



The Washington Report

ADVISORY

September 28, 2009

Legislative Update

House Committee Hears Testimony on Systemic Risk and Resolution

The House Committee on Financial Services conducted a hearing on September 24 to consider Systemic Risk and Resolution Issues. Five witnesses provided testimony, including Paul Volcker, Former Chairman of the Federal Reserve Board ("Fed"), and Arthur Levitt, Former Chairman of the Securities and Exchange Commission.

Former Chairman Volcker defended the Fed's role as a systemic risk supervisor, saying that the agency was independent from political pressure, had the necessary prestige and the essential qualification of experience to oversee the financial system. He added that it would be a mistake to separate the tasks of monetary policy and supervisory policy because one informed the other.

Former Chairman Levitt stated that the powers given to the resolution authority would be more important than the systemic risk regulator. He suggested that in today's markets it would be impossible to restrict any institution from becoming "too big," such that it was important to focus on how to resolve the "fail" part. Chairman Levitt did not favor the Fed as a systemic risk regulator, saying that there would be too many conflicts.

One witness, Jeffrey Miron of Harvard University, suggested the provisions in the Administration's proposed legislation for resolution authority that would give the Federal Deposit Insurance Corporation the authority to purchase assets or debt obligations of a failing entity effectively institutionalized the Temporary Assets Relief Program ("TARP") for bank holding companies, which he did not support.

For more information, please contact Linda Gallagher, Principal: lgallagher@kpmg.com or Hugh Kelly, Principal: hckelly@kpmg.com.

In This Issue

Legislative Update

- House Committee Hears Testimony on Systemic Risk and Resolution 1
- House Bill Introduced to Expedite Credit Card Reforms 2
- House Committee Hears Testimony on Derivatives Reform; Senator Reed Introduces Derivatives Legislation 2

Bank & Thrift Regulatory Update

- Agencies Release Shared National Credits Review Results for 2009 3
- Fed Revises Certain Rate and Fee Reimbursements by Government Agencies 4
- OCC Releases Second Quarter Report on Bank Trading and Derivatives Activities 4
- BIS Working Paper Considers Effect of Bank Rescues on Market Prices 4
- OCC Schedules Workshop for Directors 5

Enterprise & Consumer Compliance Regulatory Update

- Comptroller Dugan Advocates National Preemption for National Banks 5
- OCC Issues Consumer Advisory on Reverse Mortgages 5

Recent Supervisory Actions

House Bill Introduced to Expedite Credit Card Reforms

Barney Frank, Chairman of the House Committee on Financial Services, and Representative Carolyn Maloney introduced H.R. 3639, the *Expedited CARD Reform for Consumers Act of 2009*, on September 23. The bill would amend the *Credit Card Accountability, Responsibility and Disclosure Act of 2009*, which was signed into law in May 2009, by changing the remaining effective dates for various provisions from “9 months after the enactment date” or “15 months after the enactment date” (February and August 2010, respectively) to December 1, 2009.

For more information, please contact Linda Gallagher, Principal: lgallagher@kpmg.com or Kari Greathouse, Director: kgreathouse@kpmg.com.

House Committee Hears Testimony on Derivatives Reform; Senator Reed Introduces Derivatives Legislation

The House Committee on Agriculture conducted a hearing on September 22 to review the Administration’s proposed legislation to regulate over-the-counter (“OTC”) derivatives (released by the Department of the Treasury in August 2009 as the *Over-the-Counter Derivatives Act of 2009*). Gary Gensler, Chairman of the Commodities Futures Trading Commission (“CFTC”), and Mary Shapiro, Chairman of the Securities and Exchange Commission (“SEC”), each provided testimony.

Chairman Shapiro stated that she believed the Administration’s proposal

would “go a long way toward bringing OTC derivatives under a comprehensive regulatory framework.” However, she offered a number of suggestions for Congress to consider to strengthen the legislation, including:

- Modifying the proposal so that all securities-related OTC derivatives are regulated more like securities; and commodity and other non-securities-related OTC derivatives are regulated more like futures.
- Extending the federal securities laws to all securities-related OTC derivatives and extending the *Commodity Exchange Act* to all commodity-related and non-securities related OTC derivatives.
- Defining “security-based swap” to include not only single-name and narrow-based index credit default swaps (“CDS”), but also broad-based index CDS, and other similar products, when payment is triggered by a single security or issuer or narrow-based index of securities or issuers.
- Revising the qualification standards for participation in the OTC derivatives markets.
- Clarifying that the exclusion from the regulatory scheme for OTC derivatives for products that are “identified banking products” is not available to foreign banks or their subsidiaries that are not subject to federal banking oversight.

On July 30, Barney Frank, Chairman of the House Committee on Banking, Housing and Urban Affairs, and Collin Petersen, Chairman of the House Committee on Agriculture, jointly released a concept paper that they said would guide the two committees in

drafting legislation to regulate derivatives.

Separately on September 22, Senator Jack Reed, Chairman of the Senate Committee Banking, Housing and Urban Affairs’ Subcommittee on Securities, Insurance and Investment introduced the *Comprehensive Derivatives Regulation Act of 2009*. In a press statement, Senator Reed outlined the provisions of the bill, which include:

- Requiring standardized CDS and other unregulated derivatives to be cleared through a clearinghouse;
- Establishing capital and margin requirements for derivatives dealers and other major market participants, and subjecting them to higher standards for products that are not traded on clearinghouses;
- Subjecting firms to new conduct requirements to protect investors from abusive practices and new recordkeeping and reporting requirements;
- Giving regulators new authority to set position limits and oversee the marketing of products to certain investors; and
- Rationalizing the sharing of jurisdiction between the SEC and CFTC, and establishing a process for assigning responsibility for new products. The bill provides the SEC with jurisdiction over all derivatives that are securities or can be used as synthetic substitutes for securities and gives the CFTC jurisdiction over all other derivatives. It further creates a process for the United States Court of Appeals for the District of Columbia Circuit to resolve any differences in views

between the agencies that might arise.

For more information, please contact Doug Henderson, Managing Director: douglashenderson@kpmg.com.

Bank & Thrift Regulatory Update

Agencies Release Shared National Credits Review Results for 2009

The Federal Reserve Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation (“FDIC”) and Office of Thrift Supervision (collectively, the “Agencies”) jointly released the results of their annual interagency Shared National Credits (“SNCs”) review for 2009 on September 24. The review is based on analyses of credit-related data provided by federally supervised institutions as of December 31, 2008 and March 31, 2009.

The SNC program was established in 1977 to provide an efficient and consistent review and classification of SNC, which includes any loan and/or formal loan commitment, and any asset such as real estate, stocks, notes, bonds, and debentures taken as debts previously contracted, extended to borrowers by a federally supervised institution, its subsidiaries, and affiliates that aggregates to \$20 million or more and is shared by three or more unaffiliated supervised institutions. Many of these large loan commitments are also shared with foreign banking organizations (“FBOs”) and nonbanks, including securitization pools, hedge funds, insurance companies, and pension funds.

The Agencies’ 2009 review found, among other things:

- Criticized assets, which included SNCs classified as special mention, substandard, doubtful, or loss, reached \$642 billion, up from \$373 billion last year, and represented 22.3 percent of the SNC portfolio.
 - SNC commitment volume increased 3.3 percent while the number of credits remained virtually unchanged.
 - Classified assets, which included SNCs classified as substandard, doubtful, or loss, rose to \$447 billion from \$163 billion and represented 15.5 percent of the SNC portfolio. Classified dollar volume increased 174 percent from a year ago.
 - Special mention assets declined to \$195 billion from \$210 billion and represented 6.8 percent of the SNC portfolio.
 - The severity of criticism increased with the volume of SNCs classified as doubtful and loss rising to \$110 billion, up from \$8 billion in 2008. Loans in nonaccrual status also increased to \$172 billion from \$22 billion.
 - The distribution of credits across U.S. bank organizations, FBOs, and nonbanks remained relatively unchanged. U.S. bank organizations held 40.8 percent, while FBOs and nonbanks held 38 percent and 21.2 percent, respectively. Nonbanks continued to hold a disproportionate share of classified assets - 47 percent of classified assets and 52 percent of nonaccrual loans. FDIC-insured institutions held 24.2 percent of
- classified assets and 22.7 percent of nonaccrual loans.
 - Criticized volume was led by the Media and Telecom industry group with \$112 billion, Finance and Insurance with \$76 billion, and Real Estate and Construction with \$72 billion. These three groups also represented the highest shares of criticized credits with 17.3 percent, 11.7 percent, and 11.2 percent of criticized credits in the SNC portfolio, respectively.
 - The review identified significant deterioration in credit quality of leveraged finance credits, with these loans representing more than 40 percent of the dollar volume of total criticized assets. About 72 percent of the dollar volume of the 50 largest leveraged finance SNCs were criticized, which represents one-third of all criticized assets.
 - Underwriting standards in 2008 improved from prior years, with examiners identifying fewer loans with structurally weak underwriting characteristics compared to credits written in 2007 and 2006. However, the SNC portfolio contained loans with structurally weak underwriting characteristics that were committed before mid-2007 that contributed significantly to the increase in criticized assets.

For more information, please contact Hugh Kelly, Principal: hckelly@kpmg.com or Craig Stirnweis, Director: cstirnweis@kpmg.com.

Fed Revises Certain Rate and Fee Reimbursements by Government Agencies

On September 24, the Federal Reserve Board ("Fed") issued revisions to Regulation S, *Reimbursement to Financial Institutions for Providing Financial Records; Recordkeeping Requirements for Certain Financial Records*. The revisions specifically affect Subpart A of the regulation, which sets the rates and conditions under which a government agency must reimburse a financial institution for costs incurred in producing customer financial records under the *Right to Financial Privacy Act*.

The revisions take effect January 1, 2010 and include:

- An increase to the personnel fees chargeable for searching and processing document requests;
- A requirement for financial institutions to obtain an agency's consent prior to printing electronically stored information and charging the agency a reproduction fee;
- A mechanism for automatically updating the labor rates found in the regulation every three years, beginning October 1, 2012; and
- Other technical changes.

For more information, please contact Hugh Kelly, Principal: hckelly@kpmg.com or Francis Gomez, Manager: fpgomez@kpmg.com.

OCC Releases Second Quarter Report on Bank Trading and Derivatives Activities

The Office of the Comptroller of the Currency ("OCC") released its *Quarterly Report on Bank Trading and Derivatives Activities* for the second quarter of 2009. Findings included:

- Trading revenues of \$5.2 billion in the second quarter of 2009, compared to record revenues of \$9.8 billion in the first quarter of 2009.
- Trading results continue to be influenced by the reporting of fair value adjustments for derivatives payables and receivables. Kathryn Dick, Deputy Comptroller for Credit and Market Risk explained, "On balance, trading results in the second quarter benefited from the significant tightening of corporate credit spreads, as the positive impact of increasing receivable values exceeded the negative impact of increasing payable values."
- Net current credit exposure decreased \$140 billion, or 20 percent, to \$555 billion.
- Notional amount of derivatives held by insured U.S. commercial banks increased by \$1.5 trillion (nearly 1 percent) in the second quarter, interest rate contracts increased \$2.5 trillion, and credit derivatives fell 8 percent.

The report also noted that:

- Derivatives contracts are concentrated in a small number of institutions. The largest five banks hold 97 percent of the total notional amount of derivatives, while the

largest 25 banks hold nearly 100 percent.

- Credit default swaps are the dominant product in the credit derivatives market, representing 98 percent of total credit derivatives.
- The number of commercial banks holding derivatives increased by 47 in the quarter to 1,110.

A copy of the OCC's *Quarterly Report on Bank Trading and Derivatives Activities: Second Quarter 2009* is available on the OCC's Web site.

For more information, please contact Hugh Kelly, Principal: hckelly@kpmg.com or Bill Canellis, Manager: wcanellis@kpmg.com.

BIS Working Paper Considers Effect of Bank Rescues on Market Prices

The Bank for International Settlements ("BIS") released Working Paper No. 288, entitled "*Time to buy or just buying time? The market reaction to bank rescue packages*," on September 24. The author summarizes the paper as follows:

"This paper reviews the market reaction to bank rescue packages announced in six countries between October 2008 and January 2009. The study distinguishes the impact on creditors as seen in the change of CDS [credit default swap] spreads from the impact on shareholders as seen in the movement of bank stock prices. Government interventions benefited creditors at the expense of shareholders, with bank CDS spreads narrowing around the announcements in all cases. Despite a brief positive reaction, bank stock prices continued to

underperform in all countries except the United States where the favorable terms of the government support allowed bank stocks to outperform.

For more information, please contact Hugh Kelly, Principal: hckelly@kpmg.com or Steve Giczewski, Manager: sgiczewski@kpmg.com.

OCC Schedules Workshop for New Directors

The Office of the Comptroller of the Currency (“OCC”) announced on September 21 that it has scheduled a workshop for national community bank directors on November 2, 3 and 4 in St. Louis, Missouri.

The workshop is intended to provide practical information that expands bank directors' skills and understanding of issues facing their banks. It is entitled, “*A New Director's Challenge, Mastering the Basics*,” and is geared primarily to outside directors of national community banks with assets of less than \$1 billion who have less than three years experience. However, the OCC notes that longer tenured directors that want to refresh their skill may also find the workshop beneficial.

For more information, please contact Hugh Kelly, Principal: hckelly@kpmg.com or William Canellis, Manager: wcanellis@kpmg.com.

Enterprise & Consumer Compliance Regulatory Update

Comptroller Dugan Advocates National Preemption for National Banks

John Dugan, Comptroller of the Currency, addressed the Women in Housing and Finance on September 24 about “*The Need to Preserve Uniform National Standards for National Banks*.” Comptroller Dugan said that he could not support the portion of the Administration’s proposal for a Consumer Financial Protection Agency (“CFPA”) that would repeal parts of the *National Bank Act's* preemption of state laws. In particular, he stated that such a provision is “fundamentally at odds with the concept of efficient national standards for national banks and services offered across state lines in national markets.”

Although the Administration’s proposal provides that federal rules promulgated by the CFPA would apply equally to all financial providers, including banks and nonbanks, Comptroller Dugan stated that he thought the provision was undermined by the specific grant of authority to the states to adopt different rules, the empowerment of the states to enforce federal rules and the repeal of uniform standards for national banks, all of which he said could effectively distort and displace the CFPA’s federal rulemaking. He added this would give rise to a patchwork of federal and state laws that would serve to disadvantage consumers and create uncertainties for banks operating in multiple states.

Comptroller Dugan supported providing the CFPA with supervisory and enforcement authority over nonbank financial providers but did not support stripping this authority from federal bank regulators where he believes the current system has worked well. He stated that analyses have shown state-regulated entities to be the primary source of consumer protection violations and suggested that state regulators should focus their enforcement efforts on nonbank lenders rather than dilute their resources on national banks that are already supervised by the Office of the Comptroller of the Currency.

For more information, please contact Linda Gallagher, Principal: lgallagher@kpmg.com or Kari Greathouse, Director: cgreathouse@kpmg.com.

OCC Issues Consumer Advisory on Reverse Mortgages

The Office of the Comptroller of the Currency released a Consumer Advisory brochure on September 24 to provide consumers with general information regarding the fundamentals of reverse mortgages. The brochure considers: Basics about Reverse Mortgages; Costs and Benefits of Reverse Mortgages; Rules of Thumb; and, sources of information. Copies of the brochure are available on the OCC Web site.

For more information, please contact Linda Gallagher, Principal: lgallagher@kpmg.com or Kari Greathouse, Director: cgreathouse@kpmg.com.

Recent Supervisory Actions
A Monthly Look Into Significant Federal Supervisory Actions Taken Against Financial Institutions
 Last Updated September 28, 2009

Agency	Institution Type/Size	Type of Action	Date	Synopsis of Action	Web Site
Federal Reserve Board	Bank Holding Company; State Member Bank	Order to Cease and Desist	09/25	The Federal Reserve Board entered into an Order to Cease and Desist with an Illinois bank holding company and its state member bank subsidiary to take action to ensure they restore and maintain financial soundness. The order addressed an independent accounting review, staffing and bank records.	www.federalreserve.gov
Federal Reserve Board	State Member Bank	Civil Money Penalty	09/24	The Federal Reserve Board entered into an Order for Civil Money Penalties with an Alabama state member bank to address violations of the National Flood Insurance Act.	www.federalreserve.gov
Federal Reserve Board	Bank Holding Company	Written Agreement	09/24	The Federal Reserve Board entered into a Written Agreement with a Kansas bank holding company to ensure that it serves as a source of strength for its national bank and two nonbank subsidiaries. The agreement addressed dividends, distributions, and debt and stock redemptions.	www.federalreserve.gov
Federal Reserve Board	State Member Bank	Written Agreement	09/23	The Federal Reserve Board entered into a Written Agreement with a Florida state member bank to address, among other things, deficiencies related to board oversight, credit risk management, lending and credit administration, asset improvement, allowance for loan and lease losses, capital, dividends and distributions.	www.federalreserve.gov
Federal Reserve Board	Bank Holding Company	Written Agreement	09/23	The Federal Reserve Board entered into a Written Agreement with a Utah bank holding company to ensure that it serves as a source of strength for its state nonmember bank and nonbank subsidiaries. The agreement addressed, among other things, dividends and distributions, and debt and stock redemptions.	www.federalreserve.gov
Federal Reserve Board	Bank Holding Company	Written Agreement	09/23	The Federal Reserve Board entered into a Written Agreement with a Georgia bank holding company to ensure that it serves as a source of strength for its two state nonmember bank subsidiaries and nonbank subsidiary. The agreement addressed, among other things, dividends and distributions, debt and stock redemptions and capital.	www.federalreserve.gov
Federal Reserve Board	Bank Holding Company	Written Agreement	09/22	The Federal Reserve Board entered into a Written Agreement with a Washington bank holding company to ensure that it serves as a source of strength for its state nonmember bank and various nonbank subsidiaries. The agreement addressed dividends and distributions, debt and stock redemptions, affiliate transactions and capital.	www.federalreserve.gov
Federal Reserve Board	Bank Holding Company; State member bank	Order to Cease and Desist	09/22	The Federal Reserve Board entered into an Order to Cease and Desist with a Florida bank holding company and its state member bank to address safety and soundness deficiencies related to corporate governance and management, books and records, brokered deposits and the accuracy of written materials.	www.federalreserve.gov
Federal Reserve Board	Bank Holding Company	Written Agreement	09/22	The Federal Reserve Board entered into a Written Agreement with a Minnesota bank holding company to ensure that it serves as a source of strength for its state nonmember bank subsidiary. The agreement addressed, among other things, dividends and distributions, debt and stock redemptions, affiliate transactions.	www.federalreserve.gov

FINANCIAL SERVICES REGULATORY PRACTICE – CONTACTS:

LINDA GALLAGHER, NATIONAL LEADER, FINANCIAL SERVICES REGULATORY PRACTICE TELEPHONE: 703.286.8248

LINDA GALLAGHER, PRINCIPAL, CONSUMER COMPLIANCE – TELEPHONE: 703.286.8248

DOUGLAS HENDERSON, MANAGING DIRECTOR, SECURITIES AND INVESTMENT – TELEPHONE: 212.872.6687

HUGH KELLY, PRINCIPAL, BANK REGULATORY – TELEPHONE: 202.533.5200

LINDA WATTERS, MANAGING DIRECTOR, INSURANCE – TELEPHONE: 312.665.2523

<p>FINANCIAL SERVICES LEGISLATION KAREN STAINES.....202.533.5452</p> <p>CROSS-BORDER REGULATORY HUGH KELLY.....202.533.5200 CRAIG STIRNWEIS.....212.872.5960</p>	<p>SAFETY & SOUNDNESS, CORPORATE LICENSING & GOVERNANCE, CAPITAL / BASEL II, AND ERM REGULATORY HUGH KELLY.....202.533.5200 CRAIG STIRNWEIS.....212.872.5960 STEVE GICZEWSKI312.665.2935 ANNE DUBOIS.....212.954.8486</p>
<p>FOREIGN BANKING ORGANIZATIONS HUGH KELLY.....202.533.5200 CRAIG STIRNWEIS.....212.872.5960 FRANCIS GOMEZ.....212.872.5662</p>	<p>ASSET MANAGEMENT, TRUST, FIDUCIARY REGULATORY AND REGULATORY REPORTING WILLIAM CANELLIS.....973.912.4817 STEPHEN GICZEWSKI.....312.665.2935 NICOLE ANDERSON.....216.875.8234</p>
<p>CONSUMER COMPLIANCE & ENTERPRISE-WIDE COMPLIANCE LINDA GALLAGHER.....703.286.8248 KARI GREATHOUSE.....636.587.2844</p>	<p>PRIVACY AND IDENTITY THEFT REGULATORY LINDA GALLAGHER.....703.286.8248 KARI GREATHOUSE.....636.587.2844</p>
<p>SECURITIES & INVESTMENT MANAGEMENT REGULATORY DOUG HENDERSON.....212.872.6687 LUCIA BARAYBAR.....212.872.6477</p>	<p>INSURANCE REGULATORY LINDA WATTERS312.665.2623</p>

FINANCIAL RISK MANAGEMENT – OTHER CONTACTS:

MICHAEL CONOVER, PARTNER-IN CHARGE – TELEPHONE: 212.872.6402

FOR ONLINE ACCESS TO THE **KPMG WASHINGTON REPORT ARCHIVE**, PLEASE VISIT OUR WEB SITE AT
[HTTP://WWW.US.KPMG.COM/SERVICES/CONTENT.ASP?L1ID=10&L2ID=660&CID=2473](http://www.us.kpmg.com/services/content.asp?L1ID=10&L2ID=660&CID=2473)

ALL INFORMATION PROVIDED HERE IS OF A GENERAL NATURE AND IS NOT INTENDED TO ADDRESS THE CIRCUMSTANCES OF ANY PARTICULAR INDIVIDUAL OR ENTITY. ALTHOUGH WE ENDEAVOR TO PROVIDE ACCURATE AND TIMELY INFORMATION, THERE CAN BE NO GUARANTEE THAT SUCH INFORMATION IS ACCURATE AS OF THE DATE IT IS RECEIVED OR THAT IT WILL CONTINUE TO BE ACCURATE IN THE FUTURE. NO ONE SHOULD ACT UPON SUCH INFORMATION WITHOUT APPROPRIATE PROFESSIONAL ADVICE AFTER A THOROUGH EXAMINATION OF THE FACTS OF THE PARTICULAR SITUATION.