

Financial Services Regulatory Highlights

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FINRA Issues Guidance on Best Practices for Detecting and Preventing "Rogue" Trading

On April 9, 2008, FINRA issued guidance in Regulatory Notice 08-18 outlining best practices for detecting and preventing unauthorized proprietary trading.

Some of the practices highlighted in the guidance include:

- Heightened firm scrutiny of red flags such as trading limit breaches, unrealized profit loss on unsettled transactions, unusual patterns of cancellations and corrections; a pattern of aged fails to deliver;
- Increased password security and other protections of firm systems and risk management information; and
- Creating a stronger compliance culture within the firm.

FINRA also reminds firms that profitable unauthorized trading can result in regulatory exposure if it involves falsification of the firm's books and records, failures in supervisory control systems, market manipulation or fraud.

FINRA Issues a Regulatory Notice on Third-Party Research Reports

On April 7, 2008, the FINRA amended NASD Rule 2711(h)(13) and Incorporated NYSE Rule 472(k)(4) to modify a member's disclosure and supervisory review obligations when it distributes or makes available third-party research reports.

The rule change will create a new category of "independent third-party research" and will eliminate certain supervisory review requirements. The Rules:

- Require a member firm that distributes a third-party research report to accompany the report with certain current applicable disclosures;

- Require a member firm to either accompany third-party research report with the applicable disclosures or provide a Web address in the report that will direct the recipient to the location where the disclosures can be found; and

- Establish a more principles-based standard of review.

The rule was effective as of April 7, 2008.

FDIC Announces Plan to Conduct First Nationwide Survey of Banks' Efforts to Bring "Unbanked" Consumers into Economic Mainstream

On April 11, 2008, the Federal Deposit Insurance Corporation (FDIC) announced its plan to conduct the first nationwide survey of FDIC-insured institutions to assess their efforts to serve the unbanked and underbanked individuals and families.

The mail-in survey will be sent to approximately 1,300 FDIC-insured institutions and will consist of both questionnaires and case studies. The survey is part of a biennial effort by the FDIC to bring under and unbanked individuals and families into the conventional finance system. The questions will focus on:

- Banks' financial education and outreach strategies;
- Deposit, payment and credit products offered to entry-level consumers; and
- Other topics.

FTC Approves Filing of Staff Comment to the Federal Reserve to Restrict Certain Mortgage Practices Under TILA

On April 16, 2008, the Federal Trade Commission (FTC) submitted a Staff Comment to the Board of Governors of the Federal Reserve System (the Board) on a proposed rule to restrict certain mortgage practices under the Truth in Lending Act (TILA) and the Home Ownership Equity Protection Act (HOEPA).

The FTC comment supports the Board's goals of:

- Protecting consumers in the mortgage from unfair, abusive and deceptive lending and servicing while preserving responsible lending and sustainable home ownership;

- Ensuring that advertisements for mortgage loans are accurate and not misleading; and
- Providing consumers with transaction-specific disclosures early enough to use while shopping.

FinCEN Releases Foreign Corruption SAR Guidance

On April 17, 2008, Financial Crimes Enforcement Network (FinCEN) announced the publication of guidance developed to enable financial institutions to file more precise Suspicious Activity Reports (SARs). The publication has been developed in an effort to better assist law enforcement authorities in targeting foreign corruption related to money laundering. Specifically, it focuses on transactions that may involve senior political figures, acting individually or through government agencies and associated front companies, seeking to move the proceeds of foreign corruption to or through the U.S. financial system.

The term "senior foreign political figure" includes: a current or former senior official of a foreign government or of a major foreign political party; a current or former senior executive of a foreign government-owned commercial enterprise; a corporation, business, or other entity that has been formed by, or for the benefit of, any such individual; the immediate family members of any such individual; and the widely and publicly, or actually, known close associated of any such individual.

The term "proceeds of foreign corruption" means any asset or property that is acquired by, through, or on behalf of such corrupt public figures through misappropriation, theft, or embezzlement of public funds, the unlawful conversion of property of a foreign

government, or through the acts of bribery or extortion, and includes any property into which any such assets have been transformed or converted.

FinCEN is requesting that financial institutions include the term "foreign corruption" in the narrative portion of all SARs filed in connection with such activity.

This guidance is expected to lead to more precise SARs which provide more useful information to law enforcement investigators and FinCEN analysts. Better information, in turn, allows more effective utilization of SARs to detect and analyze trends and patterns. Furthermore, FinCEN, working with its domestic and international law enforcement partners, will be better equipped to provide feedback and subsequent guidance to the financial industry with examples of potentially suspicious activities that may assist in recognizing and detecting potential money laundering schemes and other illicit activities.

FinCEN Releases an Assessment of SAR Filings for the Insurance Industry

On April 3, 2008, the FinCEN released the *Insurance Industry Suspicious Activity Reporting* report.

The report highlights key findings of an assessment conducted by FinCEN of SAR filings for the period of May 2, 2006 through May 1, 2007 by insurance companies.

The purpose of the assessment was to identify typologies, trends and patterns relating to filing volume, filer location, subject location

and occupation, characterizations of suspected crimes, and other factors relevant to the reporting of suspicious activity on a variety of insurance products.

The report includes:

- Summaries of actual SAR narratives revealing potential money laundering trends

and frequently reported money laundering schemes;

- Preliminary observations regarding SARs filed from May 2007 through October 2007;
- Present indicia of possible illicit activity that some insurance companies have identified, and hence raise awareness of possible risks and vulnerabilities; and
- Insight into the quality of the reporting.

FinCEN analysts read and reviewed each of the 641 SARs filed by insurance companies between May 2, 2006 and May 1, 2007. The majority of these SAR filing were from insurance companies in Massachusetts, New York, and Ohio. Filers categorized over half of the subjects as policyholders of the insured, the beneficiary, the

payer, or the applicant. The next largest category of subjects was the applicant or owner of an annuity.

Consistent with data from all other financial services industries, insurance company filers most commonly cited “BSA/Money Laundering/Structuring” as the characterization of suspicious activity.

The data revealed some potential trends in illicit activity. Some of the typologies evidenced in the narratives appeared very similar to classical examples of the money laundering stages of layering and integration.

FinCEN Releases an Updated Mortgage Fraud Report

[On April 3, 2008, the FinCEN Released an update to the November 2006 mortgage fraud assessment.](#)

The previous study examined a statistical sample of SARs reporting mortgage fraud filed between April 1996 and March 2006. This updated study continues the analysis for reports filed through March 2007.

FinCEN noted a 44 percent increase in SARs reporting mortgage fraud in 2006. Analysis of the more recent data indicates that many identified trends continued and certain suspicious activities showed marked increases. For example, reports of identity theft in conjunction with mortgage fraud SARs increased 96 percent from

the previous study. In 2006, there were 37,313 mortgage fraud SARs filed. The final total for mortgage fraud SARs filed in 2007 was 52,868, an increase of 42 percent. According to FinCEN's most recent SAR data report *The SAR Activity Review; By the Numbers*, the suspicious activity characterization Mortgage Loan Fraud was the third most prevalent type of suspicious activity reported, after Bank Secrecy Act/Structuring/Money Laundering and Check Fraud.

FinCEN Issued Two Special Notices on CTRC & RMSB Postings

[On April 2, 2008, FinCEN released two revised draft forms -- FinCEN Form 103 \(Currency Transaction Report by Casinos\) \(CTRC\) and Fincen Form107 Registration of Money Services Business form \(RMSB\) for planning purposes. These drafts are for](#)

[planning purposes only and should not be used for filings. As part of these releases, FinCEN extended the effective use date of both the CTRC and RMSB to September 1, 2008.](#)

FinCEN Announces Proposal to Amend Currency Transaction Reporting Exemption Regulations

On April 23, 2008, FinCEN announced a proposal to simplify the current requirements for depository institutions to exempt their eligible customers from currency transaction reporting (CTR). Under the current regulations, depository institutions may exempt from CTR reporting requirements:

- Large reportable transactions in currency made by other depository institutions, governmental departments or agencies, or those acting with governmental authority, or public companies and their subsidiaries that are listed on one of the three major exchanges referenced in FinCEN's regulations (Phase I Exemption); and
- Reportable transactions in currency by eligible non-listed businesses or payroll customers (Phase II Exemption).

FinCEN proposes removing three existing regulatory requirements. Under the Notice of Proposed Rulemaking, depository institutions would:

- No longer be required to file exemption forms for, or to annually review, customers that are depository institutions, government agencies, or entities acting with governmental authority;
- No longer be required to biennially review a designation of exempt person filing for otherwise eligible Phase II customers; and
- No longer be required to wait 12 months before designating other eligible Phase II customers for exemption.

Modification of the CTR exemption process is part of FinCEN's continuing effort to increase the efficiency and effectiveness of BSA regulations, while maintaining the usefulness of BSA reports to law enforcement.

OCC Issues Final Rule Reducing Regulatory Burden and Updating its Rules

On April 24, 2008, the Office of the Comptroller of the Currency (OCC) published a final rule in the Federal Register to reduce unnecessary regulatory burden and revise and update various OCC regulations.

The OCC final rule includes measures updating and revising the qualifying standards and after-the-fact notice procedures that apply to national bank operating subsidiaries. It also expands the list of operating subsidiary activities that are permissible upon filing an after-the-fact notice. Other revisions reduce the burden associated with applications for fiduciary powers and intermittent branches, with change in bank control notices, and with requirements to make securities filings.

The final rule also includes other measures to incorporate previously published interpretive opinions concerning, for example, electronic

banking activities, and to harmonize the OCC rules with rules issued by other Federal agencies, to update OCC rules to reflect recent statutory changes, and to make technical and conforming amendments to improve clarity and consistency.

The OCC final rule is effective on July 1, 2008. National banks, and foreign banks taking actions with respect to Federal branches and agencies, may elect to comply voluntarily with any applicable provision of the rule prior to this effective date.

OCC Bulletin 2008-12 -- Payment Processors

The OCC issued Bulletin 2008-12 on April 24, 2008 to present guidance to national banks for due diligence, underwriting, and monitoring of entities that process payments for telemarketers and other merchant clients. As detailed in several OCC issuances, certain merchants, such as telemarketers, pose a higher risk than other merchants and require additional due diligence and close monitoring. This bulletin supplements, but does not replace, existing guidance related to Automated Clearing House (ACH) risk management, merchant processing, and remotely-created checks (RCCs).

The OCC has seen a variety of relationships between banks and processors in which the processor uses its bank relationship to process payments for merchant clients. Often the processor uses a bank account as the vehicle to conduct such payment processing. For example, a processor may be a bank customer that deposits into its account RCCs generated on behalf of merchant clients. A processor may also act as a third-party sender of ACH transactions, originating debits for its merchant clients through its customer relationship with the bank. In either case, the bank often has no direct customer relationship with the merchant. Risks are heightened when neither the processor nor the bank performs adequate due diligence on the merchants for which they are originating payments.

When a bank has a relationship with a processor, it is exposed to risks that may not be present in relationships with other commercial customers. The bank encounters strategic, credit, compliance, transaction, and reputation risks in these relationships. Banks have two distinct areas of responsibility to control these risks. The first is due diligence and underwriting, and the second is monitoring these

high-risk accounts for high levels of unauthorized returns and for suspicious or unusual patterns of activity. Proper initial due diligence, effective underwriting, and ongoing account monitoring are critical for bank safety and soundness and consumer protection. Banks should implement these controls to reduce the likelihood of establishing or maintaining an inappropriate relationship with a processor through which unscrupulous merchants can gain access to consumers' bank accounts.

Banks should also consider carefully the legal, reputation, and other risks presented by relationships with processors including risks associated with customer complaints, returned items, and potential unfair or deceptive practices. Banks that do not have the appropriate controls to address the risks in these relationships may be viewed as facilitating a processor's or its merchant client's fraud or other unlawful activity. Banks should be alert for processors that use more than one bank to process payments for merchant clients and should subject such processors to great scrutiny. Processing through multiple banks may be a signal that the processor recognizes a risk that one or more of these processing relationships may be terminated as a result of suspicious, fraudulent, or other unlawful conduct.

Financial Stability Forum Issues Report on Enhancing Market and Institutional Resilience

The Financial Stability Forum (FSF) has presented to the G7 Finance Ministers and central bank Governors a report making recommendations for enhancing the resilience of markets and financial institutions. The recommended actions are in five areas:

- Strengthened prudential oversight of capital, liquidity and risk management;
- Enhancing transparency and valuation;
- Changes in the role and uses of credit ratings;

- Strengthening the authorities' responsiveness to risks; and
- Robust arrangements for dealing with stress in the financial system.

Public sector and private sector initiatives are underway in these areas. The FSF will facilitate coordination of these initiatives and oversee their timely implementation, thus preserving the advantages of integrated global financial markets and a level playing field across countries. To restore confidence in the soundness of markets and institutions, it is essential that steps are taken now to enhance the

resilience of the global system. At the same time, the FSF recognizes the strains under which the financial system is currently operating and will pursue implementation in a way that avoids exacerbating stress in the short term. The FSF will report on progress in June followed by a fuller follow-up report in September. The FSF will continue to closely monitor implementation thereafter.

OTS CEO Letter -- Compliance with Truth in Savings and Electronic Fund Transfer Act Rules: Government Accountability Office (GAO) Report 08-281

In a Memorandum to thrift CEOs dated April 25th, the OTS noted that on January 31, 2008, the GAO published Report 08-281 which raised questions about whether consumers are able to request and obtain account terms, conditions, and fee disclosures prior to account opening. The report also raised questions about whether consumers can obtain information about these items on institution websites.

As part of the audit that led to the report, GAO employees, posing as consumers shopping for checking and savings accounts, visited 185 branches of 154 banks, thrifts, and credit unions throughout the nation to request documents on the fees associated with basic checking and savings accounts. GAO staff also reviewed information on account terms, conditions, and fees provided on institution websites.

The GAO found that consumers shopping for a checking or savings account may find it difficult to obtain information about terms, conditions, and fees. Further, the GAO reported that it was unable to obtain, upon request, a comprehensive list of all checking and savings account fees at 40 of the 185 branches (22 percent) visited. Similarly, GAO employees were unable to obtain account terms and conditions, including information on when deposited funds became available and how overdrafts were handled, for checking and savings accounts at 61 of the 185 branches (33 percent).

The OTS pointed out in its Memorandum that Regulation DD, which implements the Truth in Savings Act (TISA), requires depository institutions to disclose the amount of any fee that may be imposed

in connection with an account and the conditions under which such fees are imposed. Regulation E, which implements the Electronic Fund Transfer Act, requires financial institutions to provide consumers with initial disclosures that explain the terms and conditions of EFT services.

OTS thus advised that thrift institutions should ensure that:

- Account terms and conditions and fee disclosure information is available to consumers upon request, prior to account opening, regardless of whether they are existing or prospective customers;
- Employees receive training that incorporates the requirements of Regulation DD and Regulation E;
- Account information and fee disclosures, particularly disclosures related to electronic transactions provided to consumers, are:
 - Clear and understandable; and
 - Available in a written form that the consumer may keep.
- Recordkeeping requirements include retention of account disclosures and fee

disclosures sufficient to determine compliance with Regulation DD and Regulation E.

The OTS indicated that it remains committed to examining for compliance with these requirements.

Comptroller of the Currency Discusses Problems with the Current Environment

On April 16, 2008, the Comptroller of the Currency John C. Dugan spoke at the Exchequer Club on some of the problems in the current environment and how lessons from the late 1980's and early 1990's can help during this environment.

The Comptroller said that, with problem loans rising, it is imperative that bank management identify and address problems realistically and that the OCC deal with national banks in a consistent and balanced way.

In the last economic downturn, the OCC:

- Made unilateral adjustments to real estate appraisals which had become outdated;
- Did not give enough credit to bank management; and
- Did not make good use of effective two-way communication.

During this downturn, the OCC plans to:

- Direct management to obtain a new appraisal, then give the bank a reasonable amount of time review and make decisions about how to classify the loans;
- Give banks more latitude to do their work; and
- Engage in two-way communication.

Mr. Dugan stressed the importance of communication. "These bankers are reluctant to charge off obviously troubled loans or even to flag problems to their examiners," he said. "While this resistance to recognizing problems at the beginning of an economic downturn may be human nature, it's not healthy, because denial is not a strategy."

The OCC plans to work with community banks as problems arise.

In conclusion, the Comptroller stated, "That process works best with a combination of early and realistic problem identification by bank management, frequent and robust communication between bankers and examiners, and balanced supervision." "If we do all that, we'll go a long way towards achieving our common goal: to make sure that banks remain safe and sound, and continue to meet the credit needs of a growing and prosperous America."

Senior Supervisors Group Issues Report on Lending-Practice Disclosures for Selected Exposures

On April 11, 2008, the Senior Supervisors Group (comprised of senior financial supervisors from the United States, the United Kingdom, France, Germany, and Switzerland) issued a report that reviews the disclosure practices of financial services firms concerning their exposures to certain financial instruments considered to be high-risk.

The report provides examples of current leading practices in the reporting of information about exposures associated with such

instruments as collateralized debt obligations, residential mortgage-backed securities, commercial mortgage-backed securities, other special purpose entities, and leveraged finance loans. The leading practices were derived from the practices of twenty large internationally-oriented financial services firms - fifteen banks and five securities firms. The results of the survey indicate that disclosure practices can be

enhanced without necessarily amending current disclosure requirements. The paper provides illustrative examples of leading practice disclosures.

NAIC Launches New Report on Nationwide Snapshot of Insurance Complaints

On March 31, 2008, the National Association of Insurance Commissioners (NAIC) announced the launch of new reports on their Consumer Information Source (CIS). These monthly reports summarize consumers' top complaints against insurance companies.

The reports will include information on the most common complaints by:

- Reason;
- Type of insurance; and
- Disposition.

Additional Information

If you would like additional information about the topics discussed in this newsletter, or about PwC's Financial Services Regulatory Advisory Services, please call:

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