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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

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Leading the Past Week

There must have been something in the turkey, because all of the optimism surrounding a positive resolution to the fiscal cliff seemed to have evaporated this week. How much of this a necessary part of the theater and how much of it is legitimate breakdown in negotiations will only be able to be determined in the post-mort analyses.

In other news, while Congress continues to use the lame duck to try to clean us some loose ends – such as the Defense Authorization Bill, and the introduction of a two year extension of the Transaction Account Guarantee (TAG)- plans for next year are also taking shape as the House and Senate released their calendars, which for the first time in a while are synched up, perhaps in hope that more business can be transacted in the 113th Congress than in the 112th.

This past week also saw the start of the transition to Obama 2.0 as SEC Chairman Mary Schapiro announced she would be stepping down and the Administration elevated current Commissioner Elise Walters to temporary Chair. How a four person SEC will be able to deal with continuing to implement Dodd-Frank, or deal with the FSOC's recommendations for money market rules remains unclear.

Fiscal Cliff

Although the first round of fiscal cliff negotiations ended before the Thanksgiving holiday on a high note, with less than 20 days until the unofficial Friday-before-Christmas deadline to come up with a plan, Speaker John Boehner (R-OH) responded to the Administration's proposal on d Friday by saying things are in a "stalemate" and that "right now, we're almost nowhere."

The current betting on whether a deal will get done was best expressed by Erskine Bowles, co-chair of the Simpson-Bowles commission, who said there is a one in three chance the President and House Republicans will be able to strike a deal by the end of the year, the new skepticism comes after the White House's initial offer to address the fiscal cliff was quickly rejected by House Republicans. The Obama plan included $1.6 trillion in new tax revenues, a payroll tax cut extension, and a plan to implement $400 billion in spending cuts.

The White House plan also included provisions which would end the current debt ceiling policy, making it harder for lawmakers to put limits on the U.S.'s borrowing capacity, and requests an increase in the debt ceiling. Majority Leader Reid has also advocated for tying the debt ceiling to the fiscal cliff—saying it would be "foolish" to resolve the fiscal cliff and then have another fight over the debt ceiling. Currently, the CBO is projecting the statutory debt limit will be reached near the end of December; however, the Treasury would be able to extend the final deadline until February or early March.

The Obama plan, dubbed "not serious" by Speaker Boehner, and met with laughter from Minority Leader Mitch McConnell (R-KY), includes a number of items which Republicans have previously shot down, including provisions to immediately raise revenues without at the same time cutting spending. While the Obama's first move was met with derision, according to House Minority Whip Steny Hoyer (D-MD) it should be viewed as a starting point for negotiation. Signaling the potential for compromise, McConnell said Friday that the two parties would be closer to a resolution of the fiscal cliff if they could come to agreement on the eligibility requirements for entitlement programs. Indeed, entitlement cuts could play a large role in a final compromise, which has been reported to be much farther along than public rhetoric suggests. The talks will continue this week, perhaps with more progress than we've seen to date.

Legislative Branch

Senate

Majority Leader Reid Introduces Bill for a Two Year Extension of Full FDIC Insurance for Transaction Accounts

On November 26th, Majority Leader Harry Reid (D-NV) introduced standalone legislation to extend the Transaction Account Guarantee (TAG) program for an addition two years. The bill (S. 3637) extends the full insurance of non-interest bearing transaction accounts used by small businesses, municipal governments, hospitals and non-profits for payroll and other expenses which was created during the financial crisis to stem the flow of sudden withdrawals. While Reid introduced the legislation with no co-sponsors, the bill has significant support from the community banking industry. Paul Merski, Executive Vice President and Chief Economist of the ICBA, said "Congress is playing with fire if it lets $1.5 trillion in insured FDIC TAG accounts become abruptly uninsured overnight on December 31st." Despite the support of the Community Banks, the path for this legislation is rocky, as larger banks don't appear to support the measure, and it may be subject to a poison bill in the form of member business lending ("MBL") championed by the credit unions.

Senate Republicans Urge Finalization of JOBS Act Rules before 2013

On November 30th, eleven Republican Senators sent a letter to outgoing SEC Chairman Mary Schapiro calling on the agency to finalize a proposed rule to implement Section 201 of the bipartisan Jumpstart Our Business Startups (JOBS) Act. The rule would remove restrictions on how companies can advertise private stock offerings. Although the rule has received criticism from Democrats and some oversight groups, Senators John Thune (R-SD), Pat Toomey (R-PA), John Barrasso (R-WY), Roy Blunt (R-MO), John Boozman (R-AR), Mike Enzi (R-WY), John Hoeven (R-ND), Jim Inhofe (R-OK), Lisa Murkowski (R-AK), Jeff Sessions (R-AL), and Roger Wicker (R-MS) told Schapiro in their letter that the rule accurately reflects Congressional intent.

Widely anticipated Challenger Emerges for Chairman Johnson's Senate Seat
Last week the former Governor of South Dakota, Mike Rounds, announced his candidacy for the U.S. Senate in 2014, with the intention of challenging current Banking Committee Chairman Tim Johnson (D-SD) for his Senate seat. Johnson is one of the Members on the short list of Senators that Democrats worry about retiring in 2014.

House of Representatives
Financial Services Subcommittees Examines Basel III Capital Standards
On November 29th, two weeks after the Senate Banking Committee met to examine capital standards, the House Financial Services Subcommittees on Insurance, Housing and Community Opportunity Financial Institutions and Consumer Credit met in a joint hearing to consider the Basel III requirements. Members of both parties on the Subcommittees questioned whether the rules should apply to community banks. Chairman-to-be Jeb Hensarling said, "it is a very open question whether Basel III should even apply to our community- based financial institutions," continuing, "a case can be made that we need higher-quality capital. It is a very poor case for more complex capital standards that do not recognize the difference between large money center banks and our community financial institutions." Hensarling also pointed to the bipartisan concerns over the capital rules as a positive sign of compromise for the 113th Congress.

The hearing featured a panel of regulators and a panel of industry representatives. Director of the Fed's Division of Banking Supervision, Michael Gibson, testified that an analysis has found that the majority of banks, including 90 percent of community banks, already meet the proposed additional requirements and would not have to change their practices. Gibson also stressed that the Fed is actively reaching out to community banks for input. Among the concerns of community banks is that new risk weights on certain residential mortgages will result in punitive capital charges on all but the most vanilla loans. The comment period for the capital rules ended in October; however, the Fed, FDIC and OCC released guidance on November 9th indicating the rules will not become effective on January 1st as expected due to the need for additional time to address industry concerns.

Republican Leaders of Financial Services Committee Press for 2 Year Volcker Delay
Ahead of this week's House Financial Services Committee hearing on the Volcker Rule, both the current Chairman of the Committee Spencer Bachus (R-AL) and the incoming Chairman, Representative Jeb Hensarling (R-TX), wrote to the heads of the Fed, SEC, FDIC, OCC and CFTC, urging a delay of the Volcker rule. In their letter, Bachus and Hensarling cited concerns

over lack of clarity and transparency, and the "and the resulting confusion" and asked for a two year delay of the effective date of rule."

Bill to Merge CFTC, SEC Introduced
On November 29th, Ranking Member of the Financial Services Committee Barney Frank (D-MA) and Representative Mike Capuano (D-MA) introduced H.R. 6613, a bill to merge the CFTC and SEC. The legislation is unlikely to advance as the idea of a merger is opposed by other Members of Congress, including leadership of the Senate and House Agriculture Committees, which have jurisdiction over the CFTC. Speaking on the legislation the retiring Frank said he is introducing the bill now because it "is time for this to be on the agenda of the next Congress" and the "existence of a separate SEC and CFTC is the single largest structural defect in our regulatory system." Were the legislation to be successful, the new agency would be named the Securities and Derivatives Commission.

House Republicans Seek to Bring Up Derivatives Push Out Fix
House Republicans were pushing to hold a floor vote this week on legislation (H.R. 1838) which would tweak a provision of the Dodd-Frank Act which requires banks to "push out" derivatives activity from federally insured divisions to separate affiliates. Supporters of the bill were hoping to place the measure on the suspension calendar, which is reserved for uncontroversial measures. However, while the bill was approved by the House Financial Services Committee in February, House Agriculture Committee Ranking Member Collin Peterson (D-MN) opposed the bill being brought to the floor without the opportunity for his committee to vote on the issue. Although supportive of the measure generally, Financial Services Ranking Member Barney Frank (D-MA) supported his colleague's prerogative to hold a hearing on the bill and it was not added to the initial calendar for the week.

House Subcommittee Advances Bill Targeting Defaulting Foreign Nations
On November 29th, the House Foreign Affairs Subcommittee on Western Hemisphere approved H.R. 1798, a bill which would block access to U.S. capital markets to defaulting foreign countries that evade final U.S. court judgments of $100 million or more. The legislation also directs the SEC to flag the filings of the country in question with a warning about their failure to meet the judgments. Chairman of the Subcommittee and sponsor of the legislation, Representative Connie Mack (R-FL), said the measure is intended to pressure Argentina to repay U.S. debts.

<u>Executive Branch</u>
Federal Reserve
Top Fed Official Warns Against Risk of Cyber Attacks to U.S. Financial Stability
On November 27th, President of the Atlanta Federal Reserve Dennis Lockhart told participants at a German conference that cyberthreats are a large risk to the U.S. payments network and financial stability. Lockhart pointed to the fragmented nature and paid evolution of the payments regime as its chief vulnerabilities, saying the potential for cyberthreats should be viewed "as a persistent threat with potential systemic implications."

Fed Signals Desire to Regulate Foreign Banks More Strictly
In a speech on November 28th, Federal Reserve Governor Daniel Tarullo called for the U.S. operations of large foreign banks to be subject to the same regulatory requirements as their U.S. based competitors. Tarullo said treating the U.S. operations of foreign banks differently no longer makes sense and the banks should be required to adhere to the same capital, liquidity and stress testing requirements as domestic based institutions. Notably, Tarullo said Fed proposals governing the oversight of the largest U.S. banks—which were released in December 2011 and delayed due to questions over how the U.S. operations of foreign banks would be treated—would be released in the coming weeks in a notice of proposed rulemaking. Tarullo's remarks have already caused concern at large international banks, which have already voiced opposition to some internationally-reaching Dodd-Frank rules. Sally Miller, CEO of the Institute of International Bankers said in response to the notion of regulating international banks like their U.S. based counterparts that she was disappointed in the Fed's departure from the "longstanding case-by-case approach when dealing with foreign banking organizations."

CFPB

CFPB to Delay, Revise Remittance Rule
On November 27th, the CFPB announced that the Bureau will be making adjustments and extending the effective date of its rule on international money transfers. The delay comes in response to significant opposition with the rule expressed by banks and other regulated entities. According to the CFPB, the revised rule will address three major issues, including what would happen if a consumer provides an incorrect account number for a transfer, how remittance providers must disclose certain third-party fees. The updated rule will also reverse a provision that would have held banks liable for remittance errors, even if the fault lay with the customer. Changes to the rule are expected to be published by the Bureau in December, with a new effective date 90 days after a final rule is issued.

SEC

Schapiro to Leave SEC, Walter to Serve as Acting Chairman
On November 26th, SEC Chairman Mary Schapiro announced she will be stepping down as head of the agency effective December 14th. During her time overseeing the SEC, Schapiro is credited with revitalizing the agency after it failed to identify the Ponzi schemes run by Bernie Madoff and has been responsible for implementing the Dodd-Frank Act at the agency. SEC Commissioner Elisse Walter will serve as acting Chairman after Schapiro's departure, but is not expected to take up the chairmanship permanently. Schapiro leaves with some unfinished business for the next chairman, including money market mutual fund reform, efforts to strengthen electronic exchanges, Dodd-Frank implementation, and high-frequency trading.

CFTC

CFTC Charges Intrade with Illegally Trading Options
On November 26th, the CFTC sued Intrade, an online market prediction tool, alleging that the service let customers bet on future economic data, the price of gold and the potential for acts of war. In its complaint, the CFTC said the investment contracts traded on Intrade are technically to be considered options, which must be traded on approved and regulated exchanges. The

Commission is asking the company to pay fines and return profits that may have been obtained illegally.

CFTC Approves First Swap Clearing Determinations
On November 28th, in a 5 to 0 private vote the CFTC approved new rules for swaps that must be centrally cleared, as mandated by the Dodd-Frank Act. Under the rules, certain credit default swaps (CDS) and interest rate swaps are required to submit a swap that is identified in the rule for clearing to registered derivatives clearing organizations (DCOs) as soon as technologically practicable and no later than the effective date in March. The vote was originally intended to be a public vote; however, at the request of a commissioner, the vote was made private. Following the vote, Commissioner Scott O'Malia said the CFTC may be finalizing Dodd-Frank Act execution rules for swaps at a December 12th meeting.

Treasury
FSOC Holding Closed Meeting December 3rd
The Treasury announced last week that the Financial Stability Oversight Council will meet Monday, December 3rd for a closed session chaired by Treasury Secretary Geithner. The Treasury has not released an agenda for the closed meeting. The FSOC last met on November 13th when it proposed a set of money market mutual fund reforms.

UPCOMING HEARINGS

On Wednesday, December 5th at 9am, in 2128 Rayburn, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing on the economic impact of the derivatives provisions contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (PL 111-203).

On Thursday, December 6th at 9:30am, in 216 Hart, the Joint Economic Committee will hold a hearing on the fiscal cliff, focusing on how to protect the middle class, sustain long-term economic growth and reduce the federal deficit.

On Thursday, December 6th at 10am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Committee will hold an oversight hearing titled "Oversight of FHA: Examining HUD's Response to Fiscal Challenges."

On Thursday, December 13th at 10am, in 2128 Rayburn, the House Financial Services Committee will hold a hearing on section 619 of the Dodd-Frank Street Reform and Consumer Protection Act (PL 111-203), known as the Volker rule.