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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

June 25, 2012

Leading the Past Week

European leaders continued to endeavor to find a solution to their economic malaise, while much of the rest of the continent tried to distract themselves with a somewhat different struggle. Perhaps some divine intervention can be interpreted by German's victory over Greece in a European Cup 2012 quarter-final match (though soccer purists were certainly hold otherwise), and during the past week it certainly looked as if Germany and Angela Merkel were holding firm in their demands during the recent G20 summit. The eyes of the world will continue to focus on Europe with next week's European Council Summit, though some US thought leaders are beginning to indicate that the fortunes of the two continents may not be as tied together as originally believed. Also this past week, JP Morgan CEO Jamie Dimon appeared before the House Financial Services Committee and excellently handled a barrage of questions from both sides of the aisle. Ironically, while Dimon was forced to spend a good portion of his appearance talking about whether he believed Dodd Frank codified "too big to fail," it was the very imprimatur of the government backing of his bank that Moody's said was as justification for JP Morgan's modest downgrade in a move that saw the ratings agency downgrade 15 global banks. Finally, the Fed announced it was extending Operation Twist in an effort to spur on the flagging recovery.

Legislative Branch

Senate

Schapiro Defends Money Market Reforms before Senate Committee, Staff Set to Release Report on Changes

On June 21st, SEC Chairman Mary Schapiro appeared before the Senate Banking Committee in a hearing to examine various perspectives on money market mutual fund reforms. Facing criticism and backlash from lawmakers on her proposed reforms, Schapiro sought to convince lawmakers that, while most funds are "well and responsibly managed," they are also vulnerable to runs. Senator Patrick Toomey (R-PA) told Schapiro that the SEC is trying to portray the money market mutual fund industry as weak when, in the face of "an ongoing recession, European credit crisis, downgrade of the U.S. government, considerable redemption pressure," there has not been "a single problem" in the industry. Similarly, Senator Robert Menendez (D-NJ) expressed concerns with Schapiro's proposal to require funds to float share prices. Schapiro stressed that the goal of the money market reforms—moving to a floating net asset value (NAV) or increasing capital buffers and preventing customers from withdrawing all funds at once—is not to demonize the industry but to strengthen it.

Earlier in the week, SEC Division of Investment Management said it is ready to release recommendations for money market fund reforms as soon as the Chairman decides to put it before the Commission. While thus far Schapiro's Commissioners, including Troy Paredes, Daniel Gallagher and Luis Aguilar, have been hesitant to support reforms, division Deputy Director Robert Plaze said he is hopeful that all the Commissioners will support the staff's recommendations once they see the report. Plaze also acknowledged concerns expressed earlier in the week in a Chamber of Commerce white paper. Plaze recognized that the reforms could cause some investors to flee but said investors are always "coming and going" and a more stable product could be a draw. Nevertheless, the Chamber's June 18th report found that the reforms would cause "major shrinkage or elimination" of the industry, thus impacting municipal finance and commercial paper markets with higher funding costs for municipalities and businesses.

Senate Banking Subcommittee Examines Current State of the IPO Process

On Wednesday the Senate Banking Subcommittee on Securities, Insurance and Investment held a hearing to examine the current state of the IPO process. In addition to a discussion of the Facebook IPO, and some of the problems that occurred during that process, witnesses also stressed that the IPO process and the availability of quality information is currently unfairly skewed to the retail investors and clients of IPO underwriters, which puts ordinary investors at a disadvantage. Agreeing with witnesses, Chairman of the Subcommittee Jack Reed (R-RI) said that it is important to ensure Wall Street and regular investors have the same set of rules and everyone has "access to the same set of data and disclosures." Witnesses also cautioned lawmakers against allowing retail investors to play a larger role in IPO price setting. Ann Sherman, a professor at DePaul University, said that any regulatory changes to the IPO process must take into account that retail investors are less equipped to price set than institutional investors and giving investors equal voice in the process, such as through auction, could pose major problems.

In addition to concerns with the Facebook IPO process, Reed raised concerns with implementation of the Jumpstart Our Business Startups (JOBS) Act, noting that the disclosure exemptions for emerging growth companies allow the process to be confidential until very late in the game and could open the U.S. up to shell companies through reverse mortgages. Once again it was publicly announced that committee staff are currently looking into the problems that arose in the Facebook IPO and will determine if a full committee hearing is appropriate when briefings are completed.

However the Senate Banking Committee may not be the people on Hill that were examining the IPO process. The day before the Senate hearing, the House Oversight Committee wrote to SEC Chairman Mary Schapiro requesting regulators look into overhauling the IPO process. Citing the troubles with the Facebook IPO, Chairman Darrell Issa (R-CA) said investment banks are far too able to "dictate pricing while only indirectly considering market supply and demand." Issa requested that Schapiro respond to a number of questions involving the structure of the IPO process. The SEC is currently looking into whether Facebook's underwriters broke any rules and examining technical glitches with the NASDAQ.

House of Representatives

Regulators, Dimon Appear Before Financial Services Committee to Discuss Regulation in Face of Trading Loss

On June 19th, the House Financial Services Committee met to examine JP Morgan's recent $2 billion synthetic credit trading loss and the role of risk management and bank supervision. First, the Committee heard from a panel of regulators from the OCC, SEC, CFTC, Fed and FDIC. Similar to previous hearings in the Senate, the hearing largely focused on the events surrounding the trading loss and regulators efforts to seek out and avoid such risk management issues. Notably, Chairman Mary Schapiro told lawmakers that the SEC is investigating whether JP Morgan adequately disclosed changes to its value at risk (VaR) model which ultimately led to the trading loss. While the OCC, not the SEC, is JP Morgan's primary regulator and the derivatives trading that led to the losses was not under the purview of the SEC's regulation, the SEC is examining whether the VaR disclosures were sufficient as rules require disclosure of "changes to the value-at-risk model, the assumptions of parameters." In the second panel, JP Morgan CEO Jamie Dimon addressed changes to VaR, saying the bank "disclosed what we knew when we knew it."

After repeated reports in the press about the kid glove treatment that Dimon got during his Senate testimony, it was clear he was anticipating more rigorous questioning, and he certainly received it. Interestingly both sides seemed, at times, more interested in grandstanding on issues such as the Volcker Rule and other ongoing Dodd-Frank Act implementations, than listening to Dimon's response. On more than one occasion Dimon's answer to a question clearly didn't meet the expectation of the examiner, who simply choose to ignore it to make his/her point. This was particularly true with 'too big to fail,' as Dimon seems caught in the partisan crossfire as Democrats and Republicans argued past each other whether Dodd-Frank succeeded in solidifying or abolishing the perception of too big to fail.

House Appropriations Committee Approves Spending for Financial Regulators

On June 20th, the House Appropriations Committee approved the FY 2013 Financial Services appropriations bill by voice vote. The bill provides $21.2 billion to covered agencies—1.7 percent less than current funding levels and $2 billion less than President Obama's request and the Senate approved bill. Democrats on the Committee expressed strong reservations that the SEC is being underfunded—to the detriment of Dodd-Frank implementation. The bill funds the SEC at $1.37 billion, $50 million more than FY2012 but $195 million less than the President's request. Republicans rejected two amendments that would have increased funding for the SEC that would have raised the allocation to the $1.57 billion requested by Obama.

Also, woven into the appropriations bill was a provision stating that insurance firms will not be bound by Volcker rule restrictions and will have free reign to invest in and sponsor private funds. Despite being nonbinding, the language has the potential to support insurance industry claims that investment activity is not subject to Volcker Rule restrictions. The Committee's June 20th report said it "believes that the traditional investment activities of State-regulated insurance companies for their general accounts, including investing in both sponsored and third-party funds, are preserved by the law without constraint."

Capital Markets Subcommittee Examines Equity Market Structure
On June 20th, the House Financial Services Capital Markets and Government Sponsored Enterprises Subcommittee met to examine the U.S. equity market structure and how it impacts innovation and competition. One focus of the hearing was Representative David Schweikert's (R-AZ) amendment to the JOBS Act that requires the SEC to study the impact of quoting U.S. equity stocks in penny increments on IPOs. The study is due 90 days from the April 5th enactment. The Subcommittee also discussed Representative Patrick McHenry's (R-NC) draft bill, the Liquidity Enhancement for Small Public Companies Act, which would promote development of market quality incentive programs. Witnesses were generally supportive of the legislation which will likely be introduced in the coming weeks.

Witnesses told lawmakers that high-frequency trading, 'dark pools' and other market developments have decreased confidence in equity markets. NYSE Euronext CEO Duncan Niederauer told lawmakers that "what used to be an investors' market is now thought of as a traders market." Echoing Niederauer's concerns, Representative John Campbell (R-CA) said the May 2010 market plunge and dark pools and high frequency trades have left the public suspicious of Wall Street. Another witness, Joseph Gawronski, President and CEO of Rosenblatt Securities Inc, told the Subcommittee that over a third of equity trading now occurs off-exchange through dark pools and broker internalization. Despite such concerns, Thomas Joyce, Chairman and CEO of Knight Capital Group Inc, warned lawmakers that exchanges and brokerages have different needs and requirements. Joyce also stressed that dark pools meet a market need and increase competition, noting that it is "not the wild west out there."

House Financial Services Examines Pending Changes to Mortgage Disclosures
On June 20th the House Financial Services Insurance, Housing and Community Opportunity Subcommittee met for a hearing to examine mortgage disclosure reforms. At the hearing, CFPB Deputy Director Raj Date told lawmakers that the CFPB will issue a proposed rule by July 21st that integrates the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA), as directed by Dodd-Frank. Date continued that the Bureau will likely delay final disclosure forms and regulations until it completes its work on other mortgage reforms such as the very controversial 'ability to pay' regulations and compensation of loan originators. The TILA/RESPA rulemaking was the first CFPB rule to go through a Small Business Review Panel, and despite industry concerns with the process Date told the panel that he felt it had gone well and the CFPB had received helpful input. Members of the mortgage servicing industry testifying at the second panel urged the Bureau not to rush the final rulemaking process.

Echoing the statements made by many, Brenda Hughes, Senior Vice President of First Federal Savings Bank, said the TILA/RESPA reforms need to be coordinated with other regulatory changes pending in the mortgage loan industry.

House Financial Services Subcommittee Examines Money Services Supervision
At a June 21st hearing to consider supervision of the money services business, witnesses told lawmakers that improvements are underway to the National Mortgage Licensing System (NMLS). Witnesses included: Tim Daly, Senior Vice President at Western Union; Deborah Bortner, Director of Consumer Services for Washington State Department of Financial Institutions; Ezra Levine, Counsel for The Money Service Round Table; and Hersi Suleiman, General Manager of Amal USA, Inc. Bortner, testifying on behalf of the Conference of State Bank Supervisors, told lawmakers that the nationwide licensing system for mortgage loan originators is being expanded to include other industries and transition to a web-based system. The system will eventually include money transmitters, check cashers, payday lenders, debt collectors, debt management companies, small loan lenders, and auto finance lenders.

<u>Executive Branch</u>
Federal Reserve Board
FOMC Extends Operation Twist
Following a two day meeting of the Federal Open Market Committee (FOMC), the Fed announced it will be extending Operation Twist in an effort to support the stumbling economic recovery through selling short-term bonds and purchasing long-term securities. The FOMC predicted the move would "put downward pressure on longer-term interest rates and help to make broader financial conditions more accommodative." Operation Twist, which had been set to expire at the end of June, will now be extended to the end of 2012. During that time the Fed will buy another $267 billion worth of Treasury securities with maturities of six to 30 years while selling those with durations of three years or less. Speaking on the extension of the program, Chairman Bernanke said if the Fed does not see "continued improvement in the labor market" as a result of the Twist, it is prepared to take additional steps, a thinly veiled reference to another round of quantative easing. However, the Fed's relatively conservative actions to shore up the recovery reflect Bernanke's continued insistence that Congress do more to support the recovery, given monetary policy's limited recourses with such low interest rates.

Regulators Jointly Issue Guidance on Service Member Mortgage Practices
On June 21st, the Fed, FDIC, NCUA, OCC and CFPB jointly announced guidance to address mortgage servicer practices that may pose risk to servicemembers. The guidance seeks to ensure mortgage servicers are in compliance with consumer laws and regulations pertaining to military personnel who have received relocation orders. The guidance makes clear that, because these orders are non-negotiable with short timelines, servicemembers may be presented with difficulties if they cannot find a renter to cover the price of the mortgage or if the housing allowance is lowered at the new service location. The same day, Senator John Rockefeller (D-WV) introduced a bill (S. 3323) that would strengthen the laws that protect servicemembers and their families from losing their homes. Additionally, the Senate Banking Committee will be holding a hearing on protecting servicemembers in the consumer marketplace on June 26th.

SEC

Regulation of Stable Value Industry Dependent on Upcoming SEC/CFTC Report

In anticipation of the release of a joint SEC and CFTC study on stable value funds, practitioners foreshadow a favorable regulatory outcome. The study, authorized by the Dodd-Frank Act, will determine if stable value funds are swaps and if they merit a 'carve out' from new Dodd-Frank swaps and derivatives regulation. The Stable Value Investment Association has expressed optimism that the industry will receive such an exemption because stable value funds are not only in the public interest but they are also already regulated by DOL, the OCC and state level insurance commissioners.

CFTC

CFTC Cancels Meeting to Consider Swap Rules Guidance

On June 21st, the CFTC abruptly cancelled a meeting scheduled to take place that day to consider whether to propose interpretive guidance on the cross-border applications of Dodd-Frank swaps rules. Commissioners would also have considered whether to propose a phase compliance schedule for foreign swaps dealers to comply with Dodd-Frank rules. The Commission did not provide details on why the meeting was called off and no makeup date has been announced.

Commissioner Calls on FSOC to Urge SEC to Expedite Dodd-Frank Rulemakings

CFTC Commissioner Bart Chilton prodded the Financial Stability Oversight Council (FSOC) to step in and encourage the SEC to move forward with its Dodd-Frank responsibilities. Chilton, speaking June 19th before the Mutual Fund Directors annual conference, said a third party admonishment may help spur the agency into finishing its Dodd-Frank rulemakings. Specifically, Chilton said the SEC needs to complete the adoption of key swaps definitions so that they CFTC may implement position limits regulations which it adopted in October. Noting that the FSOC is also looking into "unresolved jurisdictional disputes" between the two regulators, it should also address this issue.

CFTC Developing New Tools for Swap Oversight

On June 20th, the CFTC announced it is developing new tools to monitor swaps transactions. Chief Data Officer, Srinivas Bangarbale, said the Commission is preparing to regulate the swaps market for the first time by creating a unique swap identifier and a unique product identifier to aide in supervision. The unique identifiers will enable the CFTC to link disparate data together and improve data aggregation across counterparties, asset classes and transactions. The Commission is also preparing to launch the CFTC Interim Compliant Identifier (CICI) which assigns codes to swap participants to track counterparties and other actors. The CFTC has not yet completed its swaps rulemakings; however, the agency has determined that recordkeeping standards will require information to be available to regulators in real time.

FDIC

ICBA Continues to Push Congress to Extend TAG

On June 15th, the Independent Community Bankers of America (ICBA) sent a letter to Senate leadership urging Congress to extend the Transaction Account Guarantee (TAG) program. The TAG program insures large, noninterest bearing accounts, such as those used by small businesses, local governments, hospitals and nonprofits, above the $250,000 FDIC limit. Meant as a backstop against runs during the financial crisis and recovery, the program is set to sunset at the end of 2012. However, the ICBA is urging a temporary, five year extension of the deposit insurance be approved well in advance of a lapse, arguing it will help small banks retain large depositors and provide loans to small businesses and consumers. The extension or sunset of TAG could have a meaningful impact on small banks as the most recent FDIC Quarterly Banking Profile found that TAG deposits made up 15 percent of total deposits, totaling $1.3 trillion.

CFPB

Electronic Database of Credit Card Complaints Goes Live

On June 19th, the CFPB's electronic database of credit card complaints went live. The database is a publically available searchable tool that is populated with credit card complaints received by the Bureau and sorted by zip code, complaint type, date of submissions and the bank or financial provider involved. Complaints contained in the database will only be those that are verified by the Bureau to reflect concerns from a consumer that has or had a "commercial relationship" with the institution. Meanwhile, the CFPB has also published a policy statement detailing the Bureau's plans for sharing and disclosing credit card complaint data.

CFPB Requests Information on Senior Financial Exploitation

On June 19th, the CFPB published a request for information on senior financial exploitation. The Dodd-Frank Act directs the CFPB to address financial literacy of American age 62 and older to ensure they have adequate knowledge to avoid unfair, deceptive, and abusive practices in their financial choices. The CFPB's Office for the Financial Protection of Older Americans is requesting information on "consumer financial products and services, financial literacy efforts, and fraudulent or deceptive practices impacting the lives of older Americans and their families." Specifically, the CFPB is seeking comment on: 1) evaluation of senior financial advisor certifications and designations; 2) providing financial advice and planning information to seniors; 3) senior certification and designation information sources; 4) financial literacy efforts; and 5) financial exploitation of older Americans.

DOL

Borzi Stresses Re-Proposed Fiduciary Rule Will Assuage Many Concerns with Original Proposal

With the re-proposal of the 2010 regulations defining fiduciary, Assistant Secretary of Labor for EBSA Phyllis Borzi said industry can expect many concerns to be addressed. Speaking at a June 21st benefits conference, Borzi said the new proposal will have "more sharply focused text" and include a more thorough economic analysis. Borzi also addressed changes in the fiduciary proposal in a June 20th letter to Representatives John Kline (R-MN) and George Miller (D-CA). In her letter, Borzi underscored the "robust" economic analysis but noted that DOL is still conducting studies and analyzing data for inclusion in the proposal.

International

Moody's Downgrades 15 Global Banks

On June 21st, Moody's Investors Services downgraded 15 of the largest international banks. Morgan Stanley, UBS, Barclays, BNP Paribas, Citigroup, Credit Agricole, Deutsche Bank, Goldman Sachs, JPMorgan Chase and Royal Bank of Canada received double-notch downgrades. Bank of America, HSBC, the Royal Bank of Scotland and Societe Generale received single-notch downgrades. Credit Suisse was the only bank to be downgraded by three notches. Notably, JP Morgan, which was dropped from an aa3 rating to an a3 rating, despite being one of the stronger banks evaluated by Moody's would have received a lower grade if the bank was not perceived to have the implicit support from the U.S. federal government. The downgrades will make funding for banks that rely on capital markets more expensive and have already reinforced the competitive advantage of "safe-haven" banks that rely on customer deposits to fund operations.

EU Parliament Rejects Proposal to Limit Influence of Credit Rating Agencies

On June 19th, the European Commission's efforts to require financial institutions to rotate credit ratings agencies every three years were rejected by the European Parliament's Economic and Monetary Affairs Committee. However, the idea of rotating agencies was not completely dismissed. The Committee adopted a plan that will be the foundation of negotiations with member states which would apply the rotation to a limited number of products on a five year basis. Parliament also adopted amendments that would: hold credit rating agencies liable for inaccuracies; enable the Commission to issue sovereign debt ratings to member states; require financial institutions to develop their own ratings; drop requirements for external ratings; and prevent future EU laws from requiring external ratings.

UPCOMING HEARINGS

On Tuesday, June 26th at 10am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Committee (Chairman Johnson, D-S.D.) will hold a hearing titled "Empowering and Protecting Servicemembers, Veterans and their Families in the Consumer Financial Marketplace: A Status Update."

On Wednesday, June 27th at 10am, in 1100 Longworth, the House Ways and Means Subcommittee on Human Resources will hold a hearing titled "How Welfare and Tax Benefits Can Discourage Work."

On Wednesday, June 27th at 10am, in 2128 Rayburn, the House Financial Services Insurance and Housing Community Opportunity Subcommittee will hold a hearing on the appraisal industry and regulations impacting the single-family mortgage market.

On Wednesday, June 27th at 10am, in 2128 Rayburn, the House Financial Services Committee will markup H.R. 4367, a bill to amend the Electronic Fund Transfer Act to limit the fee disclosure requirement for an automatic teller machine to the screen of that machine.

On Wednesday, June 27th at 2pm, in B-318 Rayburn, the House Ways and Means Subcommittee on Social Security will hold a hearing on the future of the Social Security Disability Insurance program and the disability appeals process.

On Thursday, June 28th at 10am, in 210 Capitol Visitor Center, the House Ways and Means Committee and Senate Finance Committee) hold a joint hearing on proposals relating to the taxation of capital gains as a part of a broader overhaul of the tax system.

On Thursday, June 28th, at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Insurance, Housing and Community Opportunity will hold a hearing on the appraisal industry and regulations impacting the single-family mortgage market.

On Thursday, June 28th at 2pm, in 2128 Rayburn, the House Financial Services Domestic Monetary Policy and Technology Subcommittee will hold a hearing on fractional reserve banking and its impact on monetary policy.

On Friday, June 29th at 9:30am, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit will hold a hearing titled "The Future of Money: Where Do Mobile Payments Fit In the Current Regulatory Structure?"