Jason M. Rosenstock
Direct dial 202 434 7478
JMRosenstock@mlstrategies.com

Abby Matousek
Direct dial 202 434 7329
AMatousek@mlstrategies.com

ML Strategies, LLC
701 Pennsylvania Avenue, N.W.
Washington, D.C. 20004 USA
202 434 7300
202 434 7400 fax
www.mlstrategies.com

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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

October 24, 2011

Leading the Past Week

With the House in recess and the Senate appearing to be mostly focused on voting down competing jobs bills, most of the action last week was in the administration, with various agencies continuing the implementation of Dodd-Frank. Most notably, the CFTC finalized its controversial position limit rule, which despite howls from industry, was met with disappointment from several lawmakers and consumer groups who were hoping for a stronger rule. The Fed released its final living will rule, which sets up a process to provide for the orderly wind-down of failing systemically significant firms. Finally, though not receiving the attention it probably deserves in Congress or the media, the EU continues to attempt to find a way out of its sovereign debt quagmire.

Supercommittee Update:

While the House was in recess, the Senate was in session and that meant members of the Supercommittee continued to work in the hope they could hammer out a deal to reach $1.2 trillion in deficit reduction. Last week, the Senate's Gang of Six met with the Committee to discuss the plan the group outlined over the summer. Senators Saxby Chambliss (R-GA), Tom Coburn (R-OK), Mike Crapo (R-ID), Kent Conrad (D-ND), Dick Durbin (D-IL) and Mark Warner (D-VA) each were given the opportunity to discuss their plans for five minutes.

While closed door meetings continue, the conventional wisdom about the Supercommittee becomes more and more negative. Despite having its fourth public hearing scheduled for October 26th, lawmakers, the press and the public are beginning to chaff at the lack of transparency in deficit reduction. Last week, a survey conducted by the National Journal found that a significant number of lawmakers believe deliberations are too secretive. While Democrats were largely more concerned that Republicans, one Republican member said: "the public deserves to know more about the deliberations, and members need to know more about what we may be voting on." At this point it appears that hopes for a 'grand bargain' have all but vanished. There are also rumors that members of both parties are hoping that the committee fails to produce any report, which could make this the biggest kabuki theater exhibition that Washington, has ever seen.

Legislative Branch

Senate

Home Mortgage Financing Reform to Wait Until 2013 at the Earliest:
On October 20th, the Banking, Housing, and Urban Affairs Committee heard testimony about the future federal role in 30-year, fixed-rate home loans. At the hearing, Senate Banking Committee Chairman Tim Johnson (D-SD) confirmed that reform of the housing finance system will not be undertaken anytime soon, and the Committee wouldn't begin to work on legislation until "next year." This announcement encapsulates how complicated reforming Housing finance has become, even with the Obama Administration and many Republican lawmakers favor a gradual elimination of Fannie and Freddie. However, at the same time many Democrats and some Republicans (at least in private) fear that such a move would leave homeowners without access to popular mortgages options. Without a government-backed secondary market for those loans, banks may only offer them at prohibitively high interest rates. However, as Secretary Geithner told the Committee in March, 30-year, fixed rate mortgages would be more expensive than other options laid out in any of the the Administration's housing financing reform plans.

Still, advocates of reform suggest that consumers favor such loans for their security and fear that a privatized market would not support such predictability. Witness John Fenton, President of Affinity Federal Credit Union, appeared to be advocated for reform that resulted in the *status quo*, when he said, "there should be at least two GSE-type entities to ensure competition and to perform the essential functions currently performed by Fannie and Freddie" so as to ensure that credit unions and smaller banks have access to mortgages. Nevertheless, Ranking Member Richard Shelby contended that 30-year mortgage products would still exist in a private market place so long as demand existed.

Senate Blocks Portion of Obama Jobs Plan to Hire Teachers, First Responders:

On October 20th, the Senate failed to pass a proposal pulled from the President's American Jobs Act designed to keep state workers employed and boost hiring of teachers and emergency responders. This proposal, a stripped down version of the larger Obama jobs plan is part of the Administration's effort to move smaller pieces of the proposal. Late Thursday evening, the Senate voted down both the Obama proposal (on a 50-50 vote) in part, due to Republican opposition to a 0.5 percent tax on millionaires to finance the plan. At the same time the Senate also voted down a Republican-backed proposal (by a vote of 57-43) that included a repeal of a 3% withholding requirement for all government contractors that the businesses has decried as overly burdensome.

Geithner Small Business Hearing Focuses on Large US Problems: Tax Reform, Foreclosures:

On October 18th, Treasury Secretary Geithner appeared before the Senate Small Business Committee to defend Treasury's treatment of the Small Business Lending Fund (SBLF). Geithner said the SBLF had been successful, even if the scope was not as broad as envisioned. He also added that while only $4 billion of the $30 billion dollars allocated for the program have been distributed, he viewed this as a result of low participation and a lack of qualified applicants, though he did note that the Administration had set up an onerous lending approval process as well as Treasury constraints on communicating with applicants as reasons for the small lending levels.

Committee members also used Geithner's appearance for an opportunity to question the Treasury Secretary on a variety of other issues including the President's jobs bill, foreclosures, tax reform and the Supercommittee. On the subject of housing, Geithner said the foreclosure situation is "terrible" and that "major mortgage servicers are doing an unacceptably bad job in servicing customers." He also foreshadowed an unspecific but upcoming Administration effort to aid in home refinancing.

Even as Republicans on the House Ways and Means Committee floated broad based tax overhaul in the form of a new 'territorial' tax system, Geithner cautioned the Small Business Committee against focusing solely on large, long-term reforms. Geithner recognized that the tax code requires an overhaul; however, said Congress cannot undertake "fundamental tax reform in two months," which many read as indicative of the fact that the Supercommittee is not going to include the language for substantive tax reform in its recommendation.

Senate Confirms Financial Regulators:

On October 21st, the Senate unanimously approved the nominations of 19 banking regulators. Among those confirmed included, Daniel M. Gallagher and Luis A. Aguilar to the SEC and Mark P. Wetjen to the CFTC. The three commissioners will play key roles in writing the rules to implement the Dodd-Frank Act. Also confirmed, was Janice Eberly as the Assistant Secretary for Economic Policy at the Department of the Treasury. The nomination of John Bryson to be Secretary of Commerce was also approved that day by a vote of 74 to 26.

Amendment to Increase Government-backed Mortgage Loan Limits Introduced:

On October 19th Senators Feinstein (D-CA), Isakson (R-GA), and Menendez (D-NJ) introduced an amendment to the Agriculture Appropriations bill (H.R. 2112) that would return government-backed mortgage loan limits to their higher, temporary levels set in 2008. Designed to jolt the floundering housing market by lowering the cost of borrowing, at levels authorized by Fannie Mae, Freddie Mac, and the Federal Housing Administration to purchase or guarantee costlier mortgages. That authority expired at the start of the month, which returned the upper mortgage limit to $625,000 – down from $729,750, and revised the formula for setting limits to 115% of the median home price for the area – down from 125%.

Advocates for temporarily increasing the limit through December 2013 argue that the lower levels will hamper the housing market recovery, particularly in more expensive housing markets such as New York, Los Angeles, and Washington, DC. The Administration and many Congressional Republicans disagree, arguing that it is time for the federal government to slowly extract itself from the home mortgage market. A study from the Federal Reserve, released last month, indicates that only 1.3% of Fannie and Freddie loans made last year would not be eligible under the new limits, but noted that banks will need to increase their large mortgage offerings by 50% to compensate for the government's exit. Still, such an increase may not be needed, as some argue that demand for those loans will fall in the face of likely higher, private interest rates.

Senate Hearing on ETFs Receive Limited Attention:

On October 19th, the Banking Securities Subcommittee held a hearing on exchange-traded funds (ETFs). While Chairman Jack Reed (D-RI), attempted to drive home the risks surrounding ETFs—

which are in part responsible for recent late-day market swings, including the dramatic 10% drop and subsequent rebound in the Dow Jones on May 6, 2010—his efforts were for naught as he was the only lawmaker to attend the hearing. Despite a warning released this summer by the FSOC, the near empty subcommittee hearing suggests indifference to what some argue is a dangerously leveraged and opaque investment instrument. This sentiment was echoed by Harold Bradley, CIO at the Kauffman Foundation, who said: "regulators have been slow to react to this very profitable and fast-growing niche of the financial markets, one that may endanger capital formation by its very design." Noel Archard of BlackRock recommended reclassifying ETFs that rely on derivates so as to reduce confusion surrounding an instrument that has come to signify a wide range of products.

Senate Banking Subcommittee Hears Testimony on European Debt Crisis:

On October 20th, at a Senate Banking Subcommittee hearing, Lael Brainard, Treasury Undersecretary for International Affairs stressed to Senators that Europe must "leverage up" the European Financial Stability Facility in order to combat the spread of the debt crisis. Brainard said European banks will need a backstop of "sufficient force and size to overwhelm the markets" and "take the risk of cascading defaults and bank runs off the table." The EFSF has already committed €160 billion to Greek stabilization and European governments continue to debate additional funds. (For more on EU Debt Crisis, please turn to the "International" Section).

House of Representatives

House Democrats Call on SEC to Regulate Corporate Political Spending:

On October 20th, Representative Gary Ackerman (D-NY) joined by 42 House Democrats urged the SEC to consider rulemaking to require public companies to disclose political spending to shareholders. Ackerman stated that this letter is in response to the *Citizens United v. Federal Election Commission* decision which liberalized the rules on political spending by corporations. The letter posits that shareholders have a "clear desire to be informed of corporate political spending" as they are currently "completely in the dark, unaware that their money could be funding political attack ads." Ackerman said the SEC could alleviate this problem by requiring disclosure on "existing mediums of communication" such as registration statements and proxy statements. Representatives Ackerman and Michael Capuano (D-MA) have previously introduced legislation aimed at unraveling the *Citizens United* decision by amending securities laws to include political spending disclosures. The Council of Institutional Investors has also called on the SEC to regulate political expenditures asking for "comprehensive disclosure."

<u>Executive Branch</u>

CFTC

CFTC Adopts Final Position Limit Rule Despite Concerns of Congress:

On October 18th, the CFTC approved a final position limit rule which covers 4 energy contracts, 19 agricultural contracts and 5 metals contracts with two different limits on limits: spot month and non-spot month. In spot months, traders are limited to 25 percent of the deliverable supply of a covered contract. These limits will be crafted based on current position limit levels in place at contract markets and be adjusted every year for energy and metal contracts and every two years for agriculture contracts. Non-spot month limits will be set at 10 percent of the first 25,000 contracts of open interest and 2.5 percent over 25,000.

The final position limit rule contains some concessions as a result of heavy lobbying following the original proposal such as a loosened implementation schedule, clarification of financial versus physical positions and exemptions for non-covered hedgers. Despite walking back some aspects of the January proposal, the CFTC may still see a court challenge on the grounds that the Commission did not adequately adhere to Congressional intent or that the cost-benefit analysis of the final rule was lacking

Commissioners Scott O'Malia and Jill Sommers voted against the rule which was passed on a partisan vote of 3 to 2 vote. In dissent, O'Malia said that finalizing the rule "overreached in interpreting its statutory mandate." Commissioner Michael Dunn, who was the swing vote on this issue, clearly expressed his concerns for the rule with his comments. Noting that while he voted for the rule, he described the proposal as, "at best a cure for a disease that does not exist, or a placebo for one that does." Despite the strong rhetoric criticizing the proposal Chairman Gensler said this rule will "help to protect the markets both in times of clear skies and when there is a storm on the horizon."

This rule was subject to a ferocious lobbying battle, evident by the fact that as the CFTC was considering the proposal, it received a flurry of letters from various members of Congress, including Senator Bernie Sanders (I-VT), who sent up a letter in advance of the meeting that criticized the final rule as weak; charging that it will "do little or nothing to lower prices and it will not eliminate, prevent or diminish excessive speculation." Echoing Sanders concerns that the rule doesn't go far enough, Senator Maria Cantwell also wrote to the Commission this week, charging that the rule would enable speculators to own five times the physically deliverable supply—which would increase manipulation and exacerbate volatility while increasing cost for commercial end-users. Potentially more troubling for the Commission is the fact that Senator Carl Levin (D-MI), who also would have liked to have seen an even stronger rule, has scheduled a Permanent Subcommittee on Investigations on November 3rd hearing to investigate CFTC's proposal.

CFTC Votes on Derivatives Clearing and Swap Extensions:

In addition to adopting a position limits rule last week, the Commission also approved a derivatives clearing rule and a rule extending the effective date for swaps definitions. The Commission unanimously approved the proposal to delay swaps effective dates to July 16, 2012. If the rule is finalized, it will be the second time swaps regulation has been pushed back in order to provide "temporary relief" and give the CFTC additional time to finalize swaps rules and definitions. The derivatives rule, which passed the Commission in a 3 to 2 vote, comprises five previous proposals in one final rule—establishing compliance standards through 15 "core principles." Notably, a provision requiring systemically significant clearinghouses to maintain sufficient resources to meet obligations of its two largest members in the event of default was removed from the final rule.

SEC

SEC Announces Vote on Final Hedge Fund Advisor Disclosure Rule:

This past week, SEC Chairman Mary Schapiro announced that the Commission will soon be voting on a final rule to require hedge and other private funds to disclose nonpublic data to regulators. The rule will affect approximately 200 domestic hedge fund advisors with over 80 percent of assets in hedge fund management. The rule is intended to acquire information from funds so as to better monitor financial markets for systemic risk. Schapiro said the SEC carefully weighed confidentiality, security, and jurisdictional issues crafting the final rule, though the jury on this is still out from industry's perspective. Drawing parallels to similar efforts in London, Schapiro also noted that the rule draws on a UK Financial Services Authority study of hedge funds and has been coordinated with international regulators. The goal of the rule is to gather data that can be funneled to the Financial Stability Oversight Council ("FSOC") which has been tasked by Dodd-Frank to examine the financial services industry in search for systemically risky entities and transactions.

CFPB

CFPB Receives Comment that Larger Participant Rule Should be Tweaked, Broadened:

In what some may view as a rare moment of agreement, but what others my cynically view as an attempt to push non-banks out of the business, the banking industry and consumer groups have found common ground over how the CFPB should regulate the non-bank sector. The Dodd-Frank Act charges the CFBP with regulating certain non-bank entities such as mortgage companies, payday lenders and private student lenders, however the law provides the Bureau with broad discretion in this area. Earlier this year, the Bureau requested public comment on how to define this responsible, known as "the larger participant rule" and asked for public comment on six addition industries: debt collectors and debt relief services, consumer reporting agencies, money transmitters, check-cashing agencies, prepaid card providers, and consumer credit providers and related activities.

As public comments have been filed with the CFPB, it is clear that some stakeholders, a few of which have been actively trying to limit the jurisdiction and reach of the Bureau, seem to be advocating for the CFPB to take a broad approach in determining which companies will be subject to non-bank supervision. For example, in its comment letter to the Bureau, the American Bankers Association (ABA) reminded the CFPB that Congress wanted the agency to "have supervisory authority over a broad range of non-bank consumer financial products and service providers so that the existing gap in regulatory oversight can be closed." This position has placed the ABA in line with some of its fiercest policy adversaries, including the California Public Interest Research Group, whose comments effectively echoed the ABA. Although, they went further, adding that the six additional categories the Bureau identified are too broad, calling for categories to be split up "to further reflect the diverse players within each field." The Independent Community Bankers of America (ICBA) and the National Association of Federal Credit Unions (NAFCU) expressed similar sentiments. While industry and consumer advocates continue to advocate on this issue, the CFPB is statutorily precluded from proceeding with non-bank supervision until a director is in place.

Federal Reserve

Fed Finalizes Living Will Rules:

On October 17th, the Federal Reserve finalized and published its rules to implement living will requirements for the largest nonbanks and bank holding companies. The Fed undertook the rulemaking jointly with the FDIC which unanimously adopted a living will rule on September 13th. According to a Fed release on the rule, banks with over $250 billion in assets will be required to "describe the company's strategy for rapid and orderly resolution in bankruptcy during times of financial distress." The rules take effect on November 30th and plans must be submitted to regulators by July 1, 2012.

International

European Debt Crisis Continues as Policymakers Meet to Discuss Solutions:

Six-days of meetings between ministers and leaders from across the 27-member European Union started on October 21st. The summit comes after Slovakia, the last holdout in the 17-member Eurozone, voted a week before to expand the EFSF to €440 billion. However, lingering disagreement between the two largest euro economies, Germany and France, may hinder additional efforts to return stability to the economic area. France favors transforming the EFSF into a bank – which could access European Central Bank (ECB) liquidity, a move opposed by Germany, the ECB, and the European Commission.

Other proposals include combining the EFSF with the European Stability Mechanism to produce a €940 billion fund capable of calming restive markets, while another calls for providing partial insurance coverage for sovereign bonds through the EFSF. Any resolution that emerges from the summit will likely need to address the weakness of private European banks exposed to the sovereign debt crisis. As much as €350 billion may be needed to recapitalize those banks, according to the International Monetary Fund. Still, one action is all but assured – the release of Greece's next €8 billion loan installment, the sixth of a €110 billion package approved in May 2010. All of the uncertainty surrounding the problem and its path to resolution is certain to consume both the media and the markets until clarity is obtained in both regards.

Miscellaneous

Florida Legislator Seeks Ban on Debit Card Fees:

Florida State Representative Jeff Clemons (D) introduced a bill on Monday October 17th which would halt efforts by banks from collecting fees from customers who use their debits cards. This comes as Bank of America announced that starting in 2012 it will charge customers $5 per month if they use their debit card to make a purchase. Other banks, including Wells Fargo, SunTrust, and Regions Financial have announced similar plans, each citing projected revenue losses as a result of the Durbin Amendment which halves the fees they can collect from retailers for debit card transactions. Clemons dismissed that defense, arguing that banks continue to reap record profits despite recent financial regulations. Still, it is unclear if Florida has sufficient jurisdiction over national banks to make such a law, though Clemons points to a 2009 Supreme Court case, *Cuomo vs. Clearing House Association*, where among other things the Court held that federal law did not prevent state law from applying to national banks.

Occupy Protests Continue, Aims Differ:

The Occupy Wall Street protest has spawned numerous sit-ins nationwide and even internationally. This comes despite lacking concrete goals or a clear organizational structure. For some, including Democratic pollster Douglas Schoen, the protest represents fringe progressive politics. In a recent Wall Street Journal op-ed, Schoen warned Democrats against embracing the movement as it is out-of-line with the views of moderate and independent voters. Discussing his survey of 200 protesters at the flagship New York location, he suggested that the protesters are ideologically uniform – in favor of raising taxes on the wealthy as well as government provision of universal healthcare, college education, and retirement benefits. Still, whether the protestors have concrete goals may be irrelevant, as it is clear that they share anger towards a variety of perceived injustices. However, it remains to be seen if the disparate groups can hold together, and channel that anger to influence next year's elections.

UPCOMING HEARINGS

The Senate will be in recess this week

On Tuesday, October 25th at 10am, in 1100 Longworth, the House Ways and Means Committee will hold a hearing on the U.S.-China economic relationship, focusing on trade practices and non-tariff barriers that hinder U.S. companies from competing in the domestic Chinese market.

On Tuesday, October 25th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on The International Monetary Policy and Trade will hold a hearing on the Eurozone crisis and implications for the United States.

On Tuesday, October 25th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Insurance, Housing and Community Opportunity will hold an oversight hearing titled "Insurance Oversight: Policy Implications for U.S. Consumers, Businesses and Jobs."

On Wednesday, October 26th at 10am, in 216 Hart, the Joint Select Deficit Reduction Committee will hold a hearing titled "Discretionary Outlays, Security and Non-Security."

On Wednesday, October 26th at 10am, in 2128 Rayburn, the House Financial Services Committee will mark up pending legislation relating to job creation and reduction of regulatory burdens on small business capital formation.

On Wednesday, October 26th at 1pm, in 2360 Rayburn, the House Small Business Committee will hold a hearing titled "Oversight of the Small Business Administration's Financing Programs."

On Thursday, October 27th at 9:30am, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit will hold a hearing on the potential impact of a proposed IRS regulation that would require banks to report annually the amount of interest earned by nonresident alien on U.S. bank deposits.