

# Financial Services Regulatory Highlights

volume 11 no. 4 April 2009

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## Federal Charter Bill Introduced in Congress

On April 2, 2009, H.R. 1800, the National Insurance Consumer Protection Act (NICPA), was introduced in the U.S. House of Representatives by Reps. Melissa Bean (D-IL) and Edward Royce (R-CA). In line with prior legislation seeking to introduce an Optional Federal Charter (OFC), NICPA would pre-empt state insurance laws and establish a federal system of regulation and supervision for national insurers and insurance producers. As with the dual system of regulation utilized for the banking sector, insurers and producers are free under NICPA to elect federal or state regulation. State insurance departments would retain authority for regulating state-licensed insurers and producers.

### Notable Changes from Prior OFC Proposals

NICPA differs from prior OFC bills in the following ways:

- **Systemic Risk Regulator:** NICPA requires the establishment of Systemic Risk Regulator housed outside Office of National Insurance (ONI) to be designated by the president to review and examine

insurers, state and federal, and their affiliates, as well as participate in examinations by state insurance regulators to determine if an insurer or its products "is having, or would have, serious adverse effects on economic conditions or financial stability." The Systemic Risk Regulator has broad authority to remediate such a state, including the power to prohibit activity by an insurer or the sale of the products at issue. In addition, the Systemic Risk Regulator, in conjunction with the Commissioner may make a determination as to which insurers are systemically important and may be required to convert to federal regulation.

- **Coordinating Council for Financial Regulators:** Comprised of federal financial regulators, including the National Insurance Commissioner, and presidential appointments, the Council would collectively identify and set policy issues related to the health and competitiveness of the financial services industry. In addition, the Council has responsibility for coordinating activity among state and federal financial regulators and with developing model supervisory policies for state and federal financial regulators.
- **Consumer Protections:** NICPA calls for a Division of Consumer Affairs (DCA) to be led by a Director under the National Commissioner's supervision. The DCA is required to maintain a branch in each state. The DCA would also maintain a national hotline and website for complaint reporting, and would report to Congress annually regarding complaint volume and handling.

- **National Holding Companies Regulation:** NICPA grants the National Insurance Commissioner authority to subject national holding companies to capital, liquidity, dividend, operational, and any other standards that the Commissioner deems appropriate to ensure their solvency and sound operation.
- **More Frequent Examinations:** Under NICPA national insurers would be subject to “full-scope, on-site” examinations every two years (compared to every three years in prior bills).
- **National Guaranty Association:** NICPA establishes a National Insurance Guaranty Corporation (NIGC), which will assume obligations to policyholders, up to limits based on those set by NAIC model laws, when a national insurer is placed into receivership. The NIGC would be funded by as-needed assessments on national insurers at the line of business level. National insurers will also be required to participate in state guaranty associations for a line of insurance in each state in which they are doing business. Prior OFC proposals did not include such dual federal/state guaranty fund participation requirements.

#### **State Provisions Not Subject to Pre-emption**

However, primarily subject to federal regulation, National Insurers and Agencies, and federally licensed producers, would be subject to the following types of state laws:

- Tax laws;
- Unclaimed property and escheat laws;

- Laws related to participation in assigned risk plans and other mandatory residual market mechanisms;
- Laws that provide for compulsory coverage of workers’ compensation or motor vehicle insurance;
- Laws requiring statistical reporting or participation in advisory organizations unrelated to rates; and
- Laws requiring participation in workers’ compensation administration mechanisms.

#### **Bill Status**

The NICPA has been referred to the House's Committee on Financial Services, and to the Committees on the Judiciary, and Energy and Commerce. No hearings have yet been scheduled on the Bill and no companion legislation has yet been introduced in the Senate.

#### **Administration's Position Unclear**

During his Congressional testimony on March 26, 2009, Treasury Secretary Geithner fell short of advocating for an Optional Federal Charter. While Secretary Geithner stated, “(t)here's a very good case for optional federal charter legislation to be introduced,” he also indicated that his recommendation on a systemic risk regulation is “fully compatible” with the state regulation of insurance and not meant to “supplant or take away the authority states have over insurance companies.” We are not otherwise aware of any comments by the administration on NICPA to date.

# SEC Releases Amendments to Regulation SHO

On April 8, 2009, the Securities Exchange Commission (SEC) proposed two approaches to restrictions on short selling. The first approach is a price test that would apply on a market wide and permanent basis and the second approach would apply only to a particular security during severe market declines in that security.

The SEC proposed two alternative short sale price tests relating to the first approach. One price test would be based on the national best bid, while the second would be based on the last sale price.

With respect to the second approach, the SEC proposed two basic alternatives. One alternative is a circuit breaker rule that would temporarily prohibit short selling in a particular security when there is a severe decline in the price of that security. This circuit breaker could

operate in place of, or in addition to, a short sale price test rule. The second alternative is a circuit breaker rule that would trigger a short sale price test rule. The SEC proposes that such a short sale price test either be based on the national best bid for any security for which there has been a severe price decline or be based on the last sale price for any security for which there has been a severe price decline.

For each of the proposed short sale price test restrictions and proposed circuit breaker rules, the SEC is also proposing to amend Regulation SHO to require that a broker-dealer mark certain sell orders "short exempt."

Comments should be received on or before June 19, 2009

# SEC Chairman Outlines Regulatory Agenda

On April 6, 2009, SEC Chairman Mary Schapiro outlined how she viewed the agency's role and her plans for ensuring that it is a strong and effective advocate for investors. She noted that investor protection starts with fair and efficient capital markets. She emphasized that the SEC's job is to ensure that the markets are structured effectively, have timely and reliable information, are well served by financial intermediaries, and are supported by a strong and focused enforcement arm.

Chairman Schapiro noted that the current infrastructure of the markets works, but indicated that the SEC is looking at practices that may disrupt fair and orderly markets. As an example, she referenced the proposed rules limiting short sales in a down market.

Regarding timely and reliable information, Chairman Schapiro noted that the SEC would consider whether to enhance disclosure around director nominee experience, qualifications and skills. Additionally, the SEC will consider whether corporate boards should disclose to shareholders their reasons for choosing their particular

leadership structure. Further consideration will be given to compensation disclosures and whether greater disclosure is needed about how a company manages risk. In the near future, the SEC will consider a proposal to ensure that a company's shareholders have a meaningful opportunity to nominate directors.

The SEC is also looking to many potential reforms such as:

- Requiring those with custody of client assets to undergo an annual third-party audit, on an unannounced basis, to confirm the safekeeping of those assets.
- Harmonizing the responsibilities of investment advisers and broker-dealers, so that investors who use either can expect a uniform level of professionalism and accountability.
- Mandating that certain investment advisers have third-party compliance audits to ensure their compliance with the law.

- Registering hedge fund advisers and potentially the hedge funds themselves.
- Requiring more disclosure from credit rating agencies, including potentially the assumptions underlying their methodologies, fees received from issuers, and factors that could change ratings.
- Overseeing the credit default swap market more vigorously, including creating new reporting and recordkeeping rules.
- Enhancing the standards applicable to money market funds.
- Providing investors in municipal securities with the same level of disclosure and investor protections that investors in other securities receive.
- Enhancing disclosures for asset-backed securities.

Finally, Chairman Schapiro noted that staying one-step ahead of predators and the practices that they employ is a constant struggle. In her estimate, the SEC's enforcement and examination resources have been seriously constrained in recent years. Chairman Schapiro is working to increase the SEC's enforcement budget to add enforcement and examination resources and the technological tools necessary to effectively prosecute enforcement cases.

## SEC Reopens Privacy Proposal for Public Comment

On April 15, 2009, the SEC announced that it had reopened the Interagency Proposal for Model Privacy Form under the Gramm-Leach-Bliley Act (GLBA) for public comment. The SEC is reopening the comment period in order to solicit public comment on the results of recent quantitative consumer testing conducted to evaluate the form.

The proposed rule would create a safe harbor for a model form that financial institutions may use to provide

disclosure of initial and annual privacy notices. The SEC also released the quantitative testing results of a consultant who evaluated the effectiveness of four different privacy notices. Both the proposal and the testing results are available on the SEC's website.

Comments regarding the proposal should be received on or before May 20, 2009.

## OTS Revises Truth in Savings Act Examination Procedures

On April 2, 2009, the Office of Thrift Supervision (OTS) updated its procedures for compliance with the Truth in Savings Act (Regulation DD), effective October 1, 2008. Regulation DD governs disclosures to consumers regarding deposit account fees and charges. The amendments clarify the requirements for electronic consumer disclosures and include a questionnaire that financial institutions may use to evaluate their Regulation DD compliance.

Under the revised examination procedures, savings associations should ensure that:

- Consumers receive appropriate disclosures for fees and account terms and conditions associated with deposit accounts prior to opening an account;
- Account disclosures are provided upon request;
- Employees receive training that incorporates the requirements of Regulation DD and Regulation E;
- Account information and fee disclosures are clear and understandable and available in a written form that the consumer may keep; and
- Recordkeeping requirements include retention of account and fee disclosures sufficient to determine compliance with Regulation DD and Regulation E.

## OCC Publishes Final Rule Regarding Risk-Based Capital Money Market Mutual Funds

On March 27, 2009, the Office of the Comptroller of the Currency (OCC) published a final rule concerning the risk-based capital treatment for certain asset-backed commercial paper (ABCP) purchased by national banks pursuant to the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (ABCP Lending Facility) established by the Federal Reserve.

The ABCP Lending Facility enables depository institutions to borrow on a nonrecourse basis from the Federal Reserve Bank of Boston if the depository

institution uses the loan proceeds to purchase high-quality ABCP from money market mutual funds. The Federal Reserve established the ABCP Lending Facility on September 19, 2008, and extended the program to October 30, 2009. The final rule, which applies to ABCP purchased pursuant to the ABCP Lending Facility, recognizes that the nonrecourse basis of the loan protects the bank from the credit and market risks of the purchased ABCP. Under the final rule, a national bank may assign a zero percent risk weight to the ABCP purchased by the bank.

# Multi-Agency Crackdown Targeting Foreclosure Rescue Scams and Loan Modification Fraud

On April 6, 2009, the Obama Administration announced a new coordinated effort between federal and state governments and the private sector to target mortgage loan modification fraud and foreclosure rescue scams. This effort aligns federal law enforcement agencies, state investigators and prosecutors, civil enforcement authorities, and the private sector to protect homeowners seeking assistance under the Administration's Making Home Affordable program from criminal actors looking to perpetrate predatory schemes.

The Department of the Treasury, the Department of Justice (DOJ), the Department of Housing and Urban Development (HUD), the Federal Trade Commission (FTC), and the Attorney General of Illinois discussed new initiatives to coordinate information and resources across agencies to maximize targeting and efficiency in fraud investigations, alert financial institutions to emerging schemes, increase enforcement actions and educate consumers to help those in financial trouble avoid becoming the victims of a loan modification or foreclosure rescue scam.

As discussed in the March issue of the Financial Services Regulatory Highlights, the Administration announced Making Home Affordable, a program to help eligible homeowners refinance or modify their mortgages. This opportunity for relief also brings greater opportunity for criminal actors to prey upon consumers seeking assistance.

Treasury and the Financial Crimes Enforcement Network (FinCEN) announced an advanced targeting effort to combat fraudulent loan modification schemes and coordinate ongoing efforts across agencies to investigate fraud and assist with enforcement and prosecutions. In less than a week, FinCEN's new targeting effort has produced leads that have helped various agencies to halt the illegal practices of those offering loan modification or foreclosure scams. In undertaking this effort, FinCEN will marshal information

about possible fraudulent actors, drawing upon a variety of data available to law enforcement, regulatory agencies, and the consumer protection community, for the purpose of identifying and proactively referring potential criminal targets to participating law enforcement authorities.

Additionally, on April 6, 2009, Treasury issued an Advisory, through FinCEN, alerting financial institutions to the risks of emerging schemes related to loan modifications. The advisory identifies certain "red flags" that may indicate a loan modification or foreclosure rescue scam and warrant the filing of a Suspicious Activity Report ("SAR") by a financial institution.

In the Advisory, FinCEN highlights two ways that the activities of financial institutions may intersect with these loan modification /foreclosure rescue scams:

- First, persons or entities perpetrating loan modification/foreclosure rescue scams may seek the services of financial institutions for the purpose of receiving, depositing or moving funds relating to the scams.
- Second, financial institutions may become aware of such scams through their interactions with customers who have become victims.

In order to assist law enforcement in its efforts to target this type of fraudulent activity, FinCEN requests that, if financial institutions become aware of this type of activity, they include the term "foreclosure rescue scam" in the narrative portions of all relevant SARs filed. The Suspect/Subject Information Section of the SAR should also include all information available for each party suspected of engaging in this fraudulent activity - including information such as individual or company name, address, phone number and any other identifying information.

In many circumstances, the homeowner is a victim of the scam and therefore should not be listed as a suspect unless there is reason to believe the homeowner knowingly participated in the fraudulent activity. When the homeowner is simply a victim of a scam, including all available information in the narrative portion of the SAR about the homeowner and his or her property will also assist law enforcement in investigating these potential crimes.

FinCEN will continue to monitor SARs that identify mortgage loan fraud and specifically loan modification/foreclosure rescue scams in order to provide future analysis and ways to mitigate losses to financial institutions and consumers. FinCEN will issue further advisories on this issue as appropriate.

## FinCEN and OCC Assess Civil Money Penalties

On April 21, 2009, FinCEN and the OCC announced the assessment of concurrent civil money penalties against the New York Branch of Doha Bank for past violations of the Bank Secrecy Act (BSA). In September 2006, the OCC issued a Cease and Desist Order due to BSA program deficiencies. The Cease and Desist Order mandated a look-back of wire transfers, demand drafts and pouch items processed by the Branch.

The OCC based its assessment on the Branch's failure to maintain a compliance program reasonably designed to assure and monitor compliance with the recordkeeping and reporting requirements of the BSA, and other related BSA compliance violations. Specifically, the Branch did not adequately identify, research, report, and monitor suspicious activities occurring through the Branch's funds transfers, pouch

activity, demand draft services, and correspondent relationships, and did not adequately audit and independently test such activities. The Branch also failed to conduct sufficient due diligence on its foreign correspondents.

The absence of effective internal controls and independent testing at the Branch resulted in numerous violations of the requirement to timely report suspicious transactions, and the extended period of time over which the violations occurred impaired the usefulness of the suspicious activity reports to law enforcement investigators.

The Branch, without admitting or denying the allegations, consented to payment of civil money penalties, which will be satisfied by a single payment of \$5 million to the Treasury Department.

## FTC Offers 'Red Flags' Web Site to Help Creditors and Financial Institutions Design Identity Theft Prevention Programs

On April 2, 2009, the FTC launched a web site to help entities covered by the Red Flags Rule design and implement identity theft prevention programs. The rule requires "creditors" and "financial institutions" to develop written programs to identify the warning signs of identity theft, spot them when they occur, and take appropriate steps to respond to those warning "red flags."

The FTC and the federal financial regulatory agencies developed the Red Flags Rule under the Fair and Accurate Credit Transactions Act of 2003. The Rule - seeks to reduce the overall incidence and impact of identity theft. The web site, "Fighting Fraud with the Red Flags Rule: A How To Guide for Business," available at [www.ftc.gov/redflagrule](http://www.ftc.gov/redflagrule), describes the entities that are covered by the Rule and provides information to assist

them develop identity theft prevention programs. The Web site also offers articles and guidance on specific elements of the Rule.

The Rule became effective on November 1, 2008. For entities under the FTC's jurisdiction, however, the Commission has delayed enforcement of the Rule until May 1, 2009, to provide more time for them to develop their Red Flags Programs.

## Additional Information

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