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FINANCIAL SERVICES REGULATORY REFORM UPDATE

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GOP LEADERS DOUBT ADMINISTRATION'S PREDICTION OF CATASTROPIC EFFECT OF U.S. SOVERIGN DEBT DEFAULT

As noted by David Frum, a conservative pundit and former speechwriter for President George W. Bush, there is a growing consensus among both conservative and mainstream Republicans who think a technical default is a manageable outcome. This list includes presidential candidate and former Minnesota governor Tim Pawlenty, who has announced support for a short-term default if it leads to deep and immediate spending cuts. Additionally, the ranking member and chair of the Senate and House Budget Committees, respectively Jeff Sessions (R-AL) and Paul Ryan (R-WI), have both stated that failing to raise the debt limit would not, in fact, lead to immediate disaster. And, of course there is Sen. Pat Toomey (R-PA) who is leading an effort to push the Treasury to prioritize debt service over other payments in the event the debt ceiling is not raised.

On the other end of the spectrum the Administration continues to stress that even a limited default would have catastrophic results, causing upheaval in the markets and the potential for a second recession. They are slowly being joined in this effort by leading voices on Wall Street. Earlier this week a Bank of America/Merrill Lynch executive stated that $25.6 billion in Treasury interest payments due on August 15th will be imperiled if the August 2nd deadline is not met. If this were to occur, he went on to state that money market mutual funds that invest in short-term government bills could break the buck (i.e., fall below $1 per share). Many Americans use money market accounts, which are valued for their liquidity and safety, and if they were to break the buck it could lead to a panic.

In the meantime, it appears that discussions amongst the "Biden group" will be increasing as the Obama administration indicated that for the rest of the month there will be three meetings per week in an attempt to draft a deficit-reduction plan before the July 4th recess. Also, the most anticipated foursome in DC outside of the US Open will be teeing off on next Saturday when President Obama and Speaker Boehner hit the links.

If a deal can be struck by the July 4th recess, it would still leave time for Congress to complete language in order to work out an agreement on the debt ceiling in advance of August 2nd. Additionally, it also provides enough lag time that if the deal can't pass muster in Congress (a la the first TARP vote) there will be time for a plan B before the August 2nd deadline.

Finally, though perhaps least importantly, on Thursday the Gang of Five, in an attempt to remain relevant, shared preliminary details of its deficit reduction plan with a group of about 20 Senators – an even split of Democrats and Republicans – in order to amass feedback before the formal release of a plan. Senate Budget Chairman Kent Conrad (D-ND), one of the plan's authors, stated that the recommendations are not yet finalized, and it was still unknown when the group might make it public. Members of the group have stated that the proposal aims to trim the deficit by about $4.7 trillion over the next decade, and includes spending cuts, tax increases and changes to entitlement programs. Insiders have also stated that this proposal will go further than the President's fiscal commission recommendations issued last year.

INTERCHANGE DELAY FAILS IN THE SENATE -- FOCUS SHIFTS TO FED

Thursday, Sen. John Tester's (D-MT) legislation to delay a Federal Reserve rulemaking on interchange fees failed in the Senate by a vote 54-45; six votes shy of the sixty needed to pass the amendment.

While Tester said he would not be abandoning the effort to delay the rulemaking, the amendment's lead Republican cosponsor, Sen. Bob Corker (R-TN) said that Congress is unlikely to revisit the delay this year. With the legislative battle seemingly over, stakeholders have eyes on the Federal Reserve. As Viveca Ware, Senior Vice President for Regulatory Policy at the Independent Community Banker of America, said banks are "in a wait and see mode until the Fed rule comes out." Other stakeholders, such as the Credit Union National Association, are intensifying their efforts to work with the Fed on the final rule and work with payment card networks and processers to create a legitimate two-tiered system in order to ensure real protections for exempted entities.

AGENCIES EXTEND ABS RISK RETENTION PROPOSAL COMMENT PERIOD

On Tuesday, the SEC, Office of the Comptroller of the Currency, Federal Reserve Board, Federal Deposit Insurance Corporation, Federal Housing Finance Agency and the Department of Housing and Urban Development announced that they were extending the comment period on a proposed rule pertaining to asset-backed securities (ABS) risk retention requirements. Initially, the comment period was to end on June 10th, but in response to significant Congressional pressure, the Agencies decided to extend the rulemaking so that comments are now due on August 1st. In doing so, the SEC put out a statement that "due to the complexity of the rulemaking and to allow parties more time to consider the impact of the Credit Risk [notice of proposed rulemaking] on affected markets, the Agencies have determined that an extension of the comment period until August 1, 2011 is appropriate."

The rulemaking was created by the six agencies as mandated under Section 941 of Dodd-Frank, and would require ABS sponsors to retain at least 5% of the credit risk of the assets underlying the securities, and would prohibit sponsors from transferring or hedging that credit risk. Many of the comments received by the agencies to date have centered around the exemption from risk retention for "qualified residential mortgages" (QRMs), which could be 100% securitized without any retained credit risk so long as strict underwriting standards are met and the borrower pays a 20% down payment.

Banks, the real estate industry, consumer advocates and lawmakers from both sides of the aisle have filed comments on the rulemaking, calling the 20% down payment requirement overly restrictive.

FRANK ISSUES LETTER TO CLARIFY INTENT ON BROKER-DEALER FIDUCIARY STANDARDS

In a letter to SEC Chairman Mary Schapiro, Rep. Barney Frank (D-MA) stressed that the Dodd-Frank Wall Street Reform and Consumer Protection Act was not designed to "encourage" the SEC to extend the 1940 Investment Advisors Act fiduciary standard to broker-dealers. In his letter, Frank said that the provision which calls for a uniform standard for advisors and broker-dealers was intended to be crafted an appropriate distinction between the two sectors. Frank said "while the law gives the Commission authority to establish a new standard of care, the requirement that the new standard be 'no less stringent than' 206(a) and (2) was not intended to encourage the SEC to impose the Investment Advisers Act standard on broker-dealers, but to ensure that the new standard would not be a 'watered-down' version of the investment advisors' fiduciary standard." Members of the broker-dealer industry have expressed fears that the ultimate SEC ruling in this area will impose the 1940 Act fiduciary standard on them and severely limit their operations.

VACANCIES IN ADMINISTRATION CONVEY BROADER EFFORT TO STALL REFORM

While Treasury Secretary Geithner warned against undermining efforts to stall or water down financial regulation, Senate Republicans are refusing to confirm nominees to crucial financial regulatory posts. As was widely reported, the Senate stayed in *pro forma* session the week before last in order to block the recess appoints of Elizabeth Warren and others. With the "transfer date" of July 21st fast approaching there is a growing concern that the CFPB needs a director, because until a director is confirmed, the Bureau may be hamstrung in some of its functions, including defining its authority over non-bank financial service providers. Treasury has the ability to extend the transfer date by up to six months, so there is a chance that Warren could ultimately be appointed during a recess appointment in August.

In addition to Warren, the Administration has been trying to fill other key vacancies at agencies tasked with implementing Dodd-Frank. However, instead of reducing the number of positions, recent departures have only resulted in additional vacancies. First, on June 5th, Peter Diamond, President Obama's nominee to the Federal Reserve Board of Governors, asked the White House to withdraw the nomination due to Republican opposition. Then, Chairman of the Council of Economic Advisors (CEA), Austan Goolsbee announced that he would be returning to academia in the fall. A former administration official said that the next CEA chairman will likely come from outside the administration to ensure the confirmation process is smooth and "so that the confirmation hearings can be less of a retrospective on Obama's policies to date and more of a forward-looking discussion of what could and should be done."

CFTC SETS TENTATIVE DATE TO ISSUE MEASURE ON DERIVATIVES END USERS

On June 9th, CFTC Chairman Gary Gensler announced that the agency will likely issue a proposal by June 14th that will shield the "harmless" users of the derivatives market from negative legal consequences and uncertainty associated with implementation of Dodd-Frank. The proposal aims to temporarily blunt the effects of Title VII of the financial reform legislation and provides relief while the agency finishes rule writing on parts of Title VII. If the Commission approves a proposal on June 14th, the agency will seek a short public comment period. Additionally, Gensler said the agency is working with the SEC on the relief strategy. The SEC recently announced that it is considering providing guidance on Title VII to remove uncertainty and provide additional clarification in advance of the July 16th statutory deadline for rulemaking.

Chairman Gensler will be testifying before the Senate Agriculture Committee the day after this announcement comes out and we anticipate that he will be questioned thoroughly about it, as well as other concerns about the pace of the CFTC's rulemaking in implementing Dodd-Frank.

JP MORGAN CEO PUBLICALLY ATTACKS FED CHAIRMAN ON REGULATORY REFORM

On June 7th, at a bankers' conference in Atlanta, CEO of JPMorgan Chase Jamie Dimon took the rare action of publicly questioning Fed Chairman Ben Bernanke in an open forum on banking reform. Dimon's actions were viewed by some as the mark of an unprecedented hostility on the part of the banking industry to push back on regulations. During the exchange, Dimon asked Bernanke if he is concerned that "overzealous" regulation will interfere with an economic recovery. Bernanke responded to Dimon's accusations that the Fed's regulations will stall economic growth by saying that the Fed does not have the quantitative tools to assess the net impact of upcoming regulation. William Poole, former president of the Federal Reserve Bank of St. Louis, said that Dimon has "thrown down the gauntlet" and "now what is needed are detailed studies of the costs of regulations." We expect that Republicans will use Dimon's words to continue to push for the administration to release more economic analysis in advance of rulemaking, especially because Dimon is traditionally viewed as one of the Democrats strongest voices in the banking industry.

GEITHNER URGES CONGRESS AND EU TO EFFECT ROBUST FINANCIAL REFORM

Earlier this week, in a speech before the International Monetary Conference, Treasury Secretary Geithner stressed that efforts to delay or lessen the impact of financial regulation would hurt the financial industry. Geithner's remarks were aimed not only at Congress – which has several pieces of legislation aimed at delaying implementation of the Dodd-Frank Act in the works – but also at the banking community and international regulators. In making the case for prompt, strong regulation, Geithner cited the UK's "light-touch" financial rules before the banking crisis as one of the main factors causing the financial crisis.

Amid worries that increased U.S. regulation will put the U.S. financial sector at a competitive disadvantage, Geithner stressed that the UK example "should be a cautionary note for other countries deciding whether to try to take advantage of the rise in standards in the United States." Similarly, Geithner made the case for a set of global standards to level the playing field and prevent regulatory arbitrage including regulation to increase systemic surcharge requirements for large financial institutions, create capital and leverage requirements and create international standards for margins on uncleared derivatives trades. Speaking about the international derivatives market, Geithner said it is important to take a "global approach on margins that will help reduce opportunities for regulatory arbitrage and prevent a race to the bottom on margin."

CFTC Commissioner Bart Chilton also spoke this week, and echoed Geithner's comments about a level playing field, stating that regulatory arbitrage can be averted if European regulators and the U.S. harmonize plans for swaps oversight. Chilton said that "as long as there is a coordinated and comprehensive effort to harmonize financial regulations" business will not flee overseas. He also stressed that strong regulations will not destroy competitiveness but rather make the U.S., EU and other countries that join in on swaps and other regulation even more competitive.

NEW ATTACKS ON COMMODITY "SPECULATION" ON THE HORIZON

With continued volatility in the commodity markets, and the impact of that volatility on the price of oil, it should be little surprise that various governmental bodies are taking aim at speculators. This past Monday, the United Nations Conference on Trade and Development (UNCTAD) released a report which concluded that speculators play a large role in driving surges in commodity prices. The report goes on to recommend that governments engage in "direct intervention" in markets to deflate commodity bubbles. The report cites the use of transactions taxes as one possible means of intervention to slow commodities speculation. In regards to oil, the report states "that speculation currently accounts for as much as 20 percent" of the current price of crude oil. Additionally, we are hearing that the staff of the Homeland Security and Government Affairs Permanent Subcommittee on Investigations is planning an investigation into the role of speculation in crude oil pricing. Given that Senator Carl Levin (D-MI) an avowed opponent of non-end users in the commodities markets, is the Chairman of the subcommittee, the results of the study will likely mirror those of the UNCTAD study. However, unlike the UN study, the permanent subcommittee has the power to make recommendations to the Department of Justice about prosecutions.

AS CITIBANK JOINS THE GROWING LIST OF "HACKED COMPANIES" THE FINANICAL SERVICES INDUSTRY COMES INTO THE SIGHTS OF MEMBERS OF CONGRESS LOOKING TO IMPOSE NEW DATA SECURITY RULES

Citigroup was the latest in a serious of large hacking attacks that have stricken the likes of Sony, Epsilon and others. On Thursday, the bank made a statement that 200,000 accounts were breached (about 1% of its 21 million customers on the continent), in early May, and the hackers were able to obtain customers' names, account numbers, and email addresses, among other things. Although cyber attacks on the financial industry have been occurring regularly for years, the Citi one is one of the largest direct attacks on a major bank and has shed light on the inefficient practices by banks and major credit card companies to safeguard customers' personal information.

In light of this, Rep. Mary Bono Mack (R-CA), chair of the House Energy and Commerce Subcommittee on Commerce, Manufacturing and Trade, will be holding a hearing this coming Wednesday to examine a draft version of her data breach legislation. Neither the witness list not the draft bill have been made public yet, but the hearing indicates that Bono Mack is eager to move a bill that will set a federal standard on breach notification and improve private sector data security. She stated that "hopefully, the lessons learned from this spate of high-profile data breaches will be instructive as we ready legislation to provide consumers with better safeguards in the future. The time has come for Congress to take decisive action. We need a uniform national standard for data security and data breach notification. In the meantime, regulators need to do a better job of being a consumer watchdog."

UPCOMING HEARINGS

On Monday, June 13th at 4pm, in 2141 Rayburn, the House Judiciary Subcommittee on Intellectual Property, Competition and the Internet will hold a hearing titled "Competition and Consolidation in Financial Markets: The New York Stock Exchange-Deutsche Boerse Merger."

On Tuesday, June 14th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions will convene a hearing on "too big to fail."

On Tuesday, June 14th at 10am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Committee will hold a confirmation hearing on pending nominations for the SEC and Securities Investor Protection Corporation.

On Tuesday, June 14th at 11am, in 2175 Rayburn, the House Education and Workforce Subcommittee on Health, Employment, Labor and Pensions will hold a hearing titled "Retirement Security: Challenges Confronting Pension Plan Sponsors, Workers and Retirees."

On Tuesday, June 14th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on International Monetary Policy and Trade will hold an oversight hearing of the World Bank and multilateral development banks.

On Wednesday, June 15th at 9:30am, in 328-A Russell, the Senate Agriculture, Nutrition and Forestry Committee will hold an oversight hearing on the implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which deals with regulation of the over-the-counter derivatives market, including agricultural commodities.

On Wednesday, June 15th at 10am, in 2128 Rayburn, the House Financial Services Committee will hold a hearing to receive the Treasury's annual report on the state of the international financial system. Treasury Secretary Timothy Geithner is expected to testify.

On Wednesday, June 15th at 10am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Subcommittee on Financial Institutions and Consumer Protection will hold a hearing titled "Enhancing Safety and Soundness: Lessons Learned and Opportunities for Continued Improvement."

On Wednesday, June 15th at 1pm, in 2360 Rayburn, the House Small Business Committee will hold a hearing titled "Lifting the Weight of Regulations: Growing Jobs by Reducing Regulatory Burdens."

On Thursday, June 16th at 10am, in 2128 Rayburn, the House Financial Services Committee will meet for a hearing on international financial regulatory coordination.

On Thursday, June 16th at 10am, in 2167 Rayburn, the House Transportation and Infrastructure Subcommittee on Economic Development, Public Buildings and Emergency Management will hold a hearing titled "the SEC's $500 million fleecing of America."

On Thursday, June 16th at 10am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Committee will hold a hearing titled "Credit Unions: Member Business Lending."

On Thursday, June 16th at a time TBD, in a location TBD, the House Appropriations Subcommittee on Financial Services and General Government will mark up draft legislation that would make fiscal 2012 appropriations for departments, agencies and programs under its jurisdiction.

On Wednesday, June 22nd at 9:30am, in 1100 Longworth, the House Ways and Means Subcommittee on Health will hold a hearing on the findings in the 2011 annual report of the board of trustees of the Social Security system.

On Wednesday, June 22nd at 10am, in 2128 Rayburn, the House Financial Services Committee will mark-up pending legislation related to Ex-Im Bank reauthorization, small business capital, debt collection and exempted securities issued by churches.

On Thurday, June 23rd at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Domestic Monetary Policy and Technology will hold a hearing on pending legislation, H.R. 1495, the Gold Reserve Transparency Act of 2011.

On Thursday, June 23rd at a time TBD, in 2359 Rayburn, the House Appropriations Committee will mark up draft legislation that would make fiscal 2012 appropriations for programs related to financial services.

On Friday, June 24th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will hold an oversight hearing on mutual funds.

On a date TBD, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit will hold a hearing on the Small Business Lending Fund (originally scheduled for April 6th).

On a date TBD, in 2128 Rayburn, the House Financial Services Committee will hold a hearing on an independent study conducted by the Boston Consulting Group on a proposal to overhaul the Securities and Exchange Commission. (originally scheduled for June 3rd).