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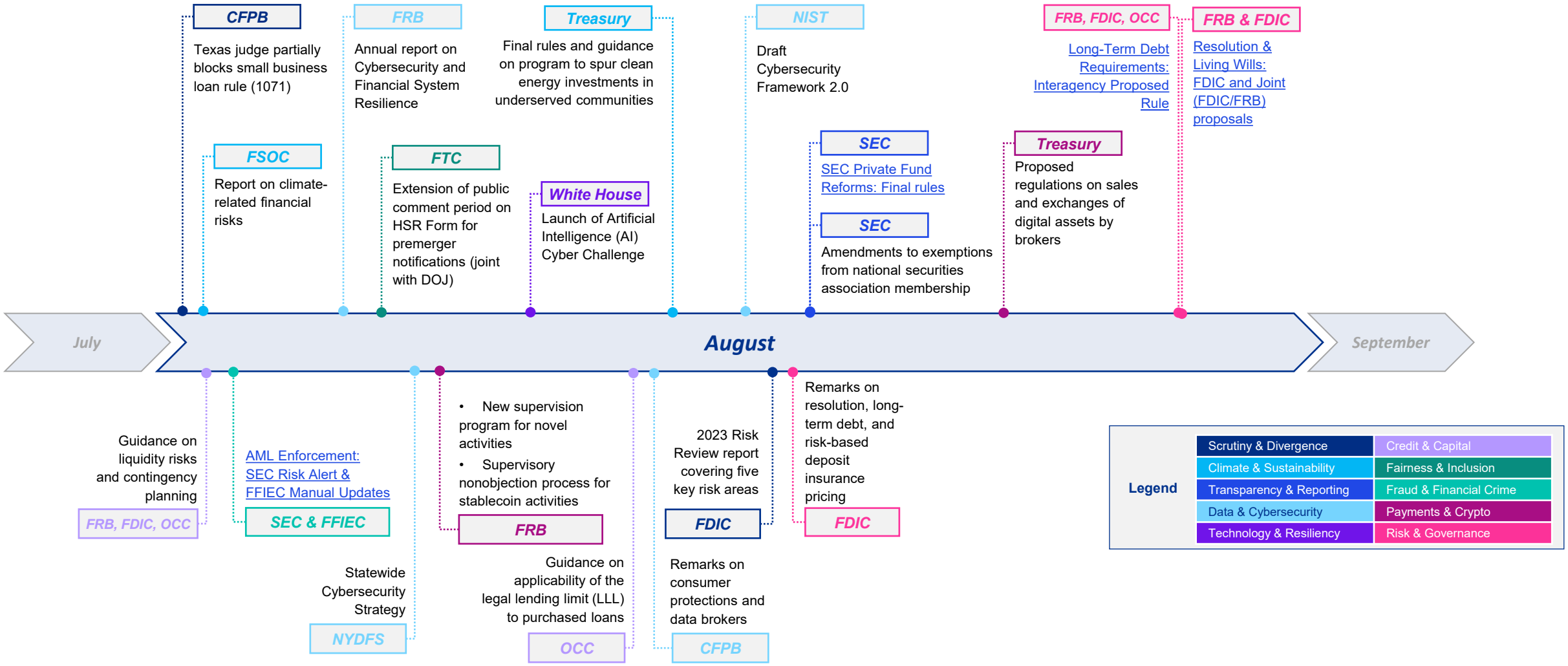
Regulatory Recap

August 2023 at a glance

Regulatory Insights: August 2023



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AML Enforcement: SEC Risk Alert & FFIEC Exam Manual Updates

The SEC Division of Examinations issued a Risk Alert presenting observations about key anti-money laundering (AML) requirements based on recent examinations across the broker-dealer industry (BDs). The Risk Alert covers: 1. AML Programs, with a focus on Independent Testing and Training, 2. Customer Identification Program Rule, 3. Customer Due Diligence (CDD) and Beneficial Ownership Requirements, and 4. General Observations.

Separately, the members of the FFIEC issued updates to six sections of its BSA/AML Examination Manual.

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- SEC (and FINRA have each identified BSA/AML compliance, customer due diligence, and beneficial ownership as key areas of examination focus (see KPMG Regulatory Alert here and here); they state the importance of AML program examinations has been elevated due to the geopolitical environment and the increased imposition of sanctions.
- Regulatory focus on financial institutions' compliance with the CDD Rule and beneficial ownership obligations, coupled with the pending Corporate Transparency Act, further raise the stakes.
- Supervision/enforcement in this area is gaining in intensity and may also include a higher focus on data traceability, transaction monitoring, suspicious activity reporting, independent reviews, and employee training.

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SEC Private Fund Reforms: Final rules

The SEC has adopted final rules and amendments under the Investment Advisers Act of 1940 that enhance regulation of private fund advisers with the goal of protecting investors. The SEC states the rules are designed to address three factors for risks and harms in an adviser's relationship with private funds and their investors: "lack of transparency, conflicts of interest, and lack of effective governance mechanisms for client disclosure, consent, and oversight."

The final rules include requirements for quarterly statements, independent audits, and fairness or valuation opinions, as well as certain restrictions and prohibitions on certain activities and recordkeeping.

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- The SEC's new rules and rule amendments expand regulation requirements for private fund advisers.
- In final form, however, the provisions include modifications from the proposal that provide some flexibility to advisers, such as:
  - The ability to now choose between a fairness opinion and a valuation opinion for advisor-led secondary transactions
  - The ability to engage in certain otherwise prohibited activities (e.g., certain fees, expenses, clawbacks) provided certain disclosures are made or investor consent obtained.
- The new requirements will improve investors' ability to monitor the costs and performance of their fund investments, including compensation, fees, and expenses, and to more easily make comparisons between prospective investments.

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Long-Term Debt Requirements: Interagency Proposed Rule

FRB, FDIC, and OCC jointly issued a proposed rulemaking on long-term debt (LTD) requirements for large bank holding companies (BHCs), U.S. intermediate holding companies (IHCs) of foreign banking organizations (FBOs), and large insured depository institutions (IDIs).

In particular, the proposed LTD requirement would provide FDIC (as receiver for a failed IDI) with optionality during a covered entity's resolution under a multiple point of entry (MPOE) or single point of entry (SPOE) strategy through several options outlined in the proposal.

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- Expansion of requirements to all banks and BHCs with total assets of $100 billion or more.
- The proposed long-term debt requirements are intended to:
  - Absorb losses that may otherwise be borne by uninsured depositors and other creditors
  - Promote market confidence in the safety of deposits and limit the potential of bank runs
  - Mitigate potential "fire sale risk" by decreasing the need to liquidate assets to meet withdrawals during resolution.
  - Minimize costs to the Deposit Insurance Fund
  - Provide the FDIC with a broader range of restructuring options
  - Reduce interconnectedness and contagion risk by discouraging investment in the long-term debt issued by other banks and prohibiting specific categories of outstanding liabilities

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Resolution & Living Wills: FDIC and Joint (FDIC/FRB) proposals

The FDIC and the FRB issue rule proposals to large insured depository institutions (IDIs) and certain large bank holding companies (BHCs) for resolution planning. As outlined below, the proposals include:

- IDIs: FDIC proposed rule for IDIs with $50 billion or more in total assets to periodically submit resolution plans. FDIC to use its authority under the Federal Deposit Insurance Act (FDI Act) to resolve the IDI in the event of insolvency. Intent is to allow insured depositors access to funds quickly and orderly (with least cost to the Deposit Insurance Fund).
- Category II & III: Joint FDIC and FRB proposed guidance to domestic and foreign Category II and III banking organizations (over $250B, not Category I banking organizations, GSIBs). The proposed guidance sets expectations for the development of resolution plans, or “living wills”. Required by the Dodd-Frank Act (and to help mitigate systemic risk), this guidance is to allow for rapid and orderly resolution under the U.S. Bankruptcy Code in the event of material financial distress or failure.

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- Strengthening of resolution planning, strategy, and reporting for at $50B, $100B, and $250B+ bank/BHC levels
- Heightened expectations regarding resolution strategy capabilities
- All supervised banks (regardless of size) should enhance resolution and liquidity risk strategy, management and governance

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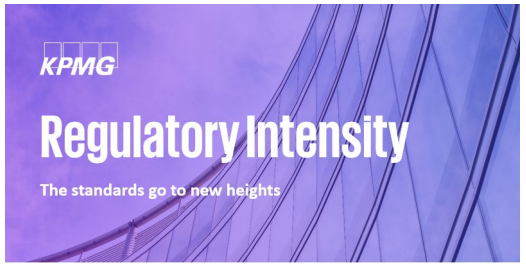
Featured Regulatory Insights Thought Leadership:

[Where will AI/GenAI regulations go?: Demonstrating 'trusted AI systems']



[Regulatory Intensity: The standards go to new heights]

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