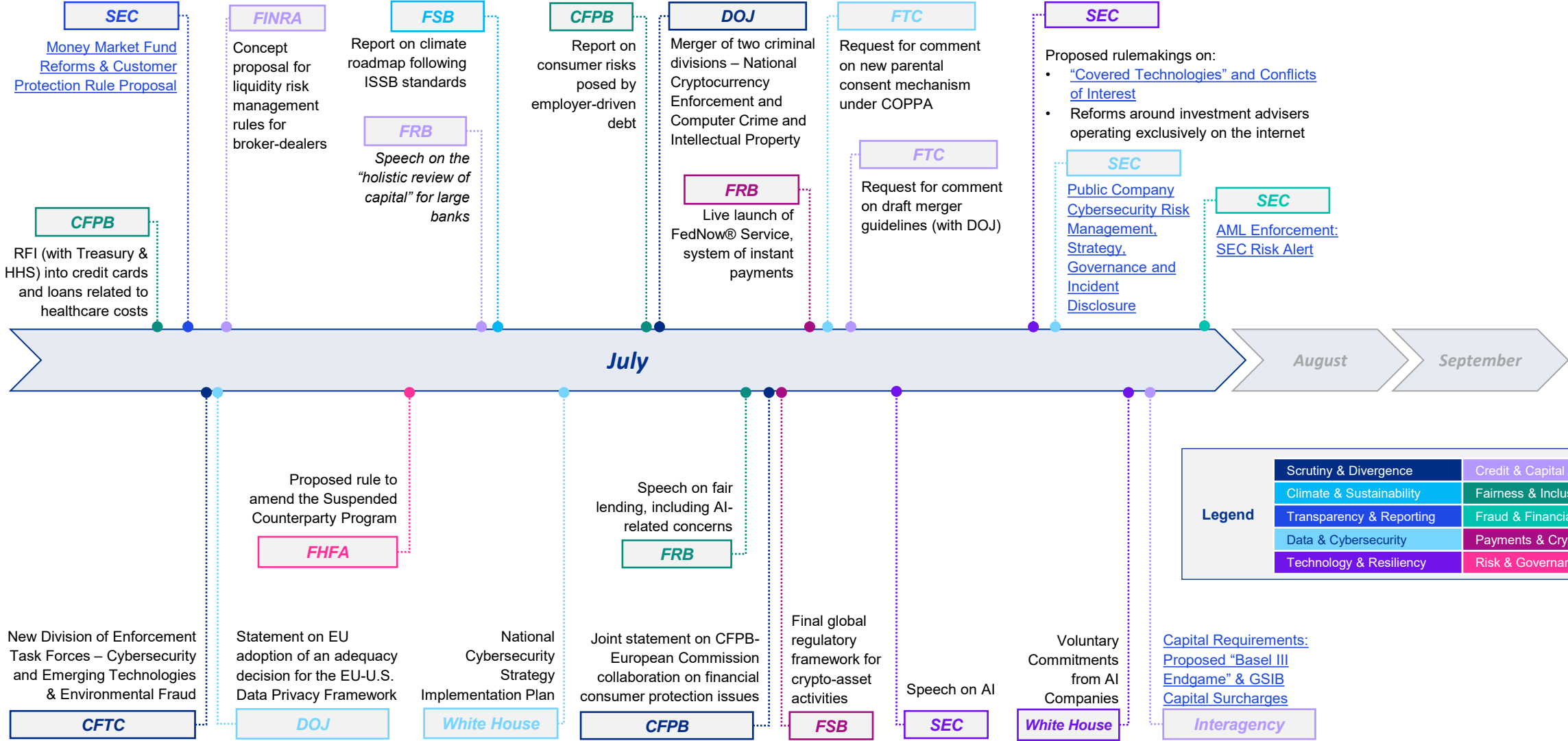




Regulatory Recap

July 2023 at a glance

Regulatory Insights: July 2023



SEC Money Market Fund Reforms & Customer Protection Rule Proposal

The SEC adopted amendments to rules under the Investment Company Act of 1940, including Rule 2a-7, that govern money market funds. Citing the susceptibility of these funds to heavy redemptions and a lack of liquidity in times of stress, the SEC states the amendments are intended to improve the resilience of money market funds.

SEC also proposed amendments to the broker-dealer customer protection rule to require certain broker-dealers to compute their customer and broker-dealer reserve deposit requirements on a daily rather than weekly basis.

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- Final rule and rule proposal closely align with the SEC's broader efforts to improve the resilience of financial markets and decrease financial stability risks during periods of market stress.
- Reforms are substantially the same as proposed except the SEC did not adopt the proposed swing pricing requirement, instead adopting a liquidity fee framework. The reforms are wide-ranging—encompassing liquidity requirements, fees, and reporting requirements—and could have significant impacts on funds' operations.
- The separate proposal for carrying broker-dealers is similarly aimed at strengthening customer/investor protections, liquidity, and market stability in the event the broker-dealer fails.



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Public Company Cybersecurity Risk Management, Strategy, Governance and Incident Disclosure

The SEC issued final rules and amendments introduce new requirements related to cybersecurity risk management, strategy, governance, and incident reporting for public companies subject to the Securities Exchange Act of 1934 (i.e., registrants).

These rules and amendments were adopted along the same thematic elements as proposed, with some modifications to lessen incident reporting and disclosures around cybersecurity expertise; the rules and amendments are intended to enhance and standardize cybersecurity disclosures, as well as establish current and periodic reporting requirements.

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- The final rule will increase the prominence of required disclosure of cybersecurity incidents in corporate filings and will likely spur boards and senior management to greater engagement on cybersecurity preparedness given the required disclosure of their roles in overseeing and implementing (as appropriate) policies, procedures, strategies, and programs to identify and manage cybersecurity risks.
- SEC significantly expanded the size of its cyber enforcement unit last year and in 2023 has named Cybersecurity (and its potential to impact operational resiliency) as an examination priority, with a key area of focus being the risk that cybersecurity failures pose to investor and consumer protection and national security.
- Key issues for review will include appropriate controls and documentation around:
 - Incident response and resiliency
 - Governance and strategy
 - Access management
 - Third-party risk management
 - Training and awareness campaigns
 - Application of lessons learned



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Capital Requirements: Proposed “Basel III Endgame” & GSIB Capital Surcharges

The FRB, OCC, and FDIC issue a joint Notice of Proposed Rulemaking that would revise the bank capital requirements. The revisions would be generally consistent with changes to the international capital standards issued by the Basel Committee on Banking Supervision, which have been generally referred to as the “Basel III Endgame”.

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- The “Basel III Endgame” focuses on capital held against credit, operational, market and credit valuation adjustment risks. Amendments are meant to:
 - Introduce a more transparent, consistent framework for measuring risk-weighted assets.
 - Apply to all banking organizations subject to Category I to IV capital standards with more than \$100B in assets.
 - Standardize the Risk Weighted Assets approaches for Credit Risk and Operational Risk.
 - Increase the “risk sensitivity” of regulatory capital measures and overall regulatory capital requirements, especially for banking organizations with high-leverage / private equity exposures, re-securitization, and large trading activities.
 - Encourage the banking organizations to re-assess their business and investment strategies to comply with the new capital requirements and further ‘optimize’ their balance sheets.
- Implementation and compliance of the proposed rules is anticipated to require a multi-year effort in such areas of governance, data, models, system infrastructure, internal controls, regulatory reporting, and capital strategies, and will span business lines and corporate functions. Companies should conduct a current-state assessment and quickly look to establish centralized coordination to drive the various transition efforts.



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“Covered Technologies” and Conflicts of Interest: SEC Proposal

The SEC issues proposed new rules under the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940 that would seek “to eliminate, or neutralize the effect of, conflicts of interest associated with broker-dealers’ or investment advisers’ interactions with investors through the use of technologies that optimize for, predict, guide, forecast, or direct, investment-related behaviors or outcomes.” The SEC also proposes amendments to the Exchange Act and the Advisers Act that would require broker-dealers and investment advisers to “maintain and preserve” books and records in accordance with the proposed rules.

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- SEC states these rules would “require that, regardless of the technology used, firms meet their obligations not to place their own interests ahead of investors’ interests.”
- Proposed definitions are intentionally broad, with “covered technologies” defined to include predictive data analytic technologies (such as AI and ML) and other technologies “that rely on historical or real-time data, lookup tables, or correlation matrices,” and “investor interaction” defined to include a variety of communications with investors (current and potential) including through advertisements.
- If adopted as proposed, broker-dealers and investment advisers would be required to identify and determine existing and potential conflicts of interest via the use of “covered technologies”, take steps to eliminate or neutralize them, and test for ongoing compliance.
- Note: The SEC proposal helps reiterate federal agency expectations in the use of “covered technologies”. This proposal aligns with an interagency statement on “automated systems” released earlier this year, which broadly applies to software and algorithmic processes, such as AI – with clear regulatory expectations that systems must be developed and deployed in a manner consistent with federal laws.



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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.

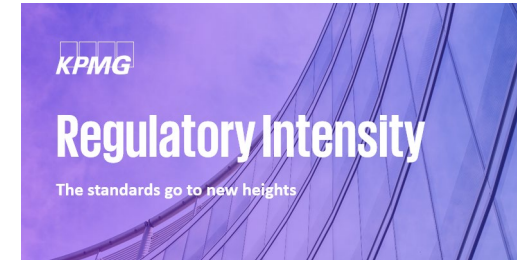
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- SEC and FINRA have each identified BSA/AML compliance, customer due diligence, and beneficial ownership as key areas of examination focus (see KPMG Regulatory Alert [here](#) and [here](#)); they state the importance of AML program examinations has 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.

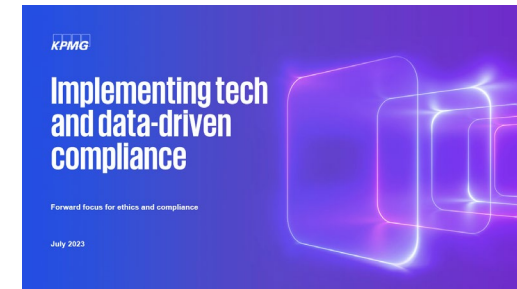


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Contact



Amy Matsuo
Principal and National Leader
Regulatory Insights
amatsuo@kpmg.com



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