Although the State of the Union is often compared to the “Super Bowl” of Washington, DC politics, this year it was more like the “senior prom” as many members of the House and Senate attempted to “pair up” and sit with a colleague from the other party in an effort to convey a sense of bipartisanship in light of the aftermath of the shooting of Congressman Giffords and others in Tucson, Arizona earlier this month. Many pundits viewed these efforts as purely optical, and of little substance, beyond the immediate effect of a more muted response to some of President Obama’s policy proposals. It will be interesting to see if any real bipartisanship results.

During his speech, Obama appeared to be going after the political center and took a nuanced approach towards curbing the U.S. budget deficit, and putting together a blueprint to “win the future,” by balancing such budget-cutting measures with the need for investments (i.e., spending) in key areas such as education, high-speed rail, clean-energy technology, and high-speed Internet for all Americans. This effort to reach out to the middle marks a continuation of a strategy initiated during the lame duck. While many of the left, as well as some on the right, may view this as pandering to Republicans, its success during November and December could be an indication that the President sees this as the path towards a successful re-election effort in 2012.

In other news, the Congressional Budget Office released a report on Wednesday projecting that the federal deficit will grow to $1.5 trillion this year, aggregating to over $12 trillion over the next decade if Congress doesn’t act to rein it in. The Senate Budget Committee met the following day to examine the CBO’s results, and to question the director of the nonpartisan branch of government. At about the same time, the Financial Crisis Inquiry Commission also published the findings of its comprehensive investigation into the causes of the 2008 financial crisis (a month after its deadline for completion). Unfortunately, the report was divided along party lines and made no policy recommendations, so it remains unlikely that the findings will actually carry any weight going forward. See below for more details on both of these reports.

In Congress, the Senate finally passed an organizing resolution confirming that Senator Tim Johnson (D-SD) will be the Chairman of the Senate Banking Committee and that Senators Kay Hagan (D-NC), Pat Toomey (R-PA), Mark Kirk (R-IL), Jerry Moran (R-KS) and Roger Wicker (R-MS) have been added to the Committee. On the House side, the House Financial Services Committee unleashed its tentative hearing schedule for the coming weeks, and it is a quite robust one. For the next two months, almost every day that the House is in session, there will be a hearing scheduled on a “top priority” item for the Republicans – monetary policy, housing finance reform, implementation of the derivatives provisions of Dodd-Frank, examination of the Financial Crisis Inquiry Commission report, and of course, interchange fees.
FINANCIAL CRISIS INQUIRY COMMISSION RELEASES FINDINGS

The significantly delayed and somewhat anticipated Financial Crisis Inquiry Commission (FCIC) report was finally released on Thursday, with findings on the causes of the 2008 economic meltdown. Overall, the report found that both the government and the industry were to blame—risky business practices were either ignored or discounted by regulators. Many factors, including the housing bubble—caused by low interest rates, easy credit, and little regulation eventually combined with toxic mortgages—contributed to the crisis that is having an enduring effect on the economy. Over-leveraging, over-the-counter derivatives, shadow banking, subprime lending and securitizing, skewed compensation incentives on Wall Street, and lax regulation were also all cited as factors in the crisis.

The report was endorsed by the 6 Democrats on the Commission, and 2 dissents were written by the remaining 4 Republicans. Attempts at bipartisanship failed, and are the reason that the report was released a month later than originally scheduled. Some reasons for the disagreements included the failure of the report to recognize international parallels to the U.S. financial crisis, and the role of U.S. government housing policy. The report made no policy recommendations, which frustrated such organizations as the U.S. Chamber of Commerce. The Chamber issued a statement that the report was another missed opportunity to produce an objective, apolitical plan to improve the U.S. financial system.

Additionally, prior to the release of the report, the FCIC also found that certain laws were broken leading up to or during the 2008 financial crisis, and as a result the Commission has referred several cases to state or federal authorities for possible prosecution. The names of individuals and institutions are being kept under wraps, though any major litigation will quickly become public. These cases are expected to be civil suits, though some Commission members did not entirely rule out the possibility of criminal charges against wrongdoers, though according to Republicans on the Committee there wasn’t enough in the recommendations to sustain additional legal activity.

SENATE BUDGET COMMITTEE GRILLS CBO DIRECTOR

It is clear that one of the top political issues in Washington this year will continue to be the federal budget deficit and how to try to fix it. The CBO released its budget estimate on Wednesday, finding that the federal deficit will reach $1.5 trillion this year, and the Senate Budget Committee held a hearing on Thursday to examine the U.S.’s progress in addressing the budget deficit and national debt. Dr. Douglas W. Elmendorf, the Director of the Congressional Budget Office (CBO) was the sole witness, and responded to questions by the 14 Senators present. Notably, Elmendorf stated that significant changes in tax and spending policies will be needed for years to come in order to balance the budget, and that the current debt is unsustainable, though he did not elaborate in greater specificity on which policies should be altered. Although the economy continues to improve, it will do so slowly and with fewer gains in unemployment.

In response to a question by Sen. Rob Portman (R-OH), Elmendorf stated that “the part of the spending that is growing very rapidly, and much faster than GDP, is spending on the government’s large healthcare programs, both because of the aging of the population… and because of rising health spending.” Over the next several years, Medicare spending will grow at an average annual rate of almost 7%, and Medicaid at a rate of 9%, while the economy grows at a rate of less than 3% annually.
In response to the sobering projections by the CBO report, Senate Budget Committee Chairman Kent Conrad (D-ND) stated that his Committee may substitute is annual five-year spending plan with a longer-term strategy to deal with the nation’s debt. Conrad noted that the federal government requires a plan to extend “way beyond” the tradition five years, and stated his frustration that there is no one else to tackle this. He especially wants to work on the issue after President Obama’s debt commission failed to reach consensus on a plan for solving the U.S.’s fiscal challenges. Conrad recently announced he would not be running for re-election in 2012, leading some to speculate on how being freed from the political realities of campaigning will impact his efforts in this area.

**HOUSE REPUBLICANS TAKE AIM AT DODD-FRANK REGS IN FIRST HEARING OF HOUSE FINANCIAL SERVICES COMMITTEE**

In its first hearing of the year, entitled “Promoting Economic Recovery and Job Creation: The Road Forward,” the House Financial Services Committee took the opportunity to heavily criticize the 300-plus rules and regulations required under Dodd-Frank. Chairman Spencer Bachus (R-AL) stated that the enormous rulemaking process is injurious to businesses and the economy, and the ensuing uncertainty is not unlike that caused by health care reform law.

One panelist, economist John Taylor of Stanford University, had two major points: uncertainty while awaiting rulemakings has hampered bank lending, and the Fed should simply focus on its inflation-fighting mandate. The Fed’s dual mandate came up repeatedly during the hearing, with Republicans questioning the latter half of the Fed’s responsibilities, that of fostering maximum employment. Rep. Mike Pence (R-IN) actually introduced legislation this past November that would reduce the Fed’s duties from two to one (stabilizing inflation). On the other hand, panelist Donald Kohn (a former Fed vice chairman) stated that the dual mandate is not problematic, and recent Fed chairmen have made price stability their chief priority. Kohn did go on to encourage Congress to discuss the concept, however.

Another panelist, Harvard Law professor Hal Scott, asserted that the new Consumer Financial Protection Bureau should be funded through the appropriations process, rather than by the Fed. Scott warned that capital requirements by the Basel Committee on Banking Supervision shouldn’t be too restrictive, and that the Volcker Rule should be narrowly interpreted in its implementation. These are all GOP arguments that we expect to hear regularly in the coming months as all these issues are addressed in the House Financial Services Committee.

**FRANK LASHES OUT AT GOP FOR ATTEMPTS TO OBSTRUCT DODD-FRANKS REGS**

Rep. Barney Frank (D-MA), Ranking Member of the House Financial Services Committee, spoke at a press conference on Tuesday, in which he spoke angrily about Republicans attempting to obstruct the implementation of the Dodd-Frank Act by denying necessary funding to the SEC and CFTC. House Republicans, in their “Pledge to America,” have vowed to significantly decrease government spending, and in fact passed a non-binding resolution on Tuesday (in which 17 Democrats crossed the aisle to cast supporting votes) that would cap the government budget at 2008 or earlier levels. Speaking before the vote, Frank stated that this would “substantially undo” much of the Dodd-Frank regulation, and would lead to a “disproportionate assault on our ability to regulate the financial industry… This is a serious threat to financial reform.” He added that Dodd-Frank appropriations would be nominal compared to the federal budget.
Rep. Spencer Bachus (R-AL), Chairman of the House Financial Services Committee, also spoke earlier in the week about the letdowns of the SEC in the past few years (e.g., failing to catch the Madoff fraud and failing to prevent the collapse of Bear Stearns and Lehman Brothers). He stated that his committee will be closely examining the agency to identify inefficient and outdated regulatory programs, and to better allocate the SEC’s resources. The SEC and CFTC, charged with the vast majority of Dodd-Frank implementation, have requested significant budget increases and are already having trouble meeting their new oversight and rulemaking mandates.

SEC PUBLISHES STUDY ON INVESTOR ACCESS TO INFO ON INVESTMENT PROS

The SEC published a study on Wednesday, which had been required by Section 919B of Dodd-Frank, on how to help investors obtain better access to information about investment professionals. In the short term, the advice is fairly minimal and includes three main recommendations. Currently, investors have to search two separate databases for information about broker-dealers and investment advisers, and thus the first proposal in the SEC study is to allow users to receive unified search results and to search both databases simultaneously. The SEC also recommended expanding the search functions of FINRA’s BrokerCheck website and the Investment Adviser Public Disclosure (IAPD) website to permit searches for broker-dealers, investment advisers, registered representatives, and investment adviser representatives, based on a location indicator. The final recommendation was to add educational content to the websites.

The study acknowledged that the optimal solution would be to consolidate the two databases, but this is unrealistic because of time constraints under Dodd-Frank. Once the 18-month timeframe for implementing these initial recommendations is complete, the study stated that the SEC and FINRA should continue to analyze whether it is feasible or advisable to expand the current amount of information available on BrokerCheck and IAPD and to modify the method for displaying that information.

TRANSACTIONS TAX IDEA DISCUSSED AT HOME AND ABROAD

French President Nicolas Sarkozy, speaking about his plans for the French presidency of the Group of 20 in 2011 at his palace earlier this week, stated that the country will “fight for” a multilateral tax on financial transactions, in order to combat market speculation and volatility and to fund development. France has an ambitious plan that includes innovative ways to use taxes to raise funds for development, and in particular for upholding promises that wealthier countries have made to help poorer countries adapt to climate change. Sarkozy considers this transaction tax idea to be a moral issue, and acknowledged that this could push some transactions into less-regulated markets.

Similarly, the co-director of the Center for Economic Policy Research (Dean Baker) urged President Obama to also endorse the idea of a financial transactions tax. Baker framed the idea as a means of reducing the U.S. budget deficit, and not as an ethical concept. He noted that the tax would have nominal impact on the average taxpayer, and yet would raise as much as $150 billion a year. The United Kingdom already has a financial transactions tax in place, and Baker pointed out that the London Stock Exchange is still the most heavily traded in Europe. He acknowledged that some transactions have certainly shifted to other countries, but “apparently investors view the benefits of trading on the London exchange as being valuable enough to outweigh the cost of the tax.” Baker went on to add that, “[p]resumably this would be even more true in the case of the United States since the U.S. market is even larger.”

SEC PROPOSES REPORTING REQUIREMENTS FOR CERTAIN ADVISERS
The SEC held a public meeting on Tuesday, in which it considered three proposals on its docket. First, the commissioners unanimously agreed to propose reporting requirements for certain private fund advisers in order to aid the Financial Stability Oversight Council (FSOC) in monitoring systemic risk. This proposal would implement Sections 404 and 406 of Dodd-Frank, which direct the SEC and CFTC to collect data from these fund advisers to keep the FSOC informed. The SEC is also considering a separate proposal, comments on which were due Monday, that would require the registration of advisers that manage at least $150 million in hedge and private equity assets.

Second, the SEC also voted 3-2 to adopt a rule (also required under Dodd-Frank) to give shareholders a voice in advisory votes on executive compensation and golden parachute pay arrangements. The final rule will grant a 2-year exemption to smaller issuers (with a public float of less than $75 million) from the say-on-pay requirements. Finally, the SEC agreed unanimously to propose a rule to change the definition of “accredited investor” to exclude the value of an investor’s primary residence when accounting for net worth.

1099 REPEAL BILLS INTRODUCED IN THE SENATE

Senate Majority Leader Harry Reid (D-NV) and Senate Finance Committee Chair Max Baucus (D-MT) introduced a bill on Tuesday that would repeal the Form 1099 information reporting mandate written into the health care reform law that was passed last year. Reid explained that the means of paying for the $19 billion repeal is still being determined. Senators Mike Johanns (R-NE) and Joe Manchin (D-WV) introduced a similar bill this week, with 52 bipartisan co-sponsors, that would also repeal the 1099 reporting requirement, but would pay for the reform with $39 billion in federal spending cutbacks. Both bills were previously introduced in November of last year, but failed to pass the Senate because there was no majority (Reid’s bill) and because of Senate rules requiring 67 votes for passage (Johanns’ bill).

The onerous reporting mandate came about under the health care reform law, which called for all businesses to file Form 1099 reports every time they paid a provider of goods or services more than $600 in a single year. Business groups have stated their opposition to what they consider to be a too time-consuming rule, and both Republicans and Democrats support passage of a repeal bill. How the repeal will be paid for is the only real point of contention.

GARRETT, FRANK EXPRESS FRUSTRATION WITH LACK OF PROGRESS ON GSE REFORM

Rep. Scott Garrett, chair of the House Financial Services Subcommittee on Capital Markets, expressed his frustration earlier this week with the White House’s delay in releasing its report on the future of Fannie Mae and Freddie Mac. He stated his plans to develop a replacement for the two behemoths that does not include “explicit” government backing, and legislation could be introduced later this year. Discussions amongst the GOP are still in the early stages, and Garrett stated that the timeline for moving forward is dependent upon the Obama administration’s report on GSE reform. Initially the administration’s recommendations were due to be published at the end of this month, but White House officials have confirmed that the report will come out closer to mid-February.

Barney Frank, at a press conference earlier in the week, also stated that he was “puzzled” by the GOP’s lack of action with regard to housing finance reform, especially after Republicans criticized the Dodd-Frank Act for leaving out Fannie and Freddie. Rep. Jeb Hensarling (R-TX) has stated that he would be
introducing a bill to fully privatize Fannie and Freddie within the next 5 years, but this method is opposed by the housing and financial services industries (who believe that some federal support is necessary).

Along those lines, Rep. Randy Neugebauer (R-TX), chairman of the House Financial Services Subcommittee on Oversight and Investigations, also weighed in on the GSE debate. Speaking at a housing policy conference put on by two major universities, he stated that the federal government should reduce its role in the mortgage business, but that the role should be withdrawn gradually because of the fragile real estate market. He emphasized “more dependence on markets and less reliance on government.”

SECURITIES LAWYERS URGE SELF-FUNDING FOR SEC

In a letter sent to key legislators earlier this week by the Federal Bar Association’s Securities Law Committee, members of the Executive Council advocated for either self-funding or substantially increased appropriations for the SEC. The senior securities lawyers, academics and financial services representatives liked the idea of increasing appropriations and paying for the increase solely through the SEC’s registration fee mechanism. Preferably, however, the council members urged a funding approach that would combine self-budgeting and self-funding. The letter stated that “the present dilemma underscores vividly why continuing to involve the SEC in the uncertainties and inevitable delays necessarily inherent in the annual appropriations process is not in the best interest of American business or investors.” The letter also emphasized that a self-funding mechanism for the SEC would require no tax dollars, add nothing to the deficit, and need no offset.

UPCOMING HEARINGS

On Tuesday, February 1st at 10am, in 608 Dirksen, the Senate Budget Committee will hold a hearing on the U.S. economic outlook.

On Wednesday, February 2nd at 10am, in 608 Dirksen, the Senate Budget Committee will hold a hearing on tax revision issues, focusing on fiscal responsibility.

On Thursday, February 3rd at 10am, in 608 Dirksen, the Senate Budget Committee will hold a hearing on the challenges facing the United States in achieving an economic recovery.

On Wednesday, February 9th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Domestic Monetary Policy and Technology will hold a hearing on monetary policy and job creation.

On Wednesday, February 9th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing on revising the operations of government sponsored enterprises.

On Thursday, February 10th at 10am, in 2128 Rayburn, the House Financial Services Committee will meet to consider the committee’s oversight plan.

On Tuesday, February 15th at 10am, in 2128 Rayburn, the House Financial Services Committee will hold a hearing on the implementation of derivatives provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act.
On Tuesday, February 15th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Oversight and Investigations will hold a hearing on the legal fees of government sponsored enterprises.

On Wednesday, February 16th at 10am, in 2128 Rayburn, the House Financial Services Committee will hold a hearing on the report issued by the Financial Crisis Inquiry Commission.

On Wednesday, February 16th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Insurance, Housing and Community Opportunity will hold a hearing on housing finance issues.

On Thursday, February 17th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit will hold a hearing on the proposal of the Federal Reserve System to regulate the fees charged by the banks and payment card networks (e.g., Visa and Mastercard) for processing debit card transactions.