “light-touch” supervision of companies applying for the new charter.

OCC Initiatives – Fintech and Innovation

Draft Licensing Manual Supplement for Evaluating Charter Applications From Financial Technology Companies

- Fintech companies that opt for a charter would be subject to bank-like requirements for business structure, compliance and risk management controls.
- Supervision would follow a risk-based approach commensurate with the size and complexity of the institution
- Fintech companies would also be assigned Camels ratings, based on capital levels, asset quality, liquidity and other factors.
- Fintechs could face special additional requirements on a case-by-case basis - including possible mandatory resolution plans.

OCC Initiatives – Fintech and Innovation

Draft Licensing Manual Supplement for Evaluating Charter Applications From Financial Technology Companies

- A company would have to detail its financial inclusion plan as part of the chartering process, including "proposed goals, approaches, activities, and milestones for serving the relevant market and community," although they would not be subject to the Community Reinvestment Act

- Fintech companies under the charter would have to face the same minimum capital requirements as banks, but in some cases, the **OCC** could raise the bar, based on factors including revenue and overall risk.

- Fintech companies would also have to face liquidity requirements and provide detailed recovery and exit plans.

FFIEC Call Report Update

- New FFIEC 051 – streamlined call report for eligible small institutions, which generally are institutions with domestic offices only and total assets of less than $1 billion.

- The introduction of the new FFIEC 051 report is part of the FFIEC's community bank call report burden-reduction initiative.

- Effective March 2017

- Extensive resources available on FFIEC website, including
  - FIL- 82-2016
  - Audio recording or March 2017 Webinar
  - Side by side comparison of FFIEC 051 and 041

Key Resources and Dates

- T+2 Settlement – Industry Webpage
- June 2015 Whitepaper: “Shortening the Settlement Cycle: The Move to T+2”
- December 2015 “T+2 Industry Implementation Playbook”
- Testing – vendors/clients – Q4 2016
- Industry testing – Q1 – Q2 2017
- **Go Live – September 5, 2017**

Selected AM – Related MRAs

- AM Audit weaknesses
  - Ineffective fiduciary audit committee oversight
  - Insufficient audit staff expertise for nature and scope of bank's fiduciary activities
  - Failure to include all significant fiduciary activities in audit plan
  - Inadequate scope or frequency for audits of fiduciary activities
  - Ineffective follow up and remediation of audit findings

Selected AM – Related MRAs

- Internal Control Weaknesses in the following areas
  - Wire Transfer authentication procedures for AM wire requests (call backs)
  - Dual control over funds movement and free deliveries
  - Segregation of duties
  - System access controls
- Fiduciary pledge requirements

Michael Orange

Senior Examination Specialist – Trust

Washington Office - PPD

Objectives

- Overview of Trust Department Model Risk Management
- Identify Agency Issuances
- Discuss Governance Framework
- Board and Senior Mgt Responsibilities
- Third-Party Vendors

Why is Model Risk Important?

- Banks continue to rely heavily on quantitative analysis and models in most aspects of financial decision making.
- Common banking activities in which models are used
  - Asset Allocation;
  - Capital Stress Testing;
  - Allowance for Loan and Lease Losses; and,
- Management needs to be attentive to the possible adverse consequences (including financial loss) of decisions based on models that are incorrect or misused, and should address those consequences through active model risk management.

Existing Agency Issuances

- **FDIC Supervisory Insights - Winter 2005 –** *Model Governance* http://www.fdic.gov/regulations/examinations/supervisory/insights/siwin05/siwin05.pdf

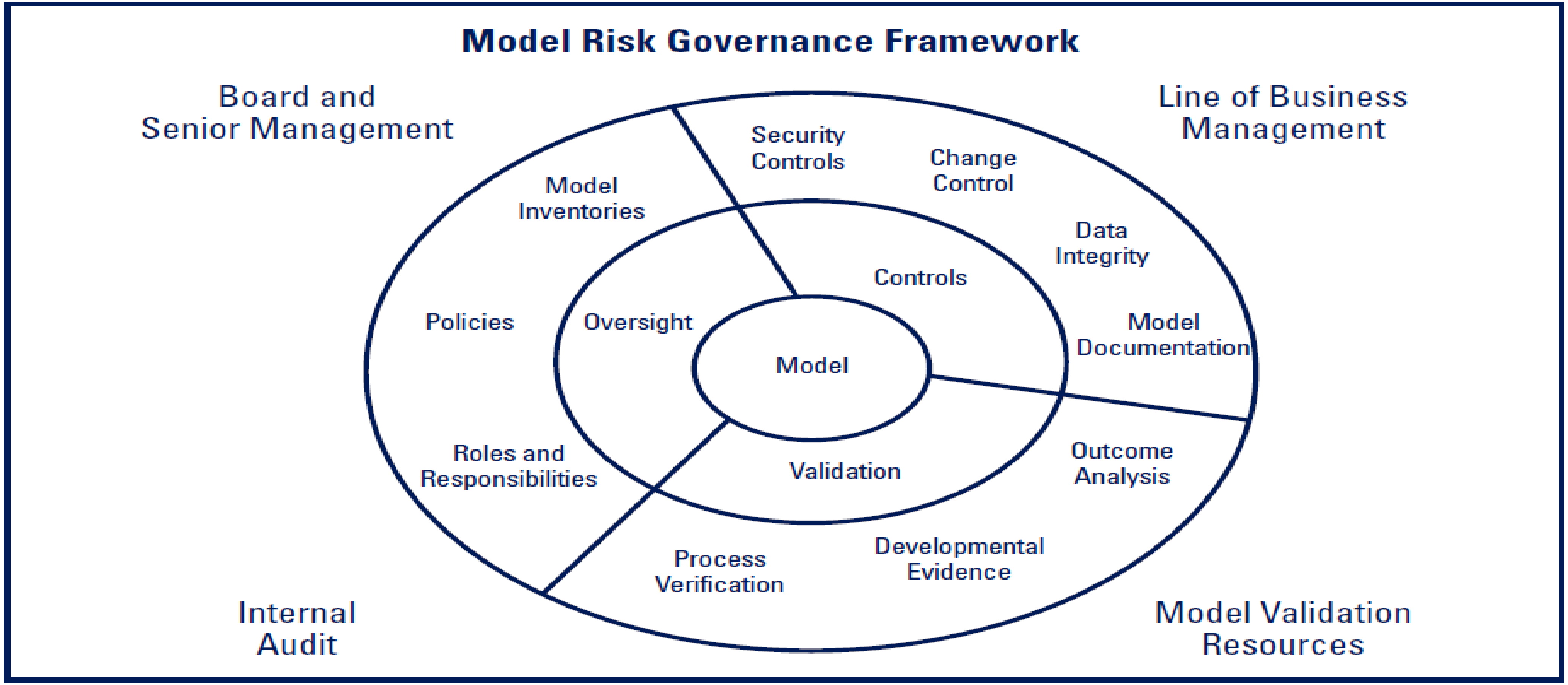
- **FRB Supervisory Letter 11-7** *Supervisory Guidance on Model Risk* (Issue Date – 4/11/2011) http://www.federalreserve.gov/bankinforeg/srletters/sr1107.htm

- **OCC 11-12** *Supervisory Guidance on Model Risk* (Issue Date – 4/11/2011) http://www.occ.treas.gov/news-issuances/bulletins/2011/bulletin-2011-12a.pdf

Common Models in Trust Dept

- Asset Allocation Models (Trust)
- Bank Security Act/Anti Money Laundering (Know Your Customers)

Model Risk Governance Framework



Board and Senior Management Responsibilities

- Model Risk Appetite
- Model Use Risk Escalation
- Model Risk Management Policy and Framework
- Periodic Model Risk Reporting
- Internal Audit/Independent Review

Third Party Models

- Regardless of whether a model is developed in-house or purchased, Model Risk Standards should be similar.
- Vendor management is key. Determine how much information about the model – its known strengths and limitations – is provided by the vendor.
- Has the vendor subjected the model to independent validation? Findings?
- Change management is critical. How will the vendor notify the bank of model changes? How often?
- Management should discuss the bank's validation requirements and assess if the vendor can meet them.

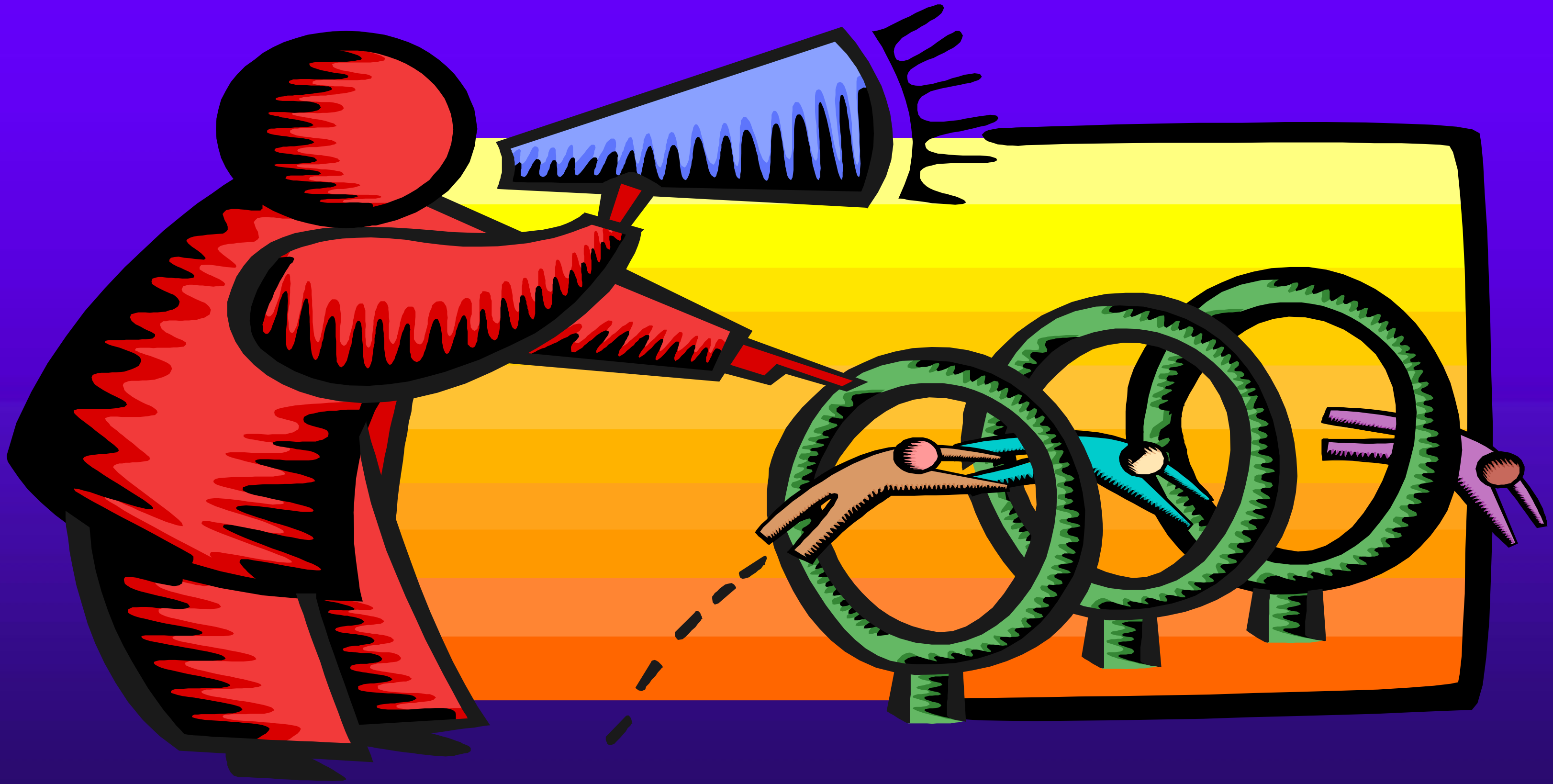
Questions

Trust Contact

- Michael W. Orange, Senior Examination Specialist – Trust FDIC Division of Risk Management Supervision, Policy and Program Development Section; Morange@fdic.gov

EMPLOYEE BENEFITS SECURITY ADMINISTRATION

What EBSA can do for (or to) your client(s)



TYPES OF VIOLATIONS

- Reporting and Disclosure
- Fiduciary
- Prohibited Transactions
- Criminal
  - Pension Area
  - Health Area

WHAT CAN WE DO TO YOU

- Civil
  - Permanent removal as a Trustee
  - Monetary penalties
  - Injunctions
- Criminal
  - Debarment
  - Prison time (probation)
  - Restitution

- TRIAL – Civil/Criminal (your time & money)

WHAT CAN WE DO FOR YOU

- VFCP
- DFVC Program
- Getting it Right
- Orphans
- Outreach Events

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T + 2 Appendix

T+2 Appendix

- September 5, 2017: US Securities Industry Migrates from T+3 to T+2 settlement cycle for US
  - equities
  - corporate and municipal bonds
  - and unit investment trusts (UIT)
  - ADRs, ETFs and mutual funds based on these instruments
- Migration from T+5 to T+3 completed in 1995
- Plans to migrate to T+2 eclipsed by "same day funds," Y2K and STP initiatives
- Focus returned post-crisis – Objectives of T+T:
  - Reduce risk
  - Require less collateral at CCPs
  - Create Efficiencies – reduce costs

Industry Considerations for T+2 Implementation

- Technology and process upgrades
  - Industry utilities
  - Buy and sell – side firms
  - Legacy system changes – downstream firms
  - Trade matching, allocation, settlement process
  - Asset servicing (income entitlements)
  - Securities Lending
- Behavioral changes - Retail investors – payment and delivery timeframes
- Industry-wide coordination/testing
- Documentation/Agreements/Regulatory changes

Bank-level considerations for T+2 Implementation

- Governance/project management
- Inventory of lines of business/products affected (AM, RNDIP)
- Inventory of systems and processes affected
  - Trade Clearance and Settlement
  - Corporate Actions, Income Processing
  - Securities Lending
- Engagement with IT, service providers, industry utilities depending on nature and scope of bank activities
- Documentation – internal and external
- Staff training
- Client communication

Appendix

Selected OCC Asset Management Guidance

OCC Bulletins, Banking Circulars, Interpretive Letters and Booklets of the *Comptroller's Handbook for Asset Management* are available at
[OCC: Capital Markets: Asset Management]

Selected OCC Handbooks

Comptrollers Handbook for Asset Management

- Asset Management *(2000)*
- Asset Management Operations & Controls (2011)
- Collective Investment Funds (2014)
- Conflicts of Interest (2015)
- Custody Services (2002)
- Investment Management Services (2001)
- Personal Fiduciary Services (2015)
- Retirement Plan Products and Services (2014)
- Unique and Hard to Value Assets (2012)

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Selected OCC Handbooks

Comptrollers Handbook for Safety and Soundness

- Community Bank Supervision (2010)
- Large Bank Supervision (2010)
- Bank Supervision Process (2007)
- Corporate Risk and Governance (2016)
- Internal and External Audits (2016)
- Internal Control (2001)
- Insider Activities (2014)
- Insurance Activities (2002)
- Retail Nondeposit Investment Products (2015)

Selected OCC Bulletins

- OCC Bulletin 2016-17, Compliance with SEC Money Market Fund Rules by Bank Fiduciaries, Deposit Sweep Arrangements, and Bank Investments
- OCC Bulletin 2014-52, Matters Requiring Attention: Updated Guidance
- OCC Bulletin 2013-29, Third-Party Relationships: Risk Management Guidance
- OCC Bulletin 2017-7, Third-Party Relationships: Supplemental Examination Procedures
- OCC 2013-8, Short-term Investment Funds Reporting Requirements
- OCC 2012-31, Short-Term Investment Funds

Selected OCC Bulletins

- OCC 2011-11, Risk Management Elements: Collective Investment Funds and Outsourced Arrangements
- OCC 2011-12, Supervisory Guidance on Model Risk Management
- OCC 2010-37, Self-Deposit of Fiduciary Funds
- OCC 2009-19, New Notice Requirements for Sweep Accounts
- OCC 2008-10, Fiduciary Activities of National Banks: Annual Reviews of Fiduciary Accounts Pursuant to 12 CFR 9.6(c)
- OCC 2008-5, Conflicts of Interest: Risk Management Guidance Divestiture of Certain Asset Management Businesses
- OCC 2007-42, Bank Securities Activities: SEC's and Federal Reserve's Final Regulation R

Selected OCC Bulletins

- OCC 2007-21, Supervision of National Trust Banks: Revised Guidance: Capital and Liquidity
- OCC 2007-6, Registered Transfer Agents: Transfer Agent Registration, Annual Reporting, and Withdrawal from Registration
- OCC 2006-24, Interagency Agreement on ERISA Referrals
- OCC Bulletin 2004-20, Risk Management of New, Expanded, or Modified Bank Products or Services: Risk Management Process
- OCC 2004-2, Banks/Thrifts Providing Financial Support to Funds Advised by the Banking Organization or its Affiliates
- OCC Bulletin 2002-16, Bank Use of Foreign-Based Third-Party Service Providers
- OCC Bulletin 2001-35, Examination Procedures to Evaluate Compliance with the Guidelines to Safeguard Customer Information