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 7, 2011

Leading the Past Week

Last week, the world's attention remained focused on the EU bailout of Greece as world markets continued to whipsaw in response to Greece's announcement that they would hold a national referendum on the bailout plan and then that it wouldn't. Although Greece's Prime Minister Papandreou survived the vote of confidence, there were rumors late Sunday afternoon that he would resign and pave the way for a coalition government. Cynically, some wonder if all of this is just unnecessary drama to keep global focus on Greece, instead of shifting it towards Italy, where analysts are growing increasingly concerned that the country is edging toward default. Regardless, all of this drama played out in the shadow of a two day summit by the G-20, where the heads of the twenty largest economies met to discuss the health of the financial sector and ways in which to economic spur growth, landing on increasing the IMF's presence in the EU sovereign debt crisis and a global action plan for growth and stability. Domestically, the CFPB was in the Congressional spotlight with two senior officials appearing before House and Senate Committees to discuss the Bureau's first one hundred days and the agency's Servicemember outreach. Additionally, a number of small business capital formation bills passed the House last week, included the somewhat controversial crowdfunding proposal.

Supercommittee Update:

Last week, amid continued closed-door discussions the Supercommittee held its fifth public hearing on previous bipartisan deficit reduction proposals. Witnesses, including Erskine Bowles, Alan Simpson, Alice Rivlin and Pete Domenici were adamant in their calls for significant long-term deficit reduction on the order of $4 trillion over ten years. Witnesses stressed that—despite the statutory goal being only $1.2 trillion—a failure to reach a much larger proposal would be a signal to markets that the US political system is unable to meet its obligations. To that end, witnesses suggested both structural entitlement reform and a simplification and broadening of the tax code that will increase revenues. The hearing was not only an opportunity to discuss deficit reduction strategies but also allowed witnesses to warn the Supercommittee of the implications of failure. Mr. Bowles told lawmakers that he is "worried you're going to fail — fail the country." And Mr. Domenici said a failure would make the Supercommittee "complicit in letting America destroy itself."

Witnesses at last week's hearing are not the only ones pressuring the Committee. On November 3rd, thirty-three Senate Republicans, including two who were members of the "Gang of Six," sent a letter to the Supercommittee proposing a deficit package which includes a tax code overhaul to reduce rates, overhauling entitlements and balancing the budget in ten years without raising new revenues.

Despite continued pleas to 'go big' at last week's hearing, the outlook for the Supercommittee is increasingly grim. With CBO Director Doug Elmendorf's 'beginning of November' deadline come and gone, talk has turned to the possibility of extending the Supercommittee's deadline. Representative Steny Hoyer (D-MD) owned to the possibility that the Committee could get an extension, stressing that the Supercommittee would not be able to extend the deadline on its own but would rather have to appeal to the full Congress for an extension. The possibility of an extension remains; however, Senate Minority Leader Mitch McConnell has said that: "This is a deadline that can't be missed. I don't think the deadline can be or will be extended. I think we need to get a result."

With the deadline for action drawing closer, it has been reported that staff for House Speaker Boehner, Senate Majority Leader Reid and Minority Leader McConnell have intervened to guide the negotiations. As talks move to the leadership level, it is interesting to note that Speaker Boehner appears to be willing to agree to some type of tax revenue in the final package. During a meeting with reporters as part of the Committee's discussions, Boehner was quoted as saying that there is "room for revenue." However, the Speaker qualified this statement saying, there are limits to what revenue may be available. Boehner's comments have thus far not spurred a breakthrough in discussions. While leadership discussions, one-on-one and other small negotiating sessions continue to take place, the Committee has not met since the exchange of proposals two weeks ago and there are no future meetings on its calendar.

<u>Legislative Branch</u>

Senate

Senate Subcommittee Examines Recent CFC Rule on Position Limits:

On November 3rd, CFTC Chairman Gary Gensler testified before the Senate Permanent Subcommittee on Investigations on the agency's oil and natural gas position limits rule. The final position limit rule covers 28 physical commodities and was approved on October 18th. The rule is largely seen as a victory for industry which gained several concessions as a result of heavy lobbying following the original proposal. Those who wished for the agency to propose stronger limits—such as Chairman of the Subcommittee Carl Levin (D-MI)—were disappointed by the final rule.

While Levin praised the completion of position limit rules during last week's hearing, he made clear that the position limit problem will not be solved by this rule. Ranking Member of the Subcommittee, Tom Coburn (R-OK) was also critical of the rule, calling it "rushed" and overbroad in that the CFTC chose "a blunt weapon of across-the-board limits for nearly every commodity." Coburn also took offense to the possibility of a court challenge to the rule, the possibility it will drive investors to overseas commodity markets and the lack of a definition for "excessive" speculation. In response to Coburn's questions in this area, Gensler said the rule was not intended to identify where excessive speculation existed and that the rule is also "preventative…to ensure there is not manipulation."

During the hearing Gensler also touched on the possible role of the CFTC in the MF Global bankruptcy, rules to oversee the $601 trillion swaps market, establishing derivatives exchanges and new rules to curb high frequency trading operations.

Bi-Cameral Robin Hood Tax Introduced:
Senator Tom Harkin (D-IA) and Representative Peter DeFazio (D-OR) introduced versions of the Financial Transaction Tax – or so-called Robin Hood Tax, on November 2nd. The bills, S. 1787 and H.R. 3313, would levy a 0.03% tax on the trading of bonds and shares, a fee which could discourage high frequency trading – a culprit of last year's May "flash crash." Although Harkin estimates that the tax could yield more than $200 billion over the next ten years, prospects for the proposal is dim. Bill Gates could not convince the G-20 to agree to a global transaction tax to combat poverty, and House Republicans are unlikely to support any tax increases.

Durbin and Reed Call for CFPB Action on Bank Fee Transparency:
On November 3rd, Senators Richard Durbin (D-IL) and Jack Reed (D-RI) called for the CFPB to adopt a new bank account fee disclosure form. The one-page form, designed by The Pew Charitable Trusts' Safe Checking in the Electronic Age Project, is designed to distill the so-called hidden fees listed in checking account disclosure forms – which are a median of 111-pages, given to consumers before opening an account. This comes as Bank of America and other institutions retreated from plans to assess monthly debit card usage fees. In a letter to Raj Date, the Senators said "if this disclosure form were adopted by the CFPB to apply to financial institutions nationwide, it would make it easier for consumers to comparison-shop across financial institutions and find the deal that best suits them."

House of Representatives
House Passes Small Business Capital and Crowdfunding Bills, Immediate Senate Action Unclear:
Last week, the House passed a number of bills dealing with small business access to capital and SEC requirements. Among these bills was H.R. 2167, introduced by Representative Patrick McHenry (R-NC) which would increase the threshold for SEC registration from 500 to 1,000 shareholders, allowing to raise up to $1 million dollars from investors who could contribute up to $10,000 or ten percent of their income. McHenry's bill passed the House by a vote of 407 to 17; however, McHenry said he is concerned that concerned that the bill "won't be able to get through the Senate" and that "allowing [an] unlimited number of accredited investors to invest in your company is no longer legislatively attainable" at this time.

The House also passed a series of bills to increase small business capital formation through reforming Securities Act Regulation A. H.R. 1070, introduced by Representative David Schweikert (D-AZ) would exempt companies that manage up to $50 million in securities for public offering from registering with the SEC. H.R. 1965, introduced by Representative Jim Himes (D-CT) would increase the shareholder registration threshold for community banks registering with the SEC from 500 to 2,000. Representative Schweikert's bill passed the House by a vote of 421 to 1 and Representative Himes bill passed by a vote of 420 to 2. Representative Kevin McCarthy's H.R. 2940 also passed the House by a vote of 413 to 11. McCarthy's bill would lift the ban on small, privately held business from advertising to attract investors. While companion bills exist in the Senate to alter Regulation A shareholder thresholds, an aide to Chairman Tim Johnson (D-SD) has told reporters that Johnson is still considering whether to give the measures a hearing. However, given that the Administration has issued support for these measures, they are likely to move through the Senate at some point in the future.

Swaps Bill to Amend Dodd-Frank Would Clarify Derivatives Rules for US Firms:
On October 31st, Representatives Scott Garrett (R-NJ) and Jim Himes (D-CT) introduced H.R. 3283, the Swap Jurisdiction Certainty Act. Garrett, Chairman of the Financial Services Capital Markets and Government-Sponsored Enterprises Subcommittee, argued that the Act would "put our job creators on a level playing field" by ensuring that U.S. financial firms that engage in swap transactions with foreign entities need only adhere to the same foreign regulations as their non-U.S. competitors. The call for clarity comes as provisions of the Dodd Frank Act could be interpreted to extend U.S. regulations to such international transactions. The bill was referred to the Financial Services and Agriculture Committees.

<u>Executive Branch</u>

CFPB

CFBP Officials Appear before Senate and House Committees to Discuss First 100 Days:
On November 2nd, Raj Date, Special Advisor to the Treasury Secretary for the CFPB, testified before the House Financial Services Committee on the first one hundred days of the CFPB. Date's testimony and the Member's questioning ran the gambit of CFPB issues, touching on: mortgage servicing, the effect of rulemaking on community banks, RESPA/TILA reforms, the transfer of powers from prudential regulators to the CFPB, qualified mortgages, protections for servicemembers and student loan forms. Additionally, many lawmakers revisited the popular concerns such as that the CFPB should be operated by a Commission rather than a Director, that the CFPB is not subject to sufficient oversight and that the Bureau should be placed on the normal appropriations process. Additionally, several Members also commented on the inability of the Bureau to regulate in certain areas without a confirmed Director, with Date lamenting that "tens of thousands of non-depository consumer financial product firms out there that are supposed to be within the supervisory authority of the Bureau but are not today, absent a director."

Following Date's appearance on the House side, Holly Petraeus, Assistant Director for the Office of Service-Member Affairs at the CFPB was among the witnesses who testified before the Senate Banking Committee on identifying and combating problems servicemembers, veterans and their families face in navigating the financial world. Petraeus focused on how the CFPB will work to protect members of the armed forces from aggressive marketers, predatory lenders and how the CFPB has already begun to empower and educate this vulnerable population. The White House followed up Petraeus's appearance with a press call to underscore the immediate need for a Director in order to protect those that serve the United States.

SEC

SEC Provides Clarity on Enforcement of Mutual Fund Advisor Fees:
On November 1st, Robert Kaplan, co-chief of the Asset Management Unit at the SEC, said that when the Commission pursues enforcement of investment advisory fees for mutual funds, they will target specific violations as opposed to 'gray areas.' Advisory fees came under new scrutiny following a March 2010 Supreme Court decision which established the standard for determining if advisor fees are excessive under Section 36(c) of the 1940 Investment Company Act. While Kaplan's announcement provided clarity on how the SEC will undertake enforcement in the future, SEC actions in this area are rare. For a recent example of SEC enforcement action one must go back to 2009 when the

Commission found that New York Life Investment Management LLC had not provided adequate information for fund directors to assess the terms of the management fees.

CFTC

CFTC Finalizes Reporting Requirements for Commodity Advisors:
On October 31st, the CFTC approved a final rule to require a new reporting form for commodity pool operators (CPOs) and commodity trading advisers (CTAs) that dually register as investment fund advisors with the SEC. The rule is a joint rulemaking with the SEC, which adopted its version—requiring investment advisors with over $150 million to file the new Form PF— last week. The new reporting requirements will be used by the FSOC in its efforts to monitor systemic risk in the US financial sector. As with the SEC rulemaking, the amount and type of information that will be required by the rule varies based on the advisor's size and on the types of funds under its purview.

The CFTC final rule makes several notable changes over the proposed rule filed in January—similar to the SEC rulemaking. In addition to narrowing the scope of the definition of "hedge fund," the rulemaking: excluded investment vehicles created to issue asset back securities; clarified that hedge fund size is to be calculated only on the fees or allocations paid to the advisor; and exempted funds using short selling to hedge against currency exposure.

FHFA

Congressional Ire over Fannie and Freddie Bonuses:
On November 2nd, Edward DeMarco, Acting Director of the Federal Housing Finance Agency (FHFA) and Conservator for Fannie Mae and Freddie Mac, looked to alleviate rising bipartisan anger for his handling of the companies during a House Financial Services Subcommittee meeting. The anger comes as more than $12 million in bonuses were approved by the FHFA for ten of the mortgage companies' departing executives. Legislators questioned the justification for bonuses since the companies continue to seek government assistance – now at $169 billion since assistance was first made available in 2008. Both companies continue to post losses, with Freddie Mac reported a $4.4 billion loss for the last quarter.

Following their transition to government conservatorship, taxpayers are now responsible for the companies' combined $5 trillion in mortgage assets. Still, DeMarco argued that the bonuses are necessary to "protect the taxpayers by having highly qualified executives running these companies." Chairman of the Senate Banking Committee, Tim Johnson (D-SD) has said he plans to hold a hearing featuring DeMarco to explain why bonuses were awarded to Fannie and Freddie executives. Johnson's hearing announcement came the same day that Freddie Mac asked the Treasury Department for an addition $6 billion in aid.

<u>International</u>

On again – off again nature of Greece Referendum:
Last week, following an historic agreement on a bailout package for Greece between Euro zone leaders and banks, Greece then sent markets and political leaders reeling with the announcement that the country would hold a national referendum on the package. The announcement of a referendum came soon after Greek Prime Minister George Papandreou assured the EU at the October 26th European Union Summit that Greece was determined to take the package and institute reforms. European leaders were quick to react, warning that there could be dire consequences not only for Greece but for the whole monetary union. Ireland's European Affairs Minister blasted Greece for its actions, saying: "The

summit last week was to deal with the uncertainty in the euro zone...and this grenade is thrown in just a few short days later."

Despite assurances from leaders across the EU that the rescue package would be implemented, stocks fell, bank shares plummeted and bond yields skyrocketed as investors fled to safer, German bonds. However, thankfully for the stability of global markets, on November 2rd, Papandreou tabled the referendum idea in favor of a parliamentary no confidence vote. Following the withdrawal of the referendum, government bond yields fell, equity prices rose and the euro strengthened against the dollar—sighs of relief from a fraught market. Despite encouraging signs, fears remain that Italy will go down a similar rode as Greece. Italian borrowing costs continued to climb following the bailout announcement and government bond yields hover around 6.5 percent—which the majority of banks have labeled unsustainable.

As European leaders struggled to deal with Greek's referendum announcement and subsequent about-face, the G-20 held a two day summit in Cannes, France to discuss the ongoing global economic crisis. The results of those discussions were released in a series of communiqués, on November 4th. There was agreement to boost the International Monetary Fund to combat the European sovereign debt crisis, but details were still thin on funding the effort. Another decision focused creating a global "action plan" to boost growth and strengthen the financial sector. In remarks following the summit, President Obama said "events in Greece over the past 24 hours have underscored the importance of implementing the plan fully and as quickly as possible."

Miscellaneous

MF Global Bankrupt, Sparking Federal Inquiries:

MF Global Holdings Ltd., a global financial derivatives broker, filed for Chapter 11 Bankruptcy protection on October 31st. While details continue to emerge regarding the firm's demise, agencies including that the CFTC, SEC, and FBI are readying for possible legal action. Much of the scrutiny concerns hundreds of millions of dollars potentially missing from customer accounts, allegations of insider trading, and questions concerning its clean audit given by Pricewaterhouse Cooper LLP just last May.

The firm was led by Jon Corzine, a former Senator, the former Governor of New Jersey, and of course a former titan of Wall Street from his days at Goldman Sachs. He resigned as CEO on Friday, November 4th as criticism mounted regarding his appetite for risky investments. Exposure to $6.3 billion in European sovereign debt is being held out as a key reason for the market's loss of faith in the firm, which caused a run that left the firm unable to sustain capital requirements. MF Global now appears to have the dubious honor of being the first U.S. firm to be a victim of the European financial crisis.

UPCOMING HEARINGS

The House is in Recess this Week

On Thursday, November 10th at 10am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Committee (Chairman Johnson, D-S.D.) will hold a hearing titled "Opportunities and Challenges for Economic Development in Indian Country."

On Thursday, November 10th at 10am, in 215 Dirksen, the Senate Finance Committee will hold a hearing titled "Unemployment Insurance: The Path Back to Work."

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.