Top 10 risk and compliance management related news stories and world events that (for better or for worse) shaped the week's agenda, and what is next

Dear Member,

Consider a software developer that sells a license, provides installation services at the request of its customer and, unlike its other arrangements, provides one day of training on the software.

Under existing U.S. GAAP, the software developer would be unable to recognize revenue until it transferred the license and completed the installation and training services because it lacks vendor specific objective evidence of fair value for the training services.

By contrast, under the new IFRS standard, the vendor likely will be able to recognize revenue earlier and would not need to separately identify and account for the training services because they appear to be immaterial in the context of the contract.
These are some of the remarks of James Schnurr, Chief Accountant, Office of the Chief Accountant, at the 34th Annual SEC and Financial Reporting Institute Conference, Pasadena, California.

**Read more at Number 5 below.**

In Number 2, we have the really interesting speech from Gabriel Bernardino, Chairman of EIOPA at the European Insurance Conference in London, about the milestones of preparation for Solvency II.

**In six months’ time, we will usher in a new era in the European insurance supervision** – the era of risk-based supervision.

Solvency II brings a new risk culture and enhanced consumer protection.

Solvency II encourages companies to identify their own risk appetite and risk profile, and asks Boards to take business decisions recognizing their economic capital consequences.

**Is Solvency II “the perfect regulatory regime”?** No, for the simple reason that there is no perfect regulatory regime as such.

**Read more at Number 2 below.**

In number 3 below, we have interesting information about a recent cybersecurity incident, from the Office of Personnel Management (OPM)

Within the last year, the Office of Personnel Management (OPM) has undertaken an aggressive effort to update its cybersecurity posture, adding numerous tools and capabilities to its various network.

The U.S. Office of Personnel Management (OPM) recently became aware of a cybersecurity incident affecting its systems and data that may have compromised the personal information of current and former Federal employees.

Within the last year, OPM has undertaken an aggressive effort to update its cybersecurity posture, adding numerous tools and capabilities to its networks.

As a result, in April 2015, OPM became aware of the incident affecting its information technology (IT) systems and data that predated the adoption of these security controls.
Beginning June 8 and continuing through June 19, OPM will be sending notifications to approximately 4 million individuals whose Personally Identifiable Information was potentially compromised in this incident.

Read more at Number 3 below.

Welcome to the Top 10 list.

Best Regards,

George Lekatis
President of the IARCP
General Manager, Compliance LLC
1200 G Street NW Suite 800,
Washington DC 20005, USA
Tel: (202) 449-9750
Email: lekatis@risk-compliance-association.com
Web: www.risk-compliance-association.com
HQ: 1220 N. Market Street Suite 804,
Wilmington DE 19801, USA
Tel: (302) 342-8828
EBA publishes final draft standards on assessment methodologies to use Advanced Measurement Approaches for operational risk

The European Banking Authority (EBA) published its final draft Regulatory Technical Standards (RTS), which specify the criteria that Competent Authorities need to take into account before granting institutions permission to use advanced measurement approaches (AMA) for calculating their capital requirements for operational risk.

These RTS are part of the overall review of internal models undertaken by the EBA and are part of the Authority’s efforts to harmonise practices for the approval of internal models in the area of credit, market and operational risk models across the EU banking sector.

Milestones of preparation for Solvency II

Gabriel Bernardino, Chairman of EIOPA
European Insurance Conference, London

In six months’ time, we will usher in a new era in the European insurance supervision – the era of risk-based supervision.

Solvency II brings a new risk culture and enhanced consumer protection.

Information About the Recent Cybersecurity Incident
Office of Personnel Management (OPM)
The House Intelligence Committee Passes Fiscal Year 2016 Intelligence Authorization Bill

This legislation provides the Intelligence Community authorization needed to protect and defend the United States.

It supports critical national security programs such as those protecting Americans against terrorism and cyberattacks.

Remarks at the 34th Annual SEC and Financial Reporting Institute Conference

James Schnurr, Chief Accountant, Office of the Chief Accountant
Pasadena, California

ESMA issues Q1 risk dashboard for securities markets

The European Securities and Markets Authority (ESMA) issued today its second Risk Dashboard 2015 for the EU’s securities markets, covering the first quarter of 2015 (1Q15).

In 1Q15, EU systemic stress remained at previous levels. Contagion, liquidity, and credit risk remained high but stable while market risk increased after having partially materialised already in the previous quarter.

The weak economic prospects, together with an intensified geopolitical uncertainty both inside and outside the EU led to an increase in volatility for most markets, signalling increasing market concerns.
Award of the "Ieke van den Burg Prize for Research on Systemic Risk": final results

The ESRB runs an annual prize for research on systemic risk by young scholars. The prize is awarded in memory of Ieke van den Burg, who was a member of the inaugural Advisory Scientific Committee (ASC) between 2011 and 2014 and a member of the European Parliament between 1999 and 2009.

FSB publishes Thematic Review on Supervisory Frameworks and Approaches for SIBs

The Financial Stability Board (FSB) published a thematic peer review on supervisory frameworks and approaches for systemically important banks (SIBs).

The review, which was conducted in close collaboration with the Basel Committee on Banking Supervision (BCBS), assesses progress towards enhancing supervisory frameworks and approaches for SIBs since the financial crisis, in particular for global systemically important banks (G-SIBs).

First Quarter 2015 Quarterly Banking Profile

Opening Statement of FDIC Chairman Martin Gruenberg

The banking industry continued to show gradual but steady improvement during the quarter.

Revenue, earnings, and loan balances were up, there was further improvement in asset quality, and the number of banks on the problem list declined to the lowest level in more than six years.
How Capital Markets Union can bolster Monetary Union

Speech by Mr Klaas Knot, President of the Netherlands Bank, at the 47th International Capital Markets Association meeting and conference, Amsterdam, 4 June 2015.

“I am confident that through the harmonization of regulation and the introduction of common standards we’ll be able to unlock important new ways of finance; productive ways that will increase the resilience of the European economy, going beyond the traditional financing channels of banking.
EBA publishes final draft standards on assessment methodologies to use Advanced Measurement Approaches for operational risk

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These RTS are part of the overall review of internal models undertaken by the EBA and are part of the Authority’s efforts to harmonise practices for the approval of internal models in the area of credit, market and operational risk models across the EU banking sector.

These RTS will be part of the Single Rulebook aimed at enhancing regulatory harmonisation in the banking sector across the European Union.

These draft RTS detail the assessment methodology to be used by Competent Authorities for operational risk AMA models.

In particular, they specify the qualitative and quantitative criteria that institutions are to meet before they can be granted permission to use AMA internal models for calculating their capital requirements to cover operational risk.

Through periodic reviews and material model extensions, Competent Authorities shall also assess that institutions maintain the prescribed requirements through time.

These RTS also lay down criteria for the supervisory assessment of the key methodological components of the operational risk measurement system.

They ensure this methodology effectively captures banks' actual and potential operational risk, is reliable and robust in generating AMA regulatory capital requirements and is comparable across institutions.

In addition, these RTS provide common standards for the supervisory assessment of a bank's operational risk governance with respect to the role and responsibilities of the operational risk management function and the reporting system and establish criteria for the supervisory assessment of
banks’ data quality and IT systems, the requirements and terms for an institution to use its AMA in the running of its business (‘use test’) and the terms and the scope of audit and internal validation of the AMA framework.

Feedback received during the public consultation period has also been taken into account by the EBA when finalising these standards.

In particular, clarifications and amendments have been introduced to clarify the scope of operational risk, as well as the scope of operational risk loss, the treatment of fraud losses in the credit area and the perimeter of conduct risk events.

**Legal basis and next steps**

The proposed draft RTS have been developed according to Article 312 (4)(a), which mandates the EBA to specify the assessment methodology under which Competent Authorities permit institutions to use advanced measurement approaches.

Once into force, these RTS will replace the following CEBS guidelines currently in place:

Section 4.3 and annexes IV and V of the Guidelines on the Implementation, Validation and Assessment of Advanced Measurement (AMA) and Internal Ratings Based (IRB) Approaches (GL-10 CEBS, issued in 2006); The Compendium of Supplementary Guidelines on implementation issues of operational risk (GL-21 CEBS, issued on September 2009); The Guidelines on Operational Risk Mitigation Techniques (GL-25 CEBS, issued on 22 December 2009).

To read more:  
Milestones of preparation for Solvency II

Gabriel Bernardino, Chairman of EIOPA
European Insurance Conference, London

Ladies and Gentlemen, Good afternoon,

I am particularly glad that modern video conference technologies allow me to participate in this conference despite the fact that this time I was unfortunately not able to travel to London. Thank you very much to JP Morgan for giving me the opportunity to speak to all of you today.

In six months’ time, we will usher in a new era in the European insurance supervision – the era of risk-based supervision.

Solvency II brings a new risk culture and enhanced consumer protection.

Solvency II encourages companies to identify their own risk appetite and risk profile, and asks Boards to take business decisions recognizing their economic capital consequences.

At the same time we will initiate a journey towards convergent supervisory practices in the EU.

Is Solvency II “the perfect regulatory regime”?

No, for the simple reason that there is no perfect regulatory regime as such.

But Solvency II is a huge step for consumer protection and stability of the EU insurance business.

Still before the new framework enters into force, intensive efforts are required from both supervisors and insurance companies.

The implementation of Solvency II will be indeed a real test for undertakings and supervisors in the EU.

Today I would like to touch upon some of the challenges and explain how I see the role of EIOPA in the move from regulation to supervision.
Solvency II – challenges

ORSA

I always say that the Own Risk and Solvency Assessment (ORSA) is the heart of the Solvency II regime.

Implementing ORSA takes time, commitment, effort and especially a clear tone from the top of the companies.

That is why boards have a fundamental role to play.

They need to set, communicate and enforce a risk culture that consistently influences, directs and aligns with the strategy and objectives of the business and thereby supports the embedding of its risk management framework and processes.

The implementation of the ORSA should be used as an opportunity to further embed the strong risk culture in the day-to-day operations of the undertakings, providing at the same time for an appropriate balance with the natural sales driven culture.

We need to see in all insurance companies that risk considerations and their capital consequences are explicitly taken into account in their strategic decisions.

Internal Models

Solvency II is one of the first insurance regulatory regimes in the world to allow for the use of internal models to calculate the undertaking’s capital requirements.

Conceptually, internal models will be more risk-sensitive, will better capture individual risk profiles and will provide a better alignment between the truly underlying economic risks and the capital requirements placed on insurance companies by Solvency II.

However, internal models are subject to validation and approval by supervisory authorities.

Insurance companies and groups need to demonstrate that their internal model meets a number of requirements: the use test, statistical quality
standards, calibration standards, validation standards and documentation standards.

And here it is important to remember: in order to convince the supervisors, you have to explain how you convinced yourself as a modelling professional and also how you convinced your board.

Only such an approach would allow having an appropriate model that meets the tests and standards.

As insurance supervisors we observe that the use of internal models in the banking side has been subject to increased scrutiny and scepticism.

Lessons need to be learned: internal models should not become a capital management and especially a capital optimization tool.

A race to the bottom will kill the underlying idea of an internal model.

Going forward, it is another responsibility of the boards of insurance companies - to make sure that internal models will continue to adhere to the highest possible technical standards and that the corresponding capital will continue to fulfil the prudential requirements set out in the Solvency II regime.

**Solvency II harmonized reporting requirements**

Another major step of Solvency II is the harmonization of reporting requirements.

This will allow huge economies of scale for the industry, especially for cross-border groups, and will create a basis for consistent risk-based supervisory analysis within the EU.

EIOPA has dedicated since a long time special attention to this work stream, extensively engaging with industry and other stakeholders through various consultations.

The comments and suggestions received helped us to shape a more efficient and proportionate reporting package.

Recognizing the need of early engagement and preparation, EIOPA included the provision of information to supervisors in the Solvency II
Preparatory Guidelines, which has significantly increased awareness and readiness for Solvency II reporting.

Lastly, in the first quarter of 2015, EIOPA has publicly consulted on the final reporting package.

**We totally understand that finalizing a reporting package so late in the process of implementing Solvency II is not the optimal solution.**

However, the reality is that only after the publication of the Delegated Acts on Solvency II EIOPA could finalize the templates and consult on them.

Facing the changes coming from the Long Term Guarantees Package, we have done our best to limit the modifications in the final templates compared to the preparatory phase ones.

**We acknowledge that later this year companies will need to allocate efforts between preparatory reporting of the 3rd quarter 2015 and the reporting under Solvency II in 2016.**

With this regard I would like to urge insurers to focus their efforts both on the annual reporting, as a real test for the Solvency II application, and on the preparatory reporting of the 3rd quarter 2015, as a very important step for testing their processes and systems.

The time has come to make a final push in preparing for the actual submission of information. Both the industry and supervisors will benefit from this last effort.

The new reporting requirements will increase the quality of the data available in the companies, which is a fundamental element to upgrade risk management.

At the same time, supervisors throughout the EU will have access to better and more granular data on assets, liabilities and own funds of insurers, allowing for a quantum leap in terms of risk-based supervision.

**Solvency II adjustments and transitional periods**

The Solvency II regime includes a number of adjustments and transitional periods on top of the market consistent basis of measurement.
The level of use of the adjustments and the transitional periods will probably be different in different countries because of the different types of contracts and products.

It is fundamental that insurance companies provide clear and transparent information to the market on the actual use of all the adjustments and transitional measures included in the regime.

This will provide an unbiased and objective representation of the financial condition of the undertaking.

It is also fundamental that market analysts and investors understand that Solvency II adjustments and transitional measures are a legitimate part of the regime.

Transitional measures do not distort the solvency reality: they are designed to ensure a smooth transition to the new regime, avoiding disruptions in the market and allowing a certain period for companies to fully recognize the impact on old books of contracts that have been underwritten in a different regulatory framework.

In a prolonged period of low interest rates, a robust risk assessment is absolutely essential.

Hence, the timely implementation of the Solvency II risk based framework recognizing these challenges is more needed than ever.

In this environment it is fundamental that supervisors monitor the situation very closely and challenge the industry on the sustainability of their business models.

Furthermore, action is needed from the industry to deal with the vulnerabilities of the “in-force” business and to restructure their mix of products.

Especially within the context of the low interest rate environment, it is important that while using the transitional measures, firms will continue to take the necessary steps to restructure their business models.

Regulatory treatment of infrastructure investments
Following a request from the European Commission, EIOPA is looking at the possibility to establish a more granular treatment of infrastructure investments.
The idea is to define a specific infrastructure asset class with clearly defined criteria and appropriate regulatory treatment.

This should include adequate calibrations according to the underlying risk profile of that category and suitable risk management requirements.

We have been working intensively on this issue and benefited from extensive dialogue with different stakeholders (from the demand and supply side and from academia) in a couple of Roundtables.

We already published a discussion paper and a public consultation with draft proposals will be published in the beginning of July.

We are targeting Infrastructure projects that generate stable cash flows, are robust under a number of stresses, possess a strong contractual framework, low financial risk and mitigated construction risk.

To find a proper calibration of the risk charges to apply to this subset of infrastructure projects is definitely a challenging task.

But we are confident that we can deliver a sound proposal that will reflect evidence of the true risk posed by this specific asset class.

Let me be very clear: We are not privileging infrastructure investments. It is not the objective of a prudential regime to incentivize any asset class in particular.

Investment decisions are to be taken by company managers not by regulators.

Nevertheless, we believe that in a prolonged period of low interest rates where search for yield is a reality, insurers will go beyond the traditional asset classes and we should have a more robust framework to deal with it.

Infrastructure projects may be part of more diversified investment portfolios and that could be something positive.

But we should have infrastructure investments treated in a sound and controlled way.

**EIOPA – from regulation to supervision**

So what is being done by EIOPA for the consistent implementation of Solvency II?
I see the mission of EIOPA in developing a European supervisory culture that can ensure the consistent implementation of Solvency II throughout the EU.

**Knowing the current different supervisory cultures in the member states you would agree with me that this is a huge task.**

EIOPA is instrumental in delivering the desired outcomes and since 2013 we started to refocus our strategic approach in the insurance area from regulation to supervision.

First of all, let me mention our work on Technical Standards and Guidelines.

In the Technical Standards we define **forms, templates and procedures** for specific areas under Solvency II, while by our Guidelines we ensure common, uniform and consistent application of the regime and establish consistent, efficient and effective supervisory practices.

**In October 2013, EIOPA issued the Guidelines for the preparation of Solvency II,** paving the way for a consistent preparation of the new regime by insurers and supervisors during 2014 and 2015.

**In October 2014, EIOPA delivered to the European Commission 6 Technical Standards** on the supervisory approval processes for Solvency II that have been recently published in the Official Journal.

We are now finalizing the review, after a public consultation, of another 10 Standards, including the crucial harmonization of regular reporting requirements by insurance undertakings in the EU.

At the same time EIOPA developed Guidelines in a number of areas, 19 were published in February 2015 and 8 are under review after consultation.

Some of these Guidelines concern the basic alignment of supervisory processes while others provide clarity to firms on what are supervisors’ expectations and limit the risk of divergent interpretations by national supervisors.

**I understand the concerns** from some parts of the industry in relation to the sheer volume of regulation and would like to assure you that we will be extremely attentive to limit further regulatory texts in the coming months to the indispensable ones.
But I remain convinced that overall the benefits in terms of supervisors alignment, level playing field and better policyholder protection will outweigh the costs.

**But EIOPA’s role goes well beyond issuing standards and guidelines.**

Our vision is to add value to the overall supervisory process in the EU, using our unique position to upgrade the quality and consistency of national supervision and strengthen the oversight of cross-border groups.

Our oversight activities are structured in 3 main areas: the participation in Colleges of Supervisors, the Centre of Expertise in internal models and the Supervisory Oversight team.

**Colleges of supervisors**

We intend to strongly use and continue reinforcing EIOPA’s participation in the colleges of supervisors.

In the EU, in most of the Member States, colleges have made good progress in the last years and have been fundamental to increase the exchange of information between supervisors worldwide, moving towards a more common analysis and measurement of risks.

**The implementation of Solvency II represents a big change for colleges.**

EIOPA has prioritised the consistent and coherent functioning of colleges and we will closely follow the implementation of the new risk-based requirements, starting with the discussions around internal model approval.

EIOPA staff will keep on working closely, in both informal and formal way, with group supervisors and individual supervisory authorities to improve the status and quality of the Colleges work.

**EIOPA’s Centre of Expertise in Internal Models**

EIOPA’s Centre of Expertise in Internal Models was created two years ago with the objective to contribute to the enhancement of convergence and consistency through the development of new tools and practices in the area of internal models.

The Centre proved to be very instrumental.
Last year it helped to develop the Common Application Package aiming to promote consistent supervisory practices for the application processes related to internal models.

The package supported insurers in understanding the granularity of documentation and evidence that is required for the formal application process.

Recently EIOPA issued the Opinion on Internal Models covering some key areas where we found inconsistencies in approaches.

In the Opinion we provided our position that for example risks related to Sovereign Exposures should be appropriately taken into account in internal models.

We provided guidance to NSAs on how to assess applications prepared in the absence of some related formal decisions, including decisions on granting equivalence to the third countries; and finally on the need to use comparative studies on internal models at the national and EU levels.

Currently the Centre focuses on the development and testing of sound on-going appropriateness indicators and benchmarking.

Later on, we will engage with the NSAs in a follow-up exercise to our Opinion.

Our goal will be to understand what actions have been taken in light of this Opinion and afterwards to consider the further measures required.

Supervisory Oversight Team

In order to build trustful relations with the NSAs, which would allow EIOPA to provide independent and challenging feedback on supervisory practices, we created a Supervisory Oversight Team.

Last year, this team already conducted 10 bilateral visits to the national supervisory authorities.

As part of its oversight role and in close cooperation with the national supervisory authority, EIOPA is overseeing the balance sheet review of the Romanian insurance sector.
At the same time I would like to underline: EIOPA does not replace national supervisory authorities.

The responsibility of the day-to-day supervision of individual undertakings and groups rests with the NSAs.

**In 2015, EIOPA adopted a multi-annual Oversight Strategy with the following goals:**

- To achieve a convergent approach to supervision across the EU in order to bring a level playing field, and remove scope for supervisory arbitrage.

- To ensure a **consistent implementation** of European regulatory and supervisory frameworks.

- To **increase the quality** of supervision in the EU, including contributing to an appropriate supervision of undertakings within the EU, and finally

- To **increase the overall efficiency** of the supervisory system by promoting effective exchange of information and developing high quality supervisory tools.

Our strategic oversight approach is to gain experience, gather information and build trust and credibility.

**We want to improve quality, efficiency and consistency of the supervision of insurance firms.**

EIOPA’s feedback to NSAs can be about different issues: for example about the way they interpret and implement EU regulations; their information exchange with other authorities; risk and financial stability analysis; actions or non-actions to particular events.

EIOPA’s feedback will be insightful, because it comes from experienced staff and is based on their observations and data about individual NSAs in the context of a view across multiple NSAs.

At the same time our feedback can sometimes be challenging.

Convergence often implies change and movement from the status quo.
As part of our oversight work we also perform “Peer Reviews”.

Their purpose is to compare and assess the practices of supervisors and contribute to the creation of convergent supervisory standards.

**EIOPA has developed methods allowing for the objective assessment and comparison between the authorities reviewed.**

On the basis of the Peer reviews, EIOPA identifies the outcomes achieved; best practices and makes concrete recommendations for improvement.

Underpinning all the supervisory convergence agenda, EIOPA is also developing a Supervisory Handbook.

**The objective is to build an array of good supervisory practices on the different areas of Solvency II.**

We have already covered areas like risk assessment; how to supervise board responsibility within the Solvency II governance system; business model analysis; supervision of non-life technical provisions; proportionality in the key functions of the system of governance; as well as prudent person principle in investment policy.

**EIOPA encourages NSA’s to adequately implement these good practices in their supervisory processes.**

In my view, this programme fully reflects on the purpose for which EIOPA was created: to promote supervisory convergence; to contribute to upgrading of the quality and consistency of national supervision and to strengthen oversight of cross-border groups.

Fundamentally we need to recognize that supervisory convergence is a journey.

**Conclusion**

The UK market has certainly one of the best levels of preparation to Solvency II.

The experience coming from the implementation of the ICAS regime and the commitment and effort put in place during the transitional phase, both from the PRA and the UK insurance undertakings and groups, is paying off.
The challenges we all are facing with regard to the Solvency II implementation are manifold - legal, financial, technological, organisational and even cultural.

But we can overcome those challenges if we all have the same vision and work for the same goal: to create a truly level playing field in the internal market for the ultimate benefit of EU undertakings and consumers.

A solid risk culture from the side of companies and a strong, credible insurance supervision from the regulatory side will move us forward towards this goal. Let’s work together on this.

Thank you for your attention.
Information About the Recent Cybersecurity Incident
Office of Personnel Management (OPM)

What Happened?

Within the last year, the Office of Personnel Management (OPM) has undertaken an aggressive effort to update its cybersecurity posture, adding numerous tools and capabilities to its various network.

The U.S. Office of Personnel Management (OPM) recently became aware of a cybersecurity incident affecting its systems and data that may have compromised the personal information of current and former Federal employees.

Within the last year, OPM has undertaken an aggressive effort to update its cybersecurity posture, adding numerous tools and capabilities to its networks.

As a result, in April 2015, OPM became aware of the incident affecting its information technology (IT) systems and data that predated the adoption of these security controls.

Since the incident was identified, OPM has partnered with the U.S. Department of Homeland Security’s U.S. Computer Emergency Readiness Team (US-CERT), and the Federal Bureau of Investigation to determine the impact to Federal personnel.
And OPM immediately implemented additional security measures to protect the sensitive information it manages.

Beginning June 8 and continuing through June 19, OPM will be sending notifications to approximately 4 million individuals whose Personally Identifiable Information was potentially compromised in this incident.

The email will come from opmcio@csid.com and it will contain information regarding credit monitoring and identity theft protection services being provided to those Federal employees impacted by the data breach.

In the event OPM does not have an email address for the individual on file, a standard letter will be sent via the U.S. Postal Service.

In order to mitigate the risk of fraud and identity theft, OPM is offering affected individuals credit monitoring services and identity theft insurance with CSID, a company that specializes in identity theft protection and fraud resolution.

This comprehensive, 18-month membership includes credit report access, credit monitoring, identity theft insurance, and recovery services and is available immediately at no cost to affected individuals identified by OPM.

Additional information is available beginning at 8 a.m. CST on June 8, 2015 on the company’s website, www.csid.com/opm (external link), and by calling toll-free 844-222-2743 (International callers: call collect 512-327-0700).

Steps for Monitoring Your Identity and Financial Information

- Monitor financial account statements and immediately report any suspicious or unusual activity to financial institutions.

- Request a free credit report at www.AnnualCreditReport.com (external link) or by calling 1-877-322-8228. Consumers are entitled by law to one free credit report per year from each of the three major credit bureaus – Equifax®, Experian®, and TransUnion® – for a total of three reports every year.

- Contact information for the credit bureaus can be found on the Federal Trade Commission (FTC) website, www.ftc.gov (external link). Review resources provided on the FTC identity theft website, www.identitytheft.gov (external link). The FTC maintains a variety of
consumer publications providing comprehensive information on computer intrusions and identity theft.

- You may place a fraud alert on your credit file to let creditors know to contact you before opening a new account in your name. Simply call TransUnion® at 1-800-680-7289 to place this alert. TransUnion® will then notify the other two credit bureaus on your behalf.

**Precautions to Help You Avoid Becoming a Victim**

- Be **suspicious of unsolicited** phone calls, visits, or email messages from individuals asking about you, your employees, your colleagues or any other internal information. If an unknown individual claims to be from a legitimate organization, try to verify his or her identity directly with the company.

- **Do not provide personal information** or information about your organization, including its structure or networks, unless you are certain of a person’s authority to have the information.

- **Do not reveal personal or financial information** in email, and do not respond to email solicitations for this information. This includes following links sent in email.

- **Do not send sensitive information** over the Internet before checking a website’s security (for more information, see Protecting Your Privacy, www.us-cert.gov/ncas/tips/ST04-013 (external link)).

- **Pay attention to the URL** of a website. Malicious websites may look identical to a legitimate site, but the URL may use a variation in spelling or a different domain (e.g., .com vs. .net).

- **If you are unsure** whether an email request is legitimate, try to verify it by contacting the company directly. Do not use contact information provided on a website connected to the request; instead, check previous statements for contact information. Information about known phishing attacks is also available online from groups such as the Anti-Phishing Working Group (www.antiphishing.org (external link)).

- **Install and maintain anti-virus software**, firewalls, and email filters to reduce some of this traffic (for more information, see Understanding Firewalls, www.us-cert.gov/ncas/tips/ST04-004 (external link); Understanding Anti-Virus Software,
- Take advantage of any anti-phishing features offered by your email client and web browser.

- Employees should take steps to monitor their personally identifiable information and report any suspected instances of identity theft to the FBI’s Internet Crime Complaint Center at www.ic3.gov (external link). Additional information about preventative steps by consulting the Federal Trade Commission’s website, www.identitytheft.gov (external link). The FTC also encourages those who discover that their information has been misused to file a complaint with the commission using the contact information below.

Questions

Were members of the military affected by the breach?

This incident did not affect military records.

No contractors were affected unless they previously held Federal civilian positions.

The incident affected current and former Federal civilian personnel, including Department of Defense civilian employees.

Have the police been notified? If so, with which police department and what is the case number?

Since the incident was identified, OPM has partnered with the U.S. Department of Homeland Security’s Computer Emergency Readiness Team (US-CERT), and the Federal Bureau of Investigation (FBI) to determine the full impact to Federal personnel and investigate the intrusion.

Federal law enforcement continues to investigate the matter and assist with remediation efforts.

OPM immediately implemented additional security measures and will continue to improve security for the sensitive information it manages.
When did this happen?

The intrusion occurred in December 2014. OPM became aware of the intrusion into its systems in April 2015 after implementing tough new measures to deter and detect cyberattacks.

During its investigation with its agency partners, the FBI and US-CERT, OPM became aware of potentially compromised data in May 2015.

What systems were affected?

For security reasons, OPM cannot publicly discuss specifics of the systems that might be affected by the compromise of personnel data.

Additionally, due to the ongoing investigation, it would be inappropriate to publicly provide information that may impact current work by law enforcement.

OPM has added additional security controls to better protect overall networks and systems and the data they store and process.

What personal information was compromised?

OPM maintains personnel records for the Federal workforce.

The kind of data that may have been compromised in this incident could include name, Social Security Number, date and place of birth, and current and former addresses.

It is the type of information you would typically find in a personnel file, such as job assignments, training records, and benefit selection decisions, but NOT the names of family members or beneficiaries and NOT information contained in actual policies.

The notifications to potentially affected individuals will state exactly what information may have been compromised.

How many people are involved?

Approximately 4 million current and former Federal employees.

Why didn't OPM tell affected individuals about the loss of the data sooner?

OPM became aware of the intrusion in April 2015.
OPM worked with US-CERT as quickly as possible to assess the extent of the malicious activity and to identify the records that may have been compromised.

During the investigation, OPM became aware of potentially compromised data in May 2015.

As with any such event, it takes time to conduct a thorough investigation and to identify the affected individuals.

It is important to note that this is an ongoing investigation that could reveal additional exposure; if that occurs, OPM will conduct additional notifications as necessary.

Protecting the integrity of the information entrusted to OPM is the agency’s highest priority.

**What is OPM doing to prevent this kind of loss from happening again?**

Because cyber threats are evolving and pervasive, OPM is continuously working to identify and mitigate threats when they occur.

OPM evaluates its IT security protocols on a continuous basis to make sure that sensitive data is protected to the greatest extent possible, across all networks where OPM data resides—including those managed by government partners and contractors.

**Has the information been misused?**

At this time, we have no evidence that there has been any use or attempted use of the information compromised in this incident.

This is an ongoing investigation and OPM will continue to be vigilant to ensure that necessary security measures are in place to further strengthen and protect our networks, systems, and data.

**I did not receive a letter stating that my information was compromised, but feel that I should have. Can you help me?**

OPM is aware of the affected data and the networks and the data on which it resides.
OPM will begin sending notifications to individuals whose PII may have been compromised on June 8, 2015.

These notifications will take place on a rolling basis through June 19, 2015.

What are the risks of identity theft with the information that was compromised?

Receiving a letter does not mean that the recipient is a victim of identity theft.

OPM is recommending that people review their letters and the recommendations provided.

In order to mitigate the risk of fraud and identity theft, we are offering credit monitoring service and identity theft insurance through CSID, a company that specializes in identity theft protection and fraud resolution.

All potentially affected individuals will receive a complimentary subscription to CSID Protector Plus for 18 months.

Every affected individual, regardless of whether or not they explicitly take action to enroll, will have $1 million of identity theft insurance and access to full-service identity restoration provided by CSID.

How long will it take to inform all the potential victims involved in the incident?

OPM will begin conducting notifications to affected individuals using email and/or USPS First Class mail on June 8, 2015 and will continue notifications on a rolling basis through June 19, 2015.

Who is responsible for this incident?

OPM does not assign attribution for cybercrimes. That question is best addressed by law enforcement agencies.

What has been the operational or mission impact to OPM?

There has been no operational impact to OPM. OPM has continued to operate at full capacity since the incident occurred.
Can my family members also receive services if they are part of my file/records?

Family members of employees were not affected by this breach.
The House Intelligence Committee Passes Fiscal Year 2016 Intelligence Authorization Bill

By a unanimous voice vote, the House Permanent Select Committee on Intelligence reported the Intelligence Authorization Act for Fiscal Year 2016 (H.R. 2596) to the full of House of Representatives.

This legislation provides the Intelligence Community authorization needed to protect and defend the United States.

It supports critical national security programs such as those protecting Americans against terrorism and cyberattacks.

The total funding authorized by the bill is consistent with the Budget Resolution and the Budget Control Act, balancing fiscal discipline and national security.

Among other things, the legislation:

· Sustains critical capabilities to fight terrorism and counter the proliferation of weapons of mass destruction.

· Funds efforts to recover from unauthorized disclosures of intelligence capabilities.

· Sustains activities in Afghanistan and Iraq to continue the fight against ISIS, al Qaeda, and the Taliban.

· Invests in the resiliency of our national security space architecture.

· Provides policy direction on sensitive intelligence operations.

· Promotes intelligence integration and sharing through investment in Intelligence Community-wide information technology enterprises.
· Enhances investments in military intelligence, surveillance, and reconnaissance aircraft.

· Funds initiatives to thwart cyberattacks and insider threats.

· Requires a report every 60 days on foreign fighters in Syria and Iraq.

“This bill will ensure that the Intelligence Community receives the resources it needs to continue protecting Americans from attack by a wide array of foreign adversaries,” said Chairman Nunes.

“The legislation is a crucial component of the committee’s oversight responsibilities, and I look forward to swift consideration of the bill by the full House of Representatives.”
Remarks at the 34th Annual SEC and Financial Reporting Institute Conference

James Schnurr, Chief Accountant, Office of the Chief Accountant
Pasadena, California

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The views expressed herein are those of the author and do not necessarily reflect the views of the Commission or of the author’s colleagues upon the staff of the Commission.

Introduction

Thank you for both the kind introduction and the invitation to speak with you today.

Before I begin, let me remind you that the views expressed today are my own and not necessarily those of the Commission, the individual Commissioners, or other colleagues on the Commission staff.

As most of you probably know, I am fortunate to have three deputy chief accountants and a chief counsel that assist me in executing the responsibilities of OCA: Julie Erhardt oversees our International Group, Wes Bricker is responsible for our Accounting Group, Brian Croteau supervises our Professional Practice Group and Jeff Minton is my Chief Counsel.

As you can imagine, each of these groups have very differing priorities, but all are important to the SEC’s mission.

Today, I would like to share my thoughts and perspectives on some of our key priorities — IFRS, the new revenue recognition standard, a future concept release on Audit Committees and the PCAOB’s standard setting activities.

Future Prospects of IFRS
This time last year, I had just retired after spending 30 years as an audit partner, and I was approached by Chair White to be the Chief Accountant. One topic we discussed was her speech in May 2014.

Chair White indicated that she was making IFRS a priority and would be asking me to advise her on the next step forward if I were to be appointed.

Although retired, I read with great interest the attention grabbing headlines from former Chairman Cox’s keynote address at this conference last year that we should “bury IFRS.”

Since arriving at the Commission last October, I have spent considerable time with my staff and others researching and discussing IFRS, and I believe Chairman Cox’s burial of IFRS entirely may have been premature.

As I mentioned publicly last month, the staff has recently heard from a number of different constituents about IFRS: preparers, investors, auditors, regulators and standard-setters.

We heard three key themes through those discussions:

- There is virtually no support to have the SEC mandate IFRS for all registrants.

- There is little support for the SEC to provide an option allowing domestic registrants to prepare their financial statements under IFRS.

- There is continued support for the objective of a single set of high-quality, globally accepted accounting standards.

So, while full scale adoption or an option does not appear to have support, it does not mean we “bury” the underlying objective of a single set of high-quality, globally accepted accounting standards.

On the contrary, constituents continue to support that idea.

So, the real questions are: what is the path to achieve that objective and how do we get there?

In my opinion, in the near term, FASB and IASB should continue to focus on converging the standards.
The boards should renew their commitment to cooperate and develop standards that eliminate differences between IFRS and U.S. GAAP whenever it meets the needs of its constituents and improves the quality of financial reporting.

I recognize the boards will not always be able to eliminate differences during the standard-setting process, primarily because they serve different constituents that have different needs.

However, when differences in standards arise, the boards should monitor the implementation of those standards with the objective of learning from the implementation and re-engaging with each other with the goal of converging to the standard with the highest quality financial reporting outcome.

The boards should apply the lessons learned from the recent revenue recognition standard and realize that even though the words may be the same, to achieve convergence, cooperation is needed after the standard-setting process is complete and during the implementation stage of the standards.

Finally, the FAF and IFRS Foundation should be supportive of the underlying objective and provide their respective boards with the support necessary to achieve convergence.

Let me close our IFRS discussion by repeating some comments I made about a month ago.

I believe that, for the foreseeable future, continued collaboration is the only realistic path to further the objective of a single set of high-quality, global accounting standards.

Accordingly, how the FAF, IFRS Foundation, FASB and IASB decide to interact in the future is critical to the advancement of the objective of a single set of high-quality, globally accepted accounting standards.

**Implementing the New Revenue Recognition Standard**

The staff continues to monitor implementation of the new revenue recognition standard to encourage consistent application not only in the U.S., but globally.
And today I’d like to offer a few observations from our monitoring activities.

I am encouraged that preparers, auditors, and standard-setters are working together to identify, evaluate and resolve issues in a consistent manner across all industries and transaction types.

As they continue to work together, I encourage them to apply each step outlined in the standard in a practical way that considers the utility of the resulting information to investors and other users of the financial statements.

Evaluating issues across industries and transaction types under the standard is critical because an important objective of the standard was to eliminate industry guidance and practices.

While I am encouraged by the progress made, there are areas where I believe more cooperation is needed to identify an appropriate and practical balance to implementing the principles of the standard.

Let me illustrate my point by reference to the guidance for identifying performance obligations.

The term performance obligation codifies and encompasses the concepts of a deliverable, a component and an element of a contract that currently exists in U.S. GAAP and is used to ensure that consistent and meaningful units of accounting are identified to report an entity’s performance in transferring goods or services to customers. And I emphasize meaningful units of accounting.

I have heard some suggest that the new standard results in significantly more performance obligations as compared to the application of the current standards.

Based on my discussions with various constituents, I do not believe that was the intent.

The new standard allows an entity to apply reasonable judgment in considering whether promised goods and services are meaningful in the context of the contract with the customer, a point which the FASB is proposing to clarify by amending the standard.
I am hopeful that the proposed amendment will include clarifying guidance and additional examples.

The IASB also intends to amend their standard to include additional examples that further illustrate how the guidance should be applied.

While the FASB and IASB approach to clarifying the guidance differs slightly, both boards, as evidenced by their discussions during their joint meeting, continue to believe they have a converged approach to identifying performance obligations.

I also believe a converged approach will help preparers focus on those revenue-related promises in their contracts that are truly important and worthy of reporting to investors.

Application of any definition, including that of performance obligation, requires sound judgment that is supported by evidence.

In this regard, the totality of the nature and purpose of the transaction with the customer should be understood, which includes understanding how the customer’s expectations are reflected in the contract terms and how the entity’s management of the contract is consistent with this purpose and its business model.

For example, did the customer order 20 ships or the procurement, management and integration services of the vendor to provide 20 ships?

A review of the entity’s marketing materials and business practices can aid in identifying and understanding the nature and purpose of the transaction.

As a general matter, I believe that many of the services that are provided may be viewed as fulfillment costs, rather than separate performance obligations that require a complex allocation of the revenue to each performance obligation.

If the company does not sell that service separately and only provides the service to a customer in connection with the sale of a good or service, then it is likely a fulfillment cost.

While the joint standard does not incorporate the concept of inconsequential and perfunctory performance obligations that currently exists in U.S. GAAP, I believe the FASB’s proposed amendment has the potential to obviate the need for such guidance.
Implementation of the revenue standard — or any standard for that matter — results in a fresh examination of an entity’s transactions, and because the revenue standard eliminates industry specific guidance, the starting point for the identification of performance obligations might differ from today.

We anticipate that the number of performance obligations identified will change relative to existing guidance.

In some cases there could be more promises to include, such as marketing incentives, while in other cases there could be fewer.

As an example of identifying fewer performance obligations, consider a software developer that sells a license, provides installation services at the request of its customer and, unlike its other arrangements, provides one day of training on the software.

Under existing U.S. GAAP, the software developer would be unable to recognize revenue until it transferred the license and completed the installation and training services because it lacks vendor specific objective evidence of fair value for the training services.

By contrast, under the new standard, the vendor likely will be able to recognize revenue earlier and would not need to separately identify and account for the training services because they appear to be immaterial in the context of the contract.

That is, reporting separate performance obligations would not be meaningful to investors.

I also envision, consistent with existing practice, that call centers that stand ready to answer questions about how to put together or install a product or to field customer complaints generally will not rise to the level of material performance obligations in the context of the contract.

These seem to be minor promises to a customer and likely are not worthy of separately identifying and reporting to investors.

Similarly, the identification of performance obligations for a broker who executes transactions, maintains custody of the customers’ securities, statutorily reports certain tax information, and as a matter of statute or courtesy provides periodic statements to its customers should consider the nature and design of the broker’s business and totality of its arrangement
with its customer when evaluating what promises should be accounted for as performance obligations.

The promises to provide tax information, periodic statements or perhaps even host a website to facilitate customers’ access to its accounts do not seem to be the material aspects of the arrangement with the customer and likely will not rise to the level of performance obligations.

Again, this type of conclusion should be drawn from a thorough understanding of an entity’s business and the nature and purpose of the transaction with the customer, and I encourage preparers and auditors to be practical in their assessment and make informed, reasonable yet supportable judgments.

Important Role of Audit Committees

Another topic I would like to address, given the integral role they play in our investor protection regime, relates to audit committees.

Last December, I spoke at the AICPA Conference about the work OCA staff is undertaking with staff in the Division of Corporation Finance to consider whether improvements can be made to existing audit committee reporting requirements.

We have been actively developing a recommendation to the Commission in the form of a concept release intended to seek feedback regarding how investors currently use the information provided in audit committee disclosures as well as feedback on the usefulness of potential enhancements, including additional disclosures.

I anticipate being in position to recommend that the Commission publish the release for public comment in the near future.

As I envision it, the value of public comment would be to aid in our understanding of audit committee disclosures that investors would find useful in informing their investment or voting decisions.

As part of its review, the staff is also giving consideration to current trends in audit committee reporting.

For example, many companies and their audit committees are currently providing disclosure beyond that which is required by the Commission’s requirements.
From that standpoint, the audit committee plays a critical role in the financial reporting process and a significant part of that role, which was mandated by the Sarbanes — Oxley Act for listed companies, is focused on the oversight of the external auditor.

Therefore, I am particularly interested in learning more from investors, audit committees, auditors, and others regarding current audit committee disclosures related to oversight of the independent auditor and whether the disclosures should be refined to provide more insight into the information the audit committee used and the factors they considered in executing their oversight of the external auditor.

This feedback will be critical to the staff in understanding the nature of the information investors are seeking and how audit committees consider what information to report.

Also on the topic of audit committees, I would like to briefly mention that although the PCAOB does not have jurisdiction over audit committees, the PCAOB has made it a priority to enhance its outreach to and interaction with audit committees.

Most recently, the Board published a new webpage for audit committees, which includes summary information from inspections and other PCAOB oversight activities.

The PCAOB has indicated that this is the first in a series of actions intended to make inspection and other information more accessible to audit committees to use in their oversight role.

I commend the Board for recognizing the importance of the role of audit committees in improving audit quality through their oversight of the external auditor, and I encourage those involved in the audit process to read this publication and provide feedback to the PCAOB on any ways such publications and other actions can be made more useful in the future.

**PCAOB Standard Setting Activities**

Speaking of the PCAOB, I would like to now turn to its standard-setting.

In December, at the AICPA Conference, I discussed my view of the need for the PCAOB to conduct a review of its standard setting process with the goal of improving the pace of its standard setting activities.
I am pleased with the initial efforts the PCAOB has undertaken to address my suggestion.

While I acknowledge that it will take time to develop and implement an improvement plan, I am optimistic that the PCAOB should be able to make significant and meaningful changes that will help improve the quality and pace of its standard setting efforts.

Such improvements have strong potential to influence the quality of audits for the benefit of investors.

While the work has just begun, we have already seen some subtle, yet encouraging, results from some of the initial changes the PCAOB has been experimenting with in its standard setting process.

The PCAOB recently issued its staff consultation paper on the use of specialists and is also scheduled to further discuss it, in addition to its standard setting efforts on auditing accounting estimates, including fair value measurements, and related disclosures at its Standing Advisory Group meeting later this month.

Several other releases are anticipated soon that are intended to advance projects related to going concern, use of other auditors, and transparency of certain participants in the audit.

One result of the PCAOB’s efforts to improve standard setting may be an increase in the number of releases you will see in the next year for public comment.

I encourage those interested in projects on the PCAOB’s agenda to pay close attention if the pace accelerates and take advantage of the opportunities to provide your perspectives. I can assure you that both the PCAOB and SEC staff pay careful attention to your input.

Notwithstanding the efforts to date, there are some very significant and fundamental issues that will need to be addressed, and I encourage the Board to continue to stay focused in assessing the results of its review and developing and implementing an improvement plan.

I remain committed to working together with the PCAOB to produce high quality auditing standards that will improve audit quality and ultimately increase investor protection, which is a mission that both the PCAOB and the Commission share.
Thank you for your kind attention, and I will be happy to address your questions on any of these topics during the Q&A session.
ESMA issues Q1 risk dashboard for securities markets

The European Securities and Markets Authority (ESMA) issued today its second Risk Dashboard 2015 for the EU’s securities markets, covering the first quarter of 2015 (1Q15).

In 1Q15, EU systemic stress remained at previous levels. Contagion, liquidity, and credit risk remained high but stable while market risk increased after having partially materialised already in the previous quarter.

The weak economic prospects, together with an intensified geopolitical uncertainty both inside and outside the EU led to an increase in volatility for most markets, signalling increasing market concerns.

Going forward, key risk concerns in the EU include high asset valuations driven by search-for-yield, weak economic prospects, resurgence of public debt policy issues in a number of EU Members States, although to various degrees, and economic and geopolitical uncertainty in the EU’s vicinity.

To read more:
Award of the "Ieke van den Burg Prize for Research on Systemic Risk": final results

The ESRB runs an annual prize for research on systemic risk by young scholars. The prize is awarded in memory of Ieke van den Burg, who was a member of the inaugural Advisory Scientific Committee (ASC) between 2011 and 2014 and a member of the European Parliament between 1999 and 2009.

After a highly competitive selection process, which involved three rounds and multiple blind peer reviews, a selection panel of the ASC (comprising Martin Hellwig, Marco Pagano, André Sapir, Viral Acharya and Markus Brunnermeier) decided to award the inaugural prize to the following paper: "The Motives For Financial Complexity: An Empirical Investigation" co-authored by Ms Claire Célérier and Mr Boris Vallée.

The selection panel considered the paper by Célérier and Vallée to be highly original and to have great policy relevance.

The prize was awarded on 29 May at a symposium of the ASC, at which Claire Célérier also presented her paper.

To read it: https://www.esrb.europa.eu/pub/pdf/other/CelerierVallee_Complexity_May2015.pdf?c4007f257bb70766fb4b5e490e57bc54

The ASC also decided to recognise the quality of two additional papers, which are both runners-up for the prize:

- "Credit Default Swap Spreads and Systemic Financial Risk" authored by Stefano Giglio

- "Bank Recapitalizations and Lending: A Little Is Not Enough" authored by Timotej Homar
FSB publishes Thematic Review on Supervisory Frameworks and Approaches for SIBs

The Financial Stability Board (FSB) published a thematic peer review on supervisory frameworks and approaches for systemically important banks (SIBs).

The review, which was conducted in close collaboration with the Basel Committee on Banking Supervision (BCBS), assesses progress towards enhancing supervisory frameworks and approaches for SIBs since the financial crisis, in particular for global systemically important banks (G-SIBs).

Increasing supervisory effectiveness is a key pillar of the FSB policy framework for reducing the moral hazard of systemically important financial institutions (SIFIs).

The peer review found that national authorities have taken significant steps to enhance supervisory effectiveness within their institutional frameworks.

Authorities are using a broader and more sophisticated range of supervisory tools, which in turn contributes to a more forward-looking supervisory approach capturing both current and emerging risks.

The scope of supervision has also been expanded to incorporate macroprudential and resolvability considerations.

These changes are underpinned by enhanced dialogue between supervisors and the board and senior management of SIBs, both in terms of level of seniority and frequency.

Corporate governance and the development of recovery and resolution plans are common areas of focus across many jurisdictions.

These findings are also reflected in the feedback from 13 G-SIBs that were surveyed as part of the peer review.

The G-SIBs noted an increase in supervisory intensity, in particular on capital and liquidity, and many highlighted an increase in the number and depth of supervisory reviews and data requests.
Supervisory actions in response to findings were also noted as having strengthened.

At the same time, G-SIBs would welcome more open and constructive challenge from supervisors as part of the supervisory dialogue.

More work, however, is needed to further improve and assess supervisory effectiveness.

In particular, a key finding from the review is the importance of strengthening cross-border supervisory cooperation and building the mutual trust that is needed – in good times, but even more so in difficult times.

Effectiveness could also be strengthened by establishing and implementing clear and transparent supervisory strategies and priorities. Communication with firms on these priorities, as well as on the outcomes from supervisory activities, including data requests, needs to be strengthened.

One of the outstanding challenges to further progress supervisory effectiveness is the need for authorities to effectively manage the volume of regulatory and supervisory changes, including by having sufficient budgetary resources and building and maintaining a skilled, capable, and experienced workforce.

Drawing from the findings of the review, the report sets out several recommendations targeting areas where more work is needed. It recommends that supervisory authorities:

Clearly define their supervisory strategy and priorities, establish a formal process for evaluating supervisory effectiveness against the stated strategy and priorities, and make further progress in attracting and retaining skilled supervisory resources.

Further strengthen their engagement with banks, particularly at the board level and with senior management, with the objective of informing supervisory risk assessments through enhanced understanding of G-SIBs’ business models.

Press banks to improve their information technology and management information systems to provide robust and timely information on the institutions’ risk on an enterprise-wide basis.
Continue to ensure that data requests are effectively targeted and evaluated for purpose and intent, including via coordination between home and host authorities.

The report also includes recommendations addressed to the standard-setting bodies (SSBs).

In particular, the BCBS should assist supervisors in establishing effective supervisory strategies and risk appetite frameworks; the FSB will work with the SSBs to explore ways to promote the objective of achieving rigorous co-ordinated assessments of risks facing G-SIFIs through supervisory colleges; and the FSB and BCBS will cooperate to develop ways to foster greater cross-border supervisory cooperation and coordination.

Ravi Menon, Chairman of the FSB’s Standing Committee on Standards Implementation, said “In recent years, there has been increased supervisory focus on system-wide risks, risk governance frameworks, and recovery and resolution planning.

This has contributed to a better understanding of banks’ business models – their complexities as well as their prospective vulnerabilities. Notwithstanding this advance, there is still room to enhance supervisory effectiveness, especially on a cross-border basis for institutions with a global footprint.”

Helen Rowell, Chair of the peer review team on supervisory frameworks and approaches for SIBs, said “As the regulatory reforms settle and memory of the global financial crisis fades, supervision will become even more important and face new challenges, especially for global institutions in quickly changing and highly interconnected economies and markets.

The report sets out recommendations that will help supervisors address these challenges, as well as impediments to more effective supervision, to ensure supervision intensity is maintained and achieving its intended outcomes.”

Notes

The FSB began a regular programme of peer reviews in 2010, consisting of thematic reviews and country reviews.

The peer review on supervisory frameworks and approaches to SIBs is the ninth thematic peer review conducted by the FSB.
Peer reviews are conducted according to the objectives and guidelines set out in the Handbook for FSB Peer Reviews. All published peer review reports are available on the FSB website.

The peer review report takes forward a recommendation set out in the FSB’s report on progress and next steps towards ending too-big-to-fail to launch a peer review of supervisory frameworks and approaches to identify improvements and remaining challenges in supervisory practices for SIBs, including the ability for supervisors to exercise judgment and more effectively challenge institutions’ risk management practices and decision-making processes.

The peer review covers those jurisdictions that are home to a G-SIB and gathers feedback from a representative number of G-SIBs selected by home authorities.

A few other FSB jurisdictions volunteered to be included in the review in order to share their experiences on changes to supervisory frameworks and approaches for banks they identify as significant for their economy.

The review focuses primarily on recommendations set out in the FSB reports on enhanced supervision, particularly those identified in the 2014 progress report, and IMF-World Bank FSAP findings on supervisory resources and operational independence.

The review also draws on recent BCBS publications relevant to supervisory effectiveness, but does not assess the implementation or effectiveness of BCBS standards or principles.

The draft report was prepared by a team of experts drawn from FSB member institutions and led by Helen Rowell, Member, Australia Prudential Regulation Authority (APRA).

The findings of the review are based on questionnaire responses from, and follow-up discussions with, supervisory authorities from FSB jurisdictions as well as chief risk officers and other senior management of 13 surveyed G-SIBs.

The FSB has been established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies in the interest of financial stability.
It brings together national authorities responsible for financial stability in 24 countries and jurisdictions, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts.

The FSB also conducts outreach with 65 other jurisdictions through its six regional consultative groups.

The FSB is chaired by Mark Carney, Governor of the Bank of England. Its Secretariat is located in Basel, Switzerland, and hosted by the Bank for International Settlements.

First Quarter 2015 Quarterly Banking Profile

Opening Statement of FDIC Chairman Martin Gruenberg

Good morning, and welcome to our release of first quarter 2015 results for FDIC-insured institutions.

The banking industry continued to show gradual but steady improvement during the quarter.

Revenue, earnings, and loan balances were up, there was further improvement in asset quality, and the number of banks on the problem list declined to the lowest level in more than six years.

However, the interest-rate environment remains a challenge for banks.

Net interest margins continued to decline during the quarter, even as banks reached-for-yield to offset the impact of low rates.

Community banks reported improved performance during the quarter that outpaced the overall industry.
Their earnings were up significantly from a year ago, and their loan growth was appreciably higher than the rest of the industry.

The first chart shows that net income was 39.8 billion dollars during the first quarter. Net income was up almost 7 percent from a year ago, primarily due to an improvement in net operating revenues.

A majority of banks reported higher operating revenues and earnings during the quarter compared to a year ago.

Community banks—as defined in the FDIC Community Banking Study—reported net income of 4.9 billion dollars in the first quarter, up 16 percent from a year ago.
Community banks benefited from strong growth in both net interest income and noninterest income.

The next chart shows that nearly two-thirds of banks reported higher earnings than a year ago, and the percentage of banks reporting higher earnings continued to grow.

The chart also shows that the share of unprofitable banks continued to trend down on a year-over-year basis, and the percentage of unprofitable banks during the first quarter was the lowest in 10 years.

Net operating revenue was up 2.6 percent from a year ago. Net interest income rose modestly due to stronger loan growth. And noninterest income
was up due to higher trading revenue and increased income from mortgage-related activities.

**Chart 4** shows that noninterest income from the sale, securitization, and servicing of residential mortgage loans was over 500 million dollars higher than a year ago.

However, the chart shows that mortgage-related noninterest income remains well below levels seen prior to mid-2013.

**Chart 5** shows that net interest margins for the industry continued to decline in the first quarter, as low interest rates and a flat yield curve continue to challenge the industry.

This has been driven primarily by declining margins at the largest banks. Community banks have been able to avoid much of the erosion in net interest margins experienced by larger banks.

Community banks have had stronger growth in longer-term, higher-yielding loans, while larger institutions have increased their share of shorter-term, lower-yielding investments.

**Chart 6** shows that the share of longer-term assets on balance sheet has been increasing since 2009, as banks reach-for-yield in this challenging interest-rate environment.

Community banks, in particular, have been increasing their holdings of longer-term assets.
At the same time, growth in longer-term funding has not kept pace. This has left banks more vulnerable to interest rate risk, which is a matter of ongoing supervisory attention.

Chart 7 shows that profitability has been improving steadily at community banks and is trending closer to that of the overall industry.

Community banks have benefited from stronger revenue growth over the past year, as they have grown their loan balances at a faster pace than the industry and they have limited the decline in net interest margins.

Chart 8:

Total loan balances rose by 53 billion dollars during the first quarter. While this appears modest relative to recent quarters, loan growth tends to be
weaker in first quarters due to seasonal factors. For example, consumers pay down credit card balances and farmers repay agricultural production loans at the beginning of the year.

From a year ago, loan balances grew by 5.4 percent, which is the highest 12-month growth rate since mid-2008.

Loan growth was even stronger among community banks, both during the quarter and from a year ago. Loan balances grew by 9.1 percent at community banks from a year ago, outpacing the industry’s 12-month growth rate.

Balances were up at community banks in all major loan categories, led by growth of 7.4 percent in 1-4 family residential mortgages, 9.5 percent in commercial real estate loans, and 10.0 percent in commercial and industrial loans.

Chart 9:

Chart 9 shows that asset-quality continued to improve. The percentage of noncurrent loans is at a sevenyear low, and the charge-off rate is the lowest since the third quarter of 2006.
For the third quarter in a row, quarterly loan-loss provisions were higher than they were a year ago. This reflects the increase in lending experienced by the industry, as well as the improvement in asset quality.

Chart 11 shows the number of banks on the problem list fell again this quarter and is now at its lowest level in six years.

There were 253 problem banks at the end of March, which is down more than 70 percent from the 888 problem banks at the peak in March 2011.

Total assets of banks on the problem list fell to 60 billion dollars, which is the lowest level in seven years.
The Deposit Insurance Fund balance grew by 2.5 billion dollars in the first quarter to 65.3 billion dollars as of March 31. Most of the increase came from assessment income.

Estimated insured deposits were 6.3 trillion dollars, up 2.3 percent from December 31.

The reserve ratio, which is the Fund balance as a percentage of estimated insured deposits, increased to 1.03 percent on March 31 from 1.01 percent on December 31. This is the highest level of the reserve ratio since March 2008.

As required by law, the Deposit Insurance Fund must achieve a minimum reserve ratio of 1.35 percent by September 30, 2020. We are well on track to achieving that goal.

In summary, the industry saw a continuation of positive trends during the first quarter. Performance indicators were favorable, notwithstanding the continued downward pressure on net interest margins.

Revenue and income were up from a year ago at a majority of banks, asset quality continued to improve, loan balances increased, and there were fewer banks on the problem list.

Community banks performed well during the quarter. Their earnings were up 16 percent from the previous year, and loan growth and margins at community banks were higher than the rest of the industry.
Still, the current interest-rate environment remains challenging for banks. Revenue growth remains subdued and net interest margins have continued to decline.

Many institutions have responded by reaching for yield, which, as we noted earlier, is a matter of ongoing supervisory attention.

Nevertheless, on balance, results from the first quarter reflect an improving banking industry with stronger community banks.

Thank you.
How Capital Markets Union can bolster Monetary Union

Speech by Mr Klaas Knot, President of the Netherlands Bank, at the 47th International Capital Markets Association meeting and conference, Amsterdam, 4 June 2015.

Mr. Chairman,

Your Excellency Minister of Finance, Jeroen Dijsselbloem, Commissioner Lord Hill, Esteemed ICMA-members and conference participants,

1. Thank you for this opportunity to share my views on the European Capital Markets Union.

First, let me express my full support for the views expressed by his Excellency, the Minister of Finance.

I, too, very much welcome the initiatives by the Commission geared at the further development and integration of European capital markets.

I am confident that through the harmonization of regulation and the introduction of common standards we’ll be able to unlock important new ways of finance; productive ways that will increase the resilience of the European economy, going beyond the traditional financing channels of banking.

2. It is true that in the euro area, small and medium-sized enterprises are still very much dependent on financing by banks.

This implies that business investment in the euro area also depends on the availability of bank credit. And this creates vulnerabilities to the European economy.

For example, when banks need to deleverage in order to strengthen their balance sheets.

3. The European bank-based financial system is often contrasted to the situation in the US, which is presumed to be more market-based. I should
note that this difference is a bit more nuanced than is commonly acknowledged.

For in the US as well, SMEs are similarly dependent on bank financing, in particular the smallest of firms.

**To the extent that smaller firms do access capital markets, this is mostly confined to specific sectors.**

A well-known example is the Silicon Valley industry, start-up tech-companies that are able to attract large sums of financing from venture-capitalists.

4. This refinement notwithstanding, in general it has been shown that well-developed access to market financing can complement bank financing. And economic research confirms that this can improve economic performance.

The Minister has eloquently explained how this would apply specifically to the European economy and set out how the Capital Markets Union relates to the recently established European Banking Union.

In my address, I want to focus on yet another perspective.

I will give you my views on why the completion of a true European Capital Markets Union is beneficial from a monetary policy perspective, for there are several reasons why better developed and integrated capital markets can make the lives of European central bankers much simpler.

5. As you know, the Governing Council of the European Central Bank aims to maintain price stability in the euro area as a whole.

To achieve this, the ECB conducts monetary policy.

Based on the outlook for inflation, we set our policy rates to steer overall financing conditions for households and firms in the euro area.

**A homogeneous transmission of our monetary policy decisions throughout the financial system enhances the appropriateness of our policy decisions.**

For the euro area as a whole, and for the participating Member States.
That is why monetary policy benefits from a level-playing field in financial markets across countries.

6. Note that I do not intend to suggest that all economic agents should be able to lend against the exact same conditions.

**Actual financing conditions for individual households and firms are to be determined by the market and not by the ECB.**

And these should appropriately reflect differences in earnings capacity and risk.

7. This is exactly what went wrong in the run-up to the crisis. Lending rates converged throughout the euro area, and no longer reflected actual underlying risks.

Several potential explanations have been put forward for this.

One reason often mentioned is the search-for-yield as a consequence of the low interest-rate environment.

Or the fact that the no-bail out clause in the EU Treaty was perceived as not credible.

Yet another explanation is that gaps in banking regulation were the primary cause of the mispricing of risks in the run-up to the crisis. In my view, all three explanations have been relevant. In fact, these factors are likely to have reinforced each other.

8. In a similar way, I believe that a lack of harmonization in regulation and common standards in euro area capital markets can also be viewed as an aggravating factor.

For heterogeneity and inconsistencies in regulation can obscure how losses will be distributed once financial risks materialize. And this can exacerbate the mispricing of risk in financial markets.

9. I think this is a key issue that the Commission agenda on Capital Markets Union should address.

**In my view, one of the obstacles to be tackled is the lack of harmonization in insolvency laws across countries.**
Unfortunately, in the Commission's early proposals initiatives to that effect do not feature very prominently.

Yet, I nevertheless believe it could be an effective way for Capital Markets Union to contribute to consistent pricing of risk across countries.

For it will help ensure a homogeneous, but risk-consistent transmission of monetary policy decisions.

10. But Capital Markets Union can deliver on more than just that. It can also greatly increase the efficacy of monetary policy.

Common to all monetary policy decisions is that their transmission to the real economy is sluggish and can sometimes be incomplete.

For example, the extent to which banks are able to lower lending rates following a rate cut depends on many factors beyond the control of monetary policymakers.

One can think of the level of competition in the banking sector, or the health of bank balance sheets.

A successful Capital Markets Union will open up entirely new channels for the transmission of monetary policy to the real economy, making central bankers much less dependent on a single sector for the transmission of its policy decisions.

In that sense, central banks can diversify the channels through which they can influence the economy, adding to its effectiveness.

11. Note that economic agents can benefit from Capital Markets Union in a very similar way.

Households and firms can diversify their dependency on financing, if alternative sources of finance are in abundance, making themselves less vulnerable to risks stemming from a single sector.

A well-diversified financial structure increases the resilience of the balance sheets of households and corporations to shocks.

And the resilience of the economy as a whole.
And when an economy is better able to cope with external shocks, monetary policy will not get distracted from pursuing its primary remit: delivering price stability.

12. The latter is even more relevant for monetary policy in a monetary union.

Structural differences between national economies imply that the euro area economy is prone to asymmetric shocks.

Private sector risk-sharing across countries can greatly enhance a smooth transmission of such shocks.

This is what Capital Markets Union can accomplish, for an increase in the cross-border holdings of financial instruments will enhance risk-sharing across the euro area, thus improving the functioning of the monetary union.

13. However, Capital Markets Union is no silver bullet. Clearly, its introduction does not absolve us from pursuing prudent policies in other policy areas, too. Moreover, it will take time before we can reap the full benefits of Capital Markets Union.

But there can be no doubt that it will prove an important complement to Banking Union in enhancing the functioning of our monetary union.

14. At the same time, Capital Markets Union will also bring new challenges and risks.

For example, as a result of the shift in the relative importance of the transmission channels of monetary policy.

Interest-rate decisions may transmit to the real economy differently through markets than they do through the banking sector.

This calls for careful analysis. And possibly a reassessment of the effectiveness of our monetary policy instruments.

These instruments are currently primarily geared at the banking sector.

However, to be able to influence financing conditions beyond the banking sector we may need to introduce new instruments.
15. Another possible consequence is that risks may **shift to the shadow banking sector**.

A sector that is currently **less transparent and less regulated** than the traditional banking sector.

It is yet unclear what could be the financial stability implications if such a development were to occur.

In any case, **it would warrant enhanced monitoring of developments in the sector**.

One could even argue that a more formalized supervisory framework should be put in place.

Finally, it could be conceivable that macro-prudential policy measures would have to be applied beyond the banking sector.

16. As for the potential risks associated with developing capital markets, let me highlight one more issue.

**Some might worry that by developing financial markets we will again see the introduction of complex financial instruments.**

The type of obscure instruments that according to many were the root cause of the global financial crisis.

Here, I would like to reiterate firmly that this is clearly not what I envisage.

**Rather, the goal of Capital Markets Union is to create a level-playing field by introducing simple standards that improve transparency.**

Only then, can Capital Markets Union foster financing flows that support economic growth in a sustainable way.

Dear participants, let me wrap up my address.

17. I presented to you a central banker's view on Capital Markets Union, and why I think this a very important initiative. Today, the discussion on Capital Markets Union is still at an early stage.

**The agenda is being set as-we-speak.**
Having an exchange of views on such an important topic with esteemed members of the capital markets community could not have come at a better time.

Therefore, I very much look forward to the discussions later today.

I'm confident that this conference will yield many interesting insights.

New ideas that will bring us closer to completing this important pillar of our Economic and Monetary Union.

Thank you for your attention.
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