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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

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Leading the Past Week

The theme of this past week is anger, primarily espoused by the Occupy Wall Street protests who continue to garner attention for their disenchantment with the financial services industry, corporate America and government. As the protests moved into their third week in New York and new movements spread across the country, the big question becomes: what is this group about? This week also saw vocal outcries against large banking institutions imposing new fees on debit customers, most notably expressed by the President, and by Senator Durbin who effectively encouraged a run on Bank of America. In other news, to the displeasure of Senate Republicans, Richard Cordray's nomination to be Director of the CFPB proceeded to the Senate Floor, though it is unlikely to be taken up anytime soon. Additionally, Secretary Geithner testified before the House and Senate Banking Committees, where among other things he announced that the FSOC has walked back their position on rulemaking and instead announced they would be instead issuing 'guidance.' Finally, the Volcker Rule—set to be formally released this week—was prematurely leaked, sending banks and covered institutions scrambling to determine the Rule's effects.

Supercommittee Update:

Last week marked continued skepticism that the Supercommittee will be able to achieve any sort of "grand" compromise to cut the deficit, if it reaches a bargain at all. Senate Republicans close to negotiations have been reported as saying that differences over tax increases may be "insurmountable." Aides to Senate Minority Leader Mitch McConnell (R-KY) and Senator Jon Kyl (R-AZ) believe that any "go big" plan to cut \$3 to \$4 trillion over the next decade—such as those discussed by House Speaker John Boehner (R-OH) and President Obama—is untenable because they would necessitate tax increases.

There is slight hope for compromise in the form of revenue raising ‘fees,’ including those proposed in the Biden Group talks. While certain fees may be on the table, any large deficit cutting scheme would also have to include Social Security reform or the Paul Ryan (R-WI) proposal to move to a voucher-based Medicare regime—proposals which are anathema to Democrats. Therefore, despite the appearance of a possibility for compromise, any proposal with revenue raisers or unpalatable entitlement changes would likely be unsuccessful in Congress.

While concerns continue to grow that the Supercommittee will fail to reach its \$1.2 trillion goal, McConnell and Kyl aides tried to assuage fears that such failure would indeed result in painful sequestration cuts. Aides asserted, and we continue to believe, that Congress will not follow-through with their threat of broad sweeping budget cuts.

Legislative Branch

Senate

Senate Banking Approves Cordray Nomination on Party-Lines: On October 6th, the Senate Banking Committee approved the nomination of Richard Cordray to be the first director of the Consumer Financial Protection Bureau (CFPB). Cordray’s nomination was advanced to the full Senate on a party line vote of 12 to 10. Despite the nomination moving out of Committee, there is little chance that the full Senate will take up Cordray’s nomination any time soon due to entrenched Republican opposition.

China Currency Bill Advances in the Senate: On October 3rd, the Senate voted 79-19 to open debate on the Currency Exchange Rate Oversight Reform Act of 2011 (S. 1619). The legislation is intended to categorize currency manipulation as a subsidy, thereby allowing the US government to impose countervailing duties on imports from all countries which are deemed to be subsidizing exports through undervalued currency. Supporters of the legislation posit that it will alleviate the high unemployment rate which has remained static since April. With the vote to allow debate, Majority Leader Reid (D-NV) said he anticipates the Senate will “wrap up work on the China currency [bill] quickly.” Despite Reid’s optimism, the bill has already faced significant politicization when Minority Leader Mitch McConnell (R-KY) unsuccessfully attempted to use it as a vehicle to attach the President’s jobs bill as an amendment to demonstrate lack of support for the jobs measure.

Despite optimism for Senate passage, it remains unlikely that the House will take up its version or the passed Senate bill, the Currency Reform for Fair Trade Act (H.R. 639) introduced by Representative Sander Levin (D-MI). In addition to concerns from Speaker John Boehner (R-OH) about the danger of “moving legislation through the United States Congress forcing someone to deal with the value of their currency,” Majority Leader Eric Cantor has firmly stated he will not allow a vote on the measure. Opponents of the legislation fear that the action would provoke a trade war or other retaliatory actions from China.

Banking Chairman Questions Regulators’ Attention to Congressional Intent: In a letter to the Commodity Futures Trading Commission (CFTC), the Securities and Exchange Commission (SEC), the Federal Reserve (Fed) and the Federal Deposit Insurance Corporation (FDIC), Chairman of the Senate Banking Committee Tim Johnson (D-SD) joined by House Financial Services Ranking Member Barney Frank (D-MA) voiced concerned with regulators straying from congressional intent in implementing the Dodd-Frank Act. Specifically, lawmakers pointed to rules on margin requirements, foreign subsidiaries of US institutions, clearing, trading and registration as examples of regulations that do not

match up with the spirit of the Dodd-Frank Act. Johnson and Frank took the opportunity to also stress to regulators the importance of “broad harmonization” with international regulators.

Legislation to Waive Penalties on Withdrawal of 401(k) Funds to Pay Down Mortgages Introduced: On October 5th, Senator Johnny Isakson (R-GA) along with Representative Tom Graves (R-GA) jointly introduced legislation (H.R. 3104) to allow people to withdraw money from their 401(k)s without penalty in order to meet mortgage payments. Taxes would still be owed on earnings; however the penalty levied for taking money out before retirement would be waived. In a release accompanying the introduction of the legislation, both members stressed that in order to reach an economic recovery, the housing market must recover. Isakson said “this legislation will help strengthen the American housing market because it will lead to a reduction in foreclosures.” The legislation will likely be questioned by those in support of promoting lifetime income streams for retirement as depleted 401(k)s can greatly affect when retirement can occur.

Bipartisan Repatriation Bill Introduced; Passage Unlikely Unless Tied to Other Initiatives: On October 6th, Senators John McCain (R-AZ) and Kay Hagan (D-NC) introduced repatriation legislation intended to incentivize companies to return to the US up to \$1.4 trillion in overseas profits at a reduced tax rate of 8.75 percent from the 35 percent corporate rate. The legislation also gives companies the opportunity to move to a rate as low as 5.25 percent if they create new jobs. In response, Majority Leader Reid (D-NV) said that repatriation legislation will not pass as a standalone measure and the proposal must be tied to infrastructure investment. While Reid would not provide further detail, back in June Senator Charles Schumer (D-NY) floated the idea of funding an infrastructure bank through a corporate tax holiday.

House of Representatives

Crowdfunding Legislation Clears Subcommittee Despite Concerns: On October 5th, the House Financial Services Subcommittee on Capital Markets and Government Enterprises approved two measures to carve out registration exemptions for crowdfunding and raise the threshold for internal auditing mandated by Sarbanes-Oxley. Despite the idea of increasing small business access to capital being *en vogue* in Congress, with many recent bills aimed at decreasing regulatory burdens, the crowdfunding measures faced significant opposition amid concerns over fraud and SEC resources. While approval of crowdfunding legislation was an uphill battle for Chairman Scott Garrett (R-NJ), the Subcommittee approved unanimously three measures aimed at job creation through increasing small business access to capital.

Despite concerns from Minority members of the Subcommittee and calls for Chairman Garrett to withdraw the bill, the Entrepreneur Access to Capital Act (H.R. 2930), the legislation advanced. Democrats made their concerns well heard in the debate. Representative Jim Himes (D-CT) said that crowdfunding is “opening the door to massive fraud” and Representative Maxine Waters (D-CA) expressed concerns with the SEC’s ability to monitor crowdfunding “schemes” given that Congress is “talking about cutting SEC funding.”

Legislation to Set Rates for Capital Gains and Dividends Introduced: On October 4th, Representative Peter Roskam (R-IL), member of the House Ways and Means Committee, introduced legislation to decrease the capital gains and dividends tax rates to 15 percent. Without Congressional action the top capital gains rate will return to 20 percent in 2013 and the dividends rate will be as high as 39.6 percent. President Obama has endorsed the 15 percent rate change; however, has proposed the top tax rates for

high income individuals be 20 percent. Roskam is framing his legislation in terms of job creation and recovery, saying his bill will “foster a culture that encourages investment, capital formation, and economic growth.” The bill has already been lauded by securities industry groups and a companion bill is set to be introduced in the Senate by Senator Mike Crapo (R-ID).

End-user exemption moving in the House, Stagnant in the Senate: On October 6th, Representative Michael Grimm (R-NY) said the House Financial Services Committee is close to acting on the bipartisan 2011 Business Risk Mitigation and Price Stabilization Act (H.R. 2682), a bill designed to clarify the “true derivatives end-user” exemption from swaps trading margin requirements. Grimm said the final legislation ensures true commercial end-users would be covered while “end-users employing derivatives to hedge legitimate business risk” are exempted. While the bill must also clear the House Agriculture Committee, Grimm said he is confident the bill will move through the Committee without problem and the full House will approve the bill.

The bill may be moving forward in the House; however, quick passage in the Senate is unlikely. Regardless of Senate foot dragging—a companion bill has yet to be introduced in the Senate—supporters remain optimistic. Grimm forecasted that increasing corporate pressure may force the Senate’s hand. Similarly, Jess Sharp, Executive Director of the Chamber’s Center for Capital Markets Competitiveness has said that a bipartisan vote in the House “would send a signal to the folks in control of the committees in the Senate... [that] this is really meant to solve a serious, substantive problem that people on both sides of the aisle can agree on.” Despite optimism among supporters, an aide to Tim Johnson (D-SD) said that the Senator does not wish to reopen the Dodd-Frank Act.

DeFazio, Harkin Reintroduce 2009 Bill to Tax Wall Street: Last week, it was reported that Representative Peter DeFazio (D-OR) is working with Senator Tom Harkin (D-IA) to reintroduce the “Let Wall Street Pay for the Restoration of Main Street Act of 2009.” The legislation is to be introduced before the November meeting of the G-20 and aims to tax the trading of stocks, bonds and derivatives. While the proposal went nowhere in 2009, it is plausible that there could be newfound support for such a tax given increased political pressure to cut the deficit, recent Wall Street Protests and the possibility of a similar proposal in Europe.

Business stakeholders, in anticipation of the bill’s introduction, have already been extremely vocal in opposition. Tom Quadman, Executive Director for financial reporting policy and investor opportunity at the U.S. Chamber of Commerce, hinted that enacting such a tax could drive financial service centers out of the US. Similarly, Kent Bentsen, Executive Vice President for Public Policy and Advocacy at SIFMA, said that this tax, like all sales taxes, will simply be passed on to the consumer. Despite strong protests from industry, one Senate aide was quoted as saying: “given the revenue needs in the United States, a tax like this would be considered to be a pretty strong contender in a cluster of tax proposals.”

House Agriculture Chairman Expresses Concerns over CFTC Rulemaking: On October 3rd, House Agriculture Committee Chairman Michael Conaway (R-TX), speaking at a Swap Execution Facility Conference, expressed concerns with CFTC Dodd-Frank rulemaking. Conaway said the rulemakings thus far have not been balanced, resulting in a “false choice between the Commission's proposals and unhealthy markets.” He urged regulators to pursue goals of transparency and regulation without sacrificing liquidity or the ability to innovate. Notably, Conaway announced he will be holding hearings to examine the CFTC’s inability to follow Congressional intent on swaps regulations. Specifically, Conaway will

focus on the CFTC's proposed rules for swaps dealing with "special entities" which the Chairman fears "may eliminate or encumber" certain industries to make market swaps.

Executive Branch

Treasury

Geithner Testifies before House and Senate Committees, Focuses on Upcoming SIFI Guidance: On October 6th, testifying before the Senate Banking Committee, Treasury Secretary Geithner said that the Financial Stability Oversight Council (FSOC) will be issuing guidance this week, likely October 11th, on what firms may be considered nonbank systemically important financial institutions (SIFIs). Geithner also made clear that the FSOC has walked back its position on rulemaking and instead will issue "guidance" to institutions. This marks a clear victory for industry lobbyists, since previously FSOC indicated it would engage in rulemaking on this matter. Geithner also testified later in the day in front of the House Financial Services Committee where he, again, focused on upcoming FSOC guidance. In his testimony before the House Committee Geithner also touched on what firms and institutions will fall under SIFI designation but did not give any indication if the Council will designate specific firms as SIFIs.

Treasury to Release Guidance on Lifetime Income Streams 'Soon,' Labor to Follow: On October 3rd, Mark Iwry, Senior Advisor to Treasury Secretary Tim Geithner, said that the Treasury expects to release guidance on lifetime income options "soon." At a conference sponsored by American Council of Life Insurers, AARP, the American Benefits Council, the U.S. Chamber of Commerce, and the Women's Institute for a Secure Retirement, Iwry said Treasury and Labor are currently working to 'phase' guidance between the two agencies.

Phyllis Borzi, Assistant Secretary of Labor for the Employee Benefits Security Administration, speaking at the same conference, said that the Department of Labor's guidance will be released after Treasury's, sometime around the end of this year. Both regulators said the pending guidance will incorporate findings from a 2010 request for information (RFI) on how to use defined contribution plans and individual retirement accounts to provide lifetime income streams through annuities. Borzi and Iwry said the guidance will also focus on educating people about the importance of lifetime income, partial annuitization and deferred annuities.

CFTC

CFTC Commissioner Calls for Registration for High-Speed Traders: On October 4th, CFTC Commissioner Bart Chilton warned attendees at the Golden Networking High-Frequency Trading Leaders Forum that another significant 'flash crash' is still a possibility. Chilton said that since the May 2010 flash crash there have been a number of 'mini flash crashes.' To that end, Chilton urged his peers to support the registration of all high-speed traders. Chilton also alluded to the possibility of high-frequency traders using regulatory blind spots—such as those left by not registering traders—could engage in "financial terrorism."

In his remarks, Chilton also was highly critical of an SEC rule which would eliminate the use of circuit breakers to halt trading after 3:25pm unless the market moves more than 20 percent. Chilton criticized the rule as one that would be "extraordinarily disruptive" and which "would threaten the market's infrastructure."

International

International Board Approves ‘Too Big to Fail’ Fixes: On October 3rd, the Financial Stability Board (FSB), representing central banks and finance regulatory bodies from G-20 countries and major financial markets approved a final set of ‘too big to fail’ rules including increasing capital requirements on SIFIs. The capital charges approved by the FSB were originally drafted by the Basel Committee and set charges at a fixed 1 to 2.5 percent above capital requirements set out by Basel III. The rules also include:

- A framework for “detailed monitoring in priority areas for reforms;”
- An international standard for winding down failing firms;
- A mandate that all globally systemic important financial institutions (G-SIFIs) create recovery and resolution plans; and
- Strengthened international standards for market infrastructure.

The FSB also announced that they will soon be publishing their next progress report on implementation of over-the-counter derivatives reform. Meanwhile, the Financial Stability Oversight Council (FSOC) is expected to meet soon on ‘too big to fail’ and SIFIs.

Miscellaneous

Bank of America Sees a Violent Reaction to Debit Fee Announcement: Last week, in response to Dodd-Frank debit interchange fee regulation, Bank of America—joining other large banking institutions such as JPMorgan Chase, Wells Fargo and SunTrust—announced they will be implementing new charges for debit-card users. Policy Analyst with FBR Capital Markets & Co, Ed Mills posited that the “swift, negative, viral reaction to that announcement is going to make other banks think twice about rolling [fees] out,” legislation to mitigate the effect of new fees is already appearing in Congress.

Many were angry in response to the new fees, even though Bank of America rolled them out in the most transparent manner possible. Notably President Obama questioned banks’ belief in an “inherent right” to profits and Senator Richard Durbin (the architect of debt interchange legislation) urging Bank of America customers to “get the heck out of that bank”—effectively encouraging a run on Bank of America. In order to potentially help with the impact of the fees, on October 4th, Representative Brad Miller (D-NC) introduced the Freedom and Mobility in Banking Act which would preclude banks from imposing fees on consumers who wish to close or move accounts.

Supreme Court Set to Take Up Numerous Consumer Protection Cases: With the new term of the Supreme Court beginning last week, eyes are on key banking cases focusing on consumer protection. *First American Financial v. Edwards*, which is set to be argued on November 28th, is a class action case brought under the Real Estate Settlement Procedures Act (RESPA). The case is based on the claim that a title insurance firm violated RESPA provisions through referral arrangements with outside companies and has the potential to impact other lawsuits concerned with federal consumer protection statutes. Robert Jaworski, who represents financial institutions, said that the “implications of Edwards are not necessarily restricted to just RESPA or even financial services. These types of arguments are also advanced in privacy violation cases against a broad range of industries.”

Justices will also be hearing arguments to determine whether federal courts may settle disputes that allow damages under the Telephone Consumer Protection Act (TCPA). Also being considered is

Compucredit Corp v. Greenwood which asks whether claims under the Credit Repair Organizations Act (CROA) are subject to arbitration. Additionally, up for consideration is a Fair Housing Act dispute which has the potential to affect the nature of class action suits and federal enforcement of lenders for many years. The case will answer the question of whether disparate impact claims under the FHA allow for racial discrimination. The case will likely have far reaching impacts as the Justice Department has become increasingly reliant on disparate impact analysis in cases and the decision could give Justice additional cause to pursue claims of loan bias.

Is the United States Headed Toward an "American Autumn?": Last week, the Occupy Wall Street protests continued strong for their third week while other "Occupy" meetings popped up across the country, including in Washington DC, Los Angeles and Boston. The protests largely reflect the feelings of disaffected college graduates who graduated without job prospects. According to the Bureau of Labor Statistics, eligible workers age 20 to 24 years old make up 14.3 percent of the overall unemployment rate—the largest unemployed group after the 16 to 19 age group.

Several observers are calling the Occupy movement a "progressive" version of the Tea Party movement which harkens back to Depression Era Labor movements. Notably, Van Jones, former advisor to President Obama, said that these protests may mark the beginning of an "American fall, an American autumn, just like we saw the Arab spring." The past weekend the media continued to increase its focus on the movement, with most trying to figure out exactly what the protestors want and what the movements stands for.

UPCOMING HEARINGS

On Tuesday, October 11th at 4pm, the Senate Finance Committee will mark up legislation that would implement the Colombia, Panama and South Korea Free Trade Agreements and vote on pending nominations.

On Wednesday, October 12th at 9:30am, in 608 Dirksen, the Senate Budget Committee will hold a hearing on efforts to improve the congressional budget process, focusing on proposals to adopt joint budget resolutions that would be signed by the president and other budget process overhaul issues.

On Wednesday, October 12th at 10am, in 1300 Longworth, the House Agriculture Committee will hold a hearing on legislative proposals that would amend the Wall Street Reform and Consumer Protection Act and the implementation of Title VII.

On Wednesday, October 12th at 10am, in 215 Dirksen, the Senate Finance Committee will hold a hearing on options for overhauling the tax system focusing on capital investment and manufacturing.

On Wednesday, October 12th at 10am, in 2167 Rayburn, the House Transportation and Infrastructure Subcommittee on Highways and Transit will hold a hearing titled "National Infrastructure Bank: More Bureaucracy and More Red Tape."

On Wednesday, October 12th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on International Monetary Policy and Trade Panel will hold a hearing to markup pending development banks reauthorization legislation.

On Wednesday, October 12th at 1pm, in 2220 Rayburn, the House Financial Services Subcommittee on Oversight and Investigations will hold a hearing on federal home loan banks.

On Wednesday, October 12th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit will hold a hearing on business lending by credit unions.

On Thursday, October 13th at 10am, in 2128 Rayburn, the House Financial Services International Monetary Policy and Trade Panel will hold a hearing on the relationship between the health of the U.S. housing finance system and global financial stability.

On Thursday, October 13th at 10am, in 2128 Rayburn, the House Financial services Subcommittee on Insurance, Housing and Community Opportunity will hold a hearing on the housing choice voucher program, also known as the Section 8 program.

On Thursday, October 13th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing on proposals that would amend provisions contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

On Friday, October 14th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing on proposals that would amend provisions contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act.