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Financial Services Legislative and Regulatory Update

Leading the Past Week

Congress once again worked through the weekend, but based on the [public statements](#) seemed no closer to resolving its stalemate and being able to reopen the Government. With [both sides now merging](#) the of funding the government with a vote for a “clean” [debt ceiling extension](#), Wall Street is now hoping that [Churchill’s famous axiom](#) is just slightly off and that, as some in Congress think may be necessary, the country, and the stock market, doesn’t need a replay of [September 29, 2008](#) in order to convince lawmakers of the need to increase the debt limit.

Although things took a more serious turn by the end of the week, and through the weekend, the early part of the week saw the markets react with ambivalence, as both the dollar and U.S. stock futures held steady, buoyed by a (now clearly erroneous) belief that the shutdown would be short. However, as it become increasingly likely that the shutdown could drag on for days, if not weeks, and [was likely to be merged into the debate over the debt ceiling](#), Wall Street began to react, with the stock market taking a noticeably downward trend on Wednesday and Thursday.

Adding to those fears, was the Treasury Department’s [announcement](#) on Tuesday, that it had begun to use the “final extraordinary measures” available in order to keep the country solvent, and reaffirmed that the “x-day” continues to be October 17 and then later in the week released a [report](#) describing the “catastrophic” effects that would occur upon a failure to raise the debt ceiling. Not surprisingly, stakeholders from around the world, including The International Monetary Fund’s Christine Lagarde, have weighed in urging Congress to put aside its partisan differences for the sake of the world’s economy.

With the federal government operating in a severely limited capacity this past week and with no end in sight, it also worth noting that impact the shutdown is having on the regulators. As of the end of September, the [deadlines for 280 Dodd-Frank rulemakings](#) have now passed and just less than 40%, (109) of these deadlines has been met with final rules. Going forward, regulators are likely to face

continued challenges in implementing outstanding portions of the Dodd-Frank Act due to skeleton staffs and an all but shuttered Federal Register. For example, although the Securities and Exchange Commission (SEC) has announced that it would be able to use spare funds to remain fully operational for “a few weeks,” the SEC’s recently published municipal advisor registration rule will be further delayed as the Federal Register publication and 60-day comment period has been halted due to the shutdown.

While the SEC, the Treasury, Federal Deposit Insurance Corporation (FDIC) and the Fed are still able to operate largely unaffected, the Commodity Futures Trading Commission (CFTC) has largely ceased operations. As the Financial Times [reported](#), CFTC Chairman Gensler is trying hard not to let the combination of a reduced staff and his upcoming departure from the CFTC to delay the implementation of new derivatives rules. Gensler has said that, despite the shutdown, efforts to shift derivatives to a transparent electronic platform went “more smoothly than” expected. The CFTC will also not delay the next implementation deadline for the rules, Gensler making clear that the next phase would take effect this week, imposing reporting requirements on offshore affiliates and branches of US institutions.

Legislative Branch

Senate

Senate Banking Examines Housing Finance Reform and the Mortgage Backed Securities Market

On October 1st, the Senate Banking Committee held a hearing to examine the role of private label mortgage backed securities (MBS) in federal housing finance reforms. Witnesses at the hearing included Martin Hughes, CEO of Redwood Trust, John Gidman, President of the Association of Institutional Investors, and Adam Levitan, Professor of Law at Georgetown University. Gidman told lawmakers that he would like to see an interconnected mortgage finance system involving the private-label MBS, government-backed mortgages and securities from the Federal Housing Administration (FHA), and a hybrid market with private capital backed by government guarantees. Levitan echoed these remarks saying it is the “right blend of mortgage tools to have adequate liquidity in the marketplace for borrowers.” Still Hughes added that the US market needs multiple financing sources and it is “critical” private label MBS continue to play a role, urging lawmakers to work for greater standardization of warranties and calling for mandatory arbitration as a minimum standard for resolving disputes. Committee members and witnesses repeatedly expressed the urgency of creating legislation to reform the Housing finance market and Ranking Member Crapo reiterated that the Committee’s hearings were intended to produce a bipartisan agreement by the end of the year.

House of Representatives

House Agriculture Weighs CFTC Reauthorization

On October 2nd, the House Agriculture Subcommittee on General Farm Commodities held a hearing to consider the reauthorization of the CFTC, focusing on the agency’s proposed consumer protection rule. Witnesses included CME Group Chairman Terrence Duffy, National Futures Association President Daniel Roth, and the National Grain and Feed Association regional sales manager Michael Anderson, President and CEO of the National Futures Association Daniel Roth, President of Commodity Customer Coalition James Koutoulas, and President of Frontier Futures Theodore Johnson. The CFTC proposed additional protections for market participants following the failures of MF Global and Peregrine Financial but the new rules have received mixed reviews. Duffy told lawmakers that the proposal would require users to double margin requirements and other witnesses argued that altering margin call rules would dramatically change the nature of the business.

Executive Branch

Federal Reserve

Large US Banks Submit Revised Living Wills

On October 3rd, the large US banks with over \$250 billion in assets [submitted](#) revised annual resolution plans to the Fed and the FDIC. The plans must each describe the company's strategy for rapid and orderly resolution in the event of material financial distress or failure of the bank. The public portions of the plans are available on the [FDIC](#) and [Fed](#) websites. The banks which filed include: Bank of America, Bank of New York Mellon, Barclays, Citigroup, Credit Suisse Group AG, Deutsche Bank AG, Goldman Sachs, JPMorgan Chase, Morgan Stanley, State Street and UBS AG.

Companies Call on Fed to Allow Banks to Continue Commodities Business

On October 1st, 30 companies and trade associations, organized by the Chamber of Commerce, [wrote](#) to the Fed regarding the central bank's review of the "2003 determination that certain commodity activities are complementary to financial activities and thus permissible for bank holding companies." The companies which signed the letter said that there is an important role for banks in the physical commodities space and hope that the Fed understands the need for financial hedging instruments. Lawmakers, including Senator Sherrod Brown (D-OH) who chairs the Senate Banking Subcommittee on Financial Institutions and Consumer Protection, have called for regulators to increase enforcement of banks' commodities business, citing exposure to manipulation and other systemic risks. Brown was scheduled to chair a Subcommittee hearing on this topic this week, but the hearing was delayed due to the government shutdown.

Fed to Launch Consumer Compliance Supervision Program

On October 3rd, speaking at the Conference of State Bank Supervisors Community Banking Research Conference, Governor Jerome Powell said that the Fed is launching a new initiative to review consumer compliance supervision program for community banks. The updated program will base examination intensity more directly on the bank's risk profile, including consumer compliance culture and how it identifies consumer risk. Powell said the Fed will be launching the new supervision program in 2014 and will begin training examiners later in 2013.

Treasury

Office of Financial Research Reports on Asset Manager Risk

On September 30th, the Treasury's Office of Financial Research (OFR) released a [report](#) which found that failures of large asset managers could place the financial system at risk due to data gaps which limit better monitoring of the industry. The report was generated for the Financial Stability Oversight Council (FSOC), which has the authority to place non-bank companies, such as asset managers, under Federal Reserve oversight. The report finds that some asset managers conduct activities that "increasingly cut across the financial system in a variety of ways" and sometimes provide services similar to those provided by banks and other financial companies.

HUD

HUD Proposed QM Definition for Federally Backed Mortgages

On September 30th, the Housing and Urban Development (HUD) Department proposed [new rules](#) for mortgages insured by the FHA that meet new ability-to-repay rules. The rules are a required change to the Truth in Lending Act (TILA) by the Dodd-Frank Act to provide additional clarity to the definition

of “qualified mortgages” set by the Consumer Financial Protection Bureau (CFPB). HUD sets the definition for QM loans to 30 year terms and caps upfront points and fees at 3 percent.

FHA Commissioner Highlights Positive Trajectory

Speaking at an event held by the Progressive Policy Institute and American Action Forum, FHA Commissioner Carol Galante said that, despite the recent need for an infusion of cash from the Treasury, there has been “significant improvement” in the insurance fund and the agency is on a “positive trajectory.” Galante underscored that the transfer is “not a reflection of the current fund performance, its long-term fiscal health, or its ability to pay claims,” as the FHA has taken a number of recent steps to shore up its fund. In a September 27th letter to Congress, Galante outlined the need for a \$1.7 billion transfer from the Treasury to cover large losses to its insurance fund brought on by the housing crisis. As with the rest of the Federal government, the agency is now operating in a limited capacity. Despite rumors that the FHA would not underwrite any new loans during the shutdown, the agency since clarified that it would continue to approve mortgages, but it may take longer as the FHA is working with a tenth of its usual fulltime staff.

CFPB

Bureau Holds “Banking on Campus Forum”

On September 30th, the CFPB held a [live discussion](#) on student checking and debit arrangements. The presentation drew comparisons between student checking and debit card agreements with now-illegal student loan and credit card practices. Speaking on the issue, Director Richard Cordray said that he is concerned that some “colleges and universities, whether well-intentioned or not, may be encouraging or even requiring our young people to use financial products that do not offer the best deals.”

CFPB Reports on CARD Act Progress

On October 2nd, the Bureau released a [report](#) on how the Credit Card Accountability Responsibility and Disclosure Act of 2009 (CARD Act) reduced penalty fees and made the cost of credit cards clearer to consumers. The report also found that total cost of credit has declined by two percent between 2008 and 2012. However, areas of concern remains, including potentially deceptive add-on products, fee harvester cards, deferred interest products, and online disclosures, reward product disclosures, and grace period disclosures.

CFPB Fines Meracord for Illegal Debt Settlement Practices

On October 3rd, the debt processor Meracord LLC agreed to a [settlement](#) deal with the CFPB, saying it will pay the Bureau \$1.3 million to settle charges that it helped firms in charging millions in upfront fees for debt relief. Meracord, one of the largest payment processors for the debt settlement industry, also received a [consent order](#) requiring it to halt illegal activities. The CFPB said that the illegal practices involve more than 11,000 consumers, 5,000 of which closed their accounts without resolution of their debt. In announcing the settlement, the Bureau said it is “working to ensure federal consumer financial laws are being followed at every stage of the process, including by taking action against those who unlawfully facilitate the wrongful conduct of others.”

SEC

Chairman White Outlines New Approach to High Speed Markets, Other Priorities

On October 2nd, [speaking](#) before the Security Traders Association 80th Annual Market Structure Conference, Chairman Mary Jo White outlined a new data mining effort which will enable the public access to data which the SEC uses to monitor high speed trading. The website, which is enabled by the

acquisition of Market Information Data Analytics System (Midas), will allow users to explore trading activities in “easy-to-read charts and graphs” with the goal of better understanding the high speed market. In other comments, White also said she is supportive of a possible pilot program which would allow the stocks of smaller companies to move in tick sizes. Following the Chairman’s remarks, Commissioner Gallagher said he would likely also support a pilot program that would allow small stocks to move in smaller price increments.

CFTC

Commission Enforcement Director Stepping Down

On October 1st, the CFTC announced that the Division of Enforcement Director David Meister will step down in October. Meister joined the Commission in 2011 after serving as a federal prosecutor. In a [release](#) announcing the staff change, the CFTC lauded Meister for bringing “hundreds of charges concerning the commodities, futures, swaps and other derivatives markets against institutions and individuals on Wall Street and around the globe.” The same day, CFTC Chairman Gary Gensler said that Gretchen Lowe will serve as Acting Director of the Division of Enforcement. Lowe is currently the Division’s Chief Counsel.

Upcoming Hearings

Despite the government shutdown, several hearings are planned but schedules are likely subject to change.

On Wednesday, October 9th at 10am, in 2128 Rayburn, the Housing and Insurance Subcommittee of House Financial Services Committee will hold a hearing on the status of the National Flood Insurance Program.

On Wednesday, October 9th at 10am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Committee will hold a hearing on the multifamily housing finance system.

On Wednesday, October 9th at 2pm, in 2128 Rayburn, the Capital Markets and Government Sponsored Enterprises Subcommittee of House Financial Services Committee will hold a hearing on legislation that would attempt to reduce impediments to capital formation.

On Thursday, October 10th at 10am, in 538 Dirksen, the Senate Banking, Housing, and Urban Affairs Committee will meet for a hearing titled “Impact of a Default on Financial Stability and Economic Growth.”

On Thursday, October 10th at 10am, in 2128 Rayburn, the Monetary Policy and Trade Subcommittee of House Financial Services Committee will hold a hearing to examine international central banking models.

On Thursday, October 10th at 2pm, in 2128 Rayburn, the Financial Institutions and Consumer Credit Subcommittee of House Financial Services Committee will hold a hearing on un-banked and under-banked areas in the United States.