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

Follow us on Twitter @MLSFinRegUpdate

FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

November 14, 2011

Leading the Past Week

With two weeks to go, all of Washington continues to try to figure out the ending to the most complicated *choose your own adventure* story. We of course, refer to the Supercommittee, which continues to hold the city and the country in anticipation, as we wonder "will they" or "won't they." There were both Democratic and Republican proposals that surfaced this past week, though they appeared to be more about positioning for failure rather than working toward success. Reportedly weighing on the minds of some of the Supercommittee members is the continuing unfolding instability in Europe, as Italy's financial situation weakened and Prime Minister Silvio Berlusconi resigned over the weekend. Europe's troubles, and its impact on the global economy continues to show the interconnectedness of world markets, a point that was front and center as the Financial Stability Board ("FSB") announced its list of the 29 banks, 8 of which were American, that will be considered systemically significant. Another US financial institution that received significant, and unwanted, attention was the Federal Housing Finance Agency ("FHFA") which has quickly became the proverbial Congressional piñata for their handling of bonuses to Fannie Mae and Freddie Mac executives in light of the former GSE's request for additional tax payer resources to stem continued losses. Finally, the past week saw the SEC continue to push forward with its Dodd-Frank Act implementation, announcing they are beginning to tackle executive pay ratio rules, will revisit money market fund regulations as well as having approved new reverse merger rules.

Supercommittee Update:

This past week may have seen a foreshadowing of a dramatic turn in the negotiations or simply more positioning. Only time will tell, but it did publicly mark the end of formal Republican opposition to any revenue raisers being included in the plan, with the release of a proposal put forth by Senator Pat Toomey (R-PA), that would raise $250 billion from changing the individual tax code, $50 billion from corporate tax reforms and $40 billion from reforms to the consumer price index used to calculate income tax brackets. Despite the fact that this plan was the first Republican plan to include revenue raisers, it was not met with express enthusiasm by Democrats, as for example, Senator John Kerry said that the proposal was not substantial even if it was a change in the debate.

Further, despite the appearance of cooperation on behalf of Republicans with this new proposal, aides to Democrats on the Supercommittee have said that said that lawmakers have privately criticized Toomey's plan. Democrats on the Committee charge that the Republican revenue plan would raise rates on middle- and low-income earners while cutting taxes for wealthy Americans. The plan has yet to be examined by the Joint Committee on Taxation; however, Supercommittee Democrats posit, based on previous JCT research, that the plan would be unable to preserve the progressivity of the tax code.

The release of the Toomey plan appears to have caused a counter proposal to be floated, as Democrats then released their own plan later in the week. However, just as Democrats snubbed the Republican revenue proposals, Republicans have given the proposal the "cold shoulder" according to an aide familiar with the exchange. The Democratic plan would create a "fast track" process for reaching a comprehensive tax reform proposal to raise $650 billion in new revenues without raising the rate on top earners above 35 percent.

Despite the exchange of proposals last week, the Supercommittee appears to have made no progress and continues to be stalled over taxes. According to an aide familiar with discussions, offers and counteroffers continue to move away from compromise by relapsing to party-line stances. Members of Congress are reportedly bracing for Supercommittee failure, even as Supercommittee member Representative Chris Van Hollen (D-MD) and Senate Minority Leader Mitch McConnell separately announced the Committee would not seek an extension from the Congress.

Legislative Branch

Senate

Lawmakers Continue to Push Back on Fannie and Freddie Bonus Issue:

Last week, lawmakers continued to express outrage that Fannie Mae and Freddie Mac executives were awarded their 2010 bonuses despite continued losses and requests for additional taxpayer funded support from the federal government. On November 8th, Senator John McCain (R-AZ), along with five cosponsors, introduced legislation to cancel bonuses for all senior executives at Fannie and Freddie so long as they remain under federal conservatorship. McCain is also trying to attach H.R. 674 to the legislation, which would repeal the 3 percent withholding on certain payments made to vendors by GSEs.

In addition to McCain's efforts, a group of sixty bipartisan Senators, 35 Republicans and 25 Democrats, led by Senators Mark Begich (D-AL) and John Thune (D-SD) have written to the FHFA to call for changes to the bonus system. Among other things, the letter urges the FHFA to adopt bonus payments which "more accurately reflect the public mission of the agency and the fiscal reality facing the GSEs and the federal government." Additionally, Chairman of the Senate Banking Committee Tim Johnson (D-SD) announced that his committee will hold a hearing on November 15th to examine the procedures for signing off on executive bonuses.

Meanwhile, the House is also getting involved in this issue with the House Oversight and Government Reform Committee announcing its own hearing to examine executive pay packages and is pressuring the FHFA to disclose all pay packages awarded to executives in advance of the hearing. Two senior Fannie and Freddie officials are already scheduled to testify before the Oversight Committee and there is bipartisan pressure to get FHFA Acting Director Edward DeMarco appear as well. The House Financial Services Committee is standing on the sidelines, as Chairman Bachus has indicated the

Committee will mark up the Equity in Government Compensation Act (H.R. 1221) one day before the Oversight Committee's hearing.

Architects of the Volcker Rule Continue to Push for Stricter Implementation Despite Industry Outcry to the Contrary:
On November 9th, Senators Carl Levin (D-MI) and Jeff Merkley (D-OR), sponsors of the Volcker Rule, voiced concerns with how the Administration appears to be implementing the rule. At an Americans for Financial Reform ("AFR") event, the Senators urged regulators to strengthen the proprietary trading ban and urged supporters and regulators to push back against industry opposition. These comments were timely because while there is an alphabet soup of regulatory bodies responsible for Volcker, all by the CFTC have put out a NPRM for comment. Speaking on section of the rule which requires disclosures that "permit" client notification of conflicts of interest, Levin said it is not "sufficient to 'permit.' It should be much stronger language than that." Merkley echoed Levin's sentiments saying there are "huge holes" in implementation.

At the same time that Senators Levin and Merkley were critiquing the rule for not being strong enough, the financial services industry was blasting the rule for being overly complex. At a panel hosted by the Chamber of Commerce the same day as the AFR event, it saw speakers urging regulators to include robust cost benefit analysis as part of the Volcker rule lest they expose themselves to legal challenges. Panelists cited the recent Supreme Court case *Business Roundtable v. SEC,* which struck down the SEC's Proxy Access rule for failing to properly consider the costs and economic impacts in drafting the rule. Additionally, as reported by Politico's Morning Money, some in the banking industry are also frustrated with the push for complex and burdensome rules because banks have already spun off their proprietary trading desks, which was the stated goal of the rule. In a separate interview, reported by Reuters, former Fed Chairman Paul Volcker echoed concerns of the industry over complexity of the rule; however, blamed financial industry lobbyists for creating the convoluted proposal and offered the industry a return to the Glass-Steagall separations as a significantly less complex alternative.

Our view is that both sides are frustrated by Volcker, since this rulemaking provides perhaps the clearest example of how the lack of clear congressional instruction has turned the implementation of Dodd-Frank into "Potter Stewart Rulemaking." This "know it when they see it" regulatory approach leaves both industry and consumer groups frustrated, with neither side able to find the certainty in the rules that they seek.

Senators Introduce Small Business Capital Formation Bills Similar to House Proposals:
On November 8th, Senators Pat Toomey (R-PA) and Tom Carper (D-DE) introduced legislation to raise the shareholder threshold that triggers regular reporting with the SEC from 500 to 2,000. The bill is the second piece of legislation introduced in the Senate aimed at increasing access to capital for small business by reducing regulatory requirements. The first such measure was introduced on November 2nd by Senator Scott Brown (R-MA,) who introduced legislation to create a registration exemption for crowdfunding. Senators Toomey and Carper's bill is similar to Representative David Schweikert's (R-AZ) bill to raise the shareholder threshold (H.R. 2167) which, unlike a few of the other capital formation bills, has yet to receive a vote in the House.

Chairman Johnson Asks Regulators for Update on Dodd-Frank Rulemaking:
On November 9th, Senator Johnson, wrote to various regulators responsible for implementing the financial reforms asking them to report on their progress and remind them that rules should be promulgated "thoughtfully and responsibly." Specifically, Johnson asked the SEC and CFTC to

provide: an overview of the agencies' rulemaking processes; how the agencies are reviewing regulations to address "compliance burdens;" information on public participation in rulemaking; information on agency plans to measure rules impact on "small institutions" and; details on how the FSOC has streamlined agency cooperation. In a separate letter to the GAO, Johnson asked the Office to conduct a study of the "aggregate costs of the financial crisis" and the "benefits" of the Dodd-Frank Act.

Senate Introduces Companion Bill to House Covered Bond Act:
On November 9th, Senators Kay Hagan (D-NC), Bob Corker (R-TN), Mike Crapo (R-ID) and Charles Schumer (D-NY) introduced legislation to create a covered bond market. The United States Covered Bond Act of 2011 is a companion measure to H.R. 940, introduced by Representatives Scott Garrett (R-NJ) and Carolyn Maloney (D-NY) in March. Covered Bonds, which are wildly popular in Europe, are seen as a potential way to ease the government out of the mortgage industry. To date, issues with the FDIC have prevented this legislation from moving forward and it remains unclear at this time if that impasse has been resolved.

House of Representatives
Democrats Continue to Push DOL on Fiduciary Standard Rule:
On November 9th, Politico reported that thirty Democratic Members of the House sent a letter to Labor Secretary Hilda Solis thanking the DOL for withdrawing the proposed definition of 'fiduciary' and offering guidance on future proposals. Signatories urged Solis to increase DOL's coordination with the SEC and CFTC so as to create a uniform standard, conduct a cost-benefit analysis and review the need for additional regulation. The letter also asked DOL to ensure the re-proposed rule addresses three additional concerns with the original definition: 1) The definition should be "narrowly drafted;" 2) The definition must "preserve the access of IRA owners and plan participants to investment services delivered by qualified financial professionals using whatever business model best fits the investors' objectives;" and 3) The definition provides for companies to receive adequate information on establishing plans and offering good investment options.

Executive Branch
CFPB
CFPB Announces Intention to Provide Advance Notice of Enforcement Actions:
On November 7th, the CFPB announced that the Bureau will give notice of potential enforcement actions so as to provide firms additional time to respond before the agency determines if it will undertake legal action. The Bureau's Office of Enforcement will have the option of using an early warning notice before beginning formal legal proceedings on possible consumer protection violations. The early warning notice will prompt a 14 day period when the firm under investigation may refute charges. Following a warning notice, companies may submit responses no more than 40 pages in length detailing legal and policy concerns.

The Office of Enforcement's notice is similar to the SEC Wells notice which advises the SEC to notify "a prospective defendant or respondent" of the nature of the SEC's charges and enforcement recommendations before an SEC staff memorandum is submitted to the Commission on enforcement action. The CFPB's early warning notice will be discretionary, as is the Wells notice process, and the Bureau made clear that not all instances necessitate early warning such as in the event of ongoing fraud or if immediate enforcement is needed.

SEC

Schapiro Outlines Additional Money Market Reforms in the Pipeline:

On November 7th, at a conference sponsored by SIFMA, SEC Chairwoman Mary Schapiro said the agency will soon tackle additional rulemakings to reform the money market mutual fund industry. The SEC approved rules in February 2010 to update the Investment Company Act of 1940 to reduce risk connected to funds by improving portfolio quality through requiring more liquid assets, periodic stress tests, monthly reporting to the SEC and creating a means for an orderly wind down of a fund. Nevertheless, in her remarks, Schapiro said the SEC must address the "lingering concern" about the risks that remain, such as what would happen to these funds during a time of deep financial crisis or if a fund manager makes a serious mistake.

According to published reports, the SEC is considering two additional reforms to address "structural vulnerabilities" of funds. The first potential reform would be to institute a capital buffer to increase fund liquidity in times of crisis. Schapiro has also said that the buffer could be combined with redemption restrictions to limit the ability of investors being able to pull money out of funds during a crisis. The second, and slightly more controversial proposed reform, would mandate that money markets transfer away from a stable net asset value (NAV) currently set at $1, to a floating NAV. Schapiro said the motivation for moving to a floating NAV is because the stable NAV is "brittle" and that institutional investors view the current situation as an all-or-nothing proposition, which creates bank run type environments at the first sign of trouble.

Despite the SEC insistence that the floating NAV would address structural problems within the funds, the industry opposes such a move. Critics of the floating valuation and other SEC reforms believe that it could shrink the industry by adding to complexity to valuation. In a June letter to the SEC, the Financial Services Roundtable wrote that it "strongly opposes" the floating NAV. Echoing the Roundtable's sentiments, Christopher Donahue, CEO of one of the largest fund managers, Federated Investors, said: "If you put a floating NAV on a money fund, you would see a quick and certain dissipation of the vast majority of the assets." Schapiro does not appear to be persuaded by such analysis and we anticipate the rulemaking to move quickly.

SEC Approves New Rules to Govern Reverse Mergers:

On November 9th, the SEC approved rules to strengthen requirements for reverse merger companies. Reverse mergers entail a private company acquiring a shell public company so as to operate as a public company without going through the IPO process. The new requirements were proposed by Nasdaq, the New York Stock Exchange and NYSE Amex to address the exchanges' concern over regulation on accounting fraud. During the past few years there has been a growing concern about Chinese companies taking advantage of a lax regulatory environment, as well as suspected accounting indiscretions and the SEC's actions are in part, a direct response to those concerns.

Under the new regulations, reverse merger companies will be required to meet a yearlong "seasoning period" in which they trade in the over-the-counter market or a comparable U.S. or foreign exchange and report financial records to the SEC. Additionally, before undertaking the reverse merger process, a company must meet a minimum share price for a "sustained period" before its application. The SEC will also require additional forms and annual reports from companies that apply "in connection with a substantial firm commitment underwritten public offering." In a statement following the SEC vote,

NYSE said "more rigorous standards for reverse mergers will benefit investors and issuers, and we applaud the SEC for its thoughtful attention and leadership on this important matter."

SEC Crafting Recommendations on Pay Ratio Proposal:
On November 10th, SEC officials announced that Corporate Finance Division staff is working on recommendations for a proposed rule to require companies to determine and disclose the ratio comparing the pay of the chief executive officer to that of employees. Among recommendations, staff is considering to include which employees should be covered under the proposal, how companies should determine "median" income and whether compensation disclosures should be furnished or filed. Under Section 953(b) of the Dodd-Frank Act, the SEC is required to promulgate rules to require publicly listed companies to disclose: (a) their employees' median income, excluding the income of the CEO, (b) the total income of the CEO, and (c) to calculate the ratio in between those two figures.

The pay ratio proposal has been extremely controversial. Industry officials have charged, and SEC officials have acknowledged, that the calculations will be frustratingly difficult for companies—especially large, multinational corporations. According the implementation schedule on the SEC website, rules are due to be proposed by the end of the year; however, there is no deadline for the rulemaking and SEC staff has implied that the end of December deadline is a "challenge."

DOL

Borzi Sees Need for Additional Retirement Options:
At a recent New America Foundation event on retirement security, Phyllis Borzi, Assistant Secretary of Labor for EBSA expressed concern about how the U.S. is "going to get over the current retirement crisis." Borzi said employees need more options for retirement than defined benefit plans and 401(k) plans, especially with Social Security "under assault." Borzi also touched on problems with defined benefit plans including that employees do not understand them, employees begin to utilize them too late in the game and that modern CEOs do not care for their employees the same way they did when the defined benefit plans were born.

Despite calls for Congress to address incentives for saving for retirement, the issue remains on the back burner as lawmakers set sights on deficit reduction and other high profile issues. However, Representatives Richard Neal (D-MA) and Jim Gerlach (R-PA) are poised to address the issue with a draft concurrent resolution to express the need for additional tax incentives to promote savings for a secure retirement. Additionally, the Senate Finance Committee held a hearing exploring tax reform options to promote retirement security in September. While no major action has occurred on retirement security in the Senate since then, this is a politically popular issue that will continue to resurface between now and the 2012 elections.

Federal Reserve Board

Tarullo Hints at Lessening Burdens for Small Banking Institutions:
On November 4th, Federal Reserve Board Governor Daniel Tarullo told a meeting of the American Bar Association that a working group within the Fed's Division of Bank Regulation and Supervision is considering reevaluating its rulemaking processes to alleviate burdens on small, community banks. The working group would revisit certain regulations of the Dodd-Frank Act, Basel capital standards and other areas which may potentially disproportionately affect community banks. Giving an example of how the Fed would approach the changes, Tarullo said the restructuring will largely be based on the knowledge that smaller institutions do not have the capacity to deal with many new regulations nor do

key portions of rulemakings apply to small business. Tarullo said he does not "want to have to make the small banker, or the lawyer that she hires, read through a 300-page regulation in order to figure out that 'This applies to us, and the rest of this doesn't.'" Tarullo did not go into details about how the Fed working group would accomplish this goal.

CFTC

CFTC Announces Investigation into MF Global Bankruptcy:
On November 10th, the CFTC announced that it would begin an investigation into improper handling of consumer funds by MF Global, which announced October 31st that it would file Chapter 11 bankruptcy. As Chairman Gary Gensler recused himself from the proceedings for his connections to former MF Global Chairman and CEO Jon Corzine, Commissioner Jill Sommers is fronting the investigation.

International

Financial Stability Board Identifies 29 Banks as Systemically Significant:
On November 4th, the G 20's financial regulatory taskforce, the Financial Stability Board ("FSB"), named 29 banks as global systemically important financial institutions (SIFIs). In addition to developing resolution plans or 'living wills' by the end of 2012, designated banks will be required to retain additional capital in order to increase their loss absorption capabilities. Banks will fall into different brackets of risk, requiring smaller banks to maintain additional capital on the order of 1 percent of risk-weighted assets rising to 2.5 percent for larger banks.

Institutions designated as global SIFIs will be reevaluated every November. The institutions identified this past week include: Bank of America, Bank of China, Bank of New York Mellon, Banque Populaire, Barclays, BNP Paribas, Citigroup, Commerzbank, Crédit Agricole, Credit Suisse, Deutsche Bank, Dexia, Goldman Sachs, HSBC, ING Bank, JPMorgan Chase, Lloyds Banking Group, Mitsubishi UFJ, Mizuho, Morgan Stanley, Nordea, Royal Bank of Scotland, Santander, Société Générale, State Street, Sumitomo Mitsui, UBS, Unicredit Group and Wells Fargo.

Euro Zone Finance Ministers Discuss Proposals to Recapitalize Banks:
On November 8th, European finance ministers met to continue discussion on ways to increase bank capitalization by at least $140 billion. This marks the first meeting since the October 26th agreement to shore up banks and stabilize public and private EU finances. Proposed plans for recapitalizing banks included: a syndicate system intended to ease wholesale and long-term interbank borrowing costs and establishing a capital requirement of up to 9 percent equity for banks in order to avoid deleveraging. Euro zone finance ministers struggled to reach agreement on the extent that burden sharing is needed to leverage the strength of all EU member states. Additionally, while a number of ministers pushed for the creation of an EU fund or use of the European Investment Bank to guarantee banks and financial institutions, dissenting countries rejected the proposal.

Speaking on the proposals discussed at last week's meeting, European Commission Internal Market Commissioner Michel Barnier said that "a coordinated European approach to these guarantees and a degree of sharing of guarantees is essential to break the vicious circle of weak banks and countries in need." Barnier went on to say that he hoped an agreement on bank recapitalization could be reached in December at the next meeting of EU ministers.

UPCOMING HEARINGS

On Tuesday, November 15th at 9:30am, in 2203 Rayburn, the House Oversight and Government Reform Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs will hold a hearing titled "How Roadblocks in Public Markets Prevent Job Creation on Main Street."

On Tuesday, November 15th at 10am, in 608 Dirksen, the Senate Budget Committee will hold a hearing titled "Economic Effects of Fiscal Policy Choices."

On Tuesday, November 15th at 10am, in 538 Dirksen, the Senate Banking Committee will hold an oversight hearing on the Federal Housing Finance Agency.

On Tuesday, November 15th at 10am, in 2128 Rayburn, the House Financial Services Committee will hold a hearing on legislation (H.R. 1221) to suspend the pay packages for executives of Fannie Mae and Freddie Mac and subject the executives and employees of the GSEs to the Federal pay scale.

On Tuesday, November 15th at 12pm, in 2128 Rayburn, the House Financial Services Capital Markets and Government Sponsored Enterprises Subcommittee will hold a hearing on legislation to amend provisions in the derivatives title of the Dodd-Frank Act and legislation ensuring the Securities and Exchange Commission conducts cost-benefit analyses of its rulemaking.

On Tuesday, November 15th at 2:30pm, in 253 Russell, the Senate Commerce, Science and Transportation Committee will hold a hearing on pending nominations to the Federal Trade Commission.

On Tuesday, November 15th at 3pm, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Subcommittee on Financial Institutions and Consumer Protection will hold a hearing titled "Financial Security Issues Facing Older Americans."

On Wednesday, November 16th at time TBA, in 2154 Rayburn, the House Oversight and Government Reform Committee will hold a hearing on executive compensation at the federal housing finance agencies Fannie Mae and Freddie Mac.

On Wednesday, November 16th at 9:30am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Subcommittee on Securities, Insurance, and Investment will hold a hearing titled "Management and Structural Reforms at the SEC: A Progress Report."

On Wednesday, November 16th at 10am, in 2128 Rayburn, the House Financial Services Insurance, Housing and Community Opportunity Subcommittee will hold a hearing to review the regulation of the insurance industry and its effect on jobs.

On Wednesday, November 16th at 1pm, in 2360 Rayburn, the House Small Business Contracting and Workforce Panel will hold a hearing titled "Protecting Small Business Contracting: Leadership Challenges at Two Cabinet-Level Agencies."

On Wednesday, November 16th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit and the Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a joint hearing on the Communities First Act (H.R. 1697).

On Wednesday, November 16th at 2pm, in 216 Hart, the Joint Economic Committee will hold a hearing titled "Manufacturing in the USA: Paving the Road to Job Creation."

On Wednesday, November 16th at 2:30pm, in 608 Dirksen, the Senate Budget Committee will hold a hearing on efforts to improve regulatory performance, focusing on lessons learned from the United Kingdom.

On Thursday, November 17th at 10am, in 2128 Rayburn, the House Financial Services Financial Institutions and Consumer Credit Subcommittee will meet to mark up H.R. 1588, the Consumer Rental Purchase Agreement Act, and H.R. 1723, the Common Sense Economic Recovery Act.