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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

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With less than two weeks to go before the U.S. debt ceiling is penetrated, House Speaker John Boehner (R-OH) abruptly announced that he was pulling out of his seemingly positive negotiations with President Obama. This came on the heels of a clearly divided Congress, as the House passed but then the Senate rejected the "cut, cap and balance" bill. The Dodd-Frank Act reached its one year anniversary, and both the House and Senate celebrated with oversight hearings to assess the reform law's impact on industry and federal rule making progress. The Consumer Financial Protection Bureau officially opened that same day, as mandated by Dodd-Frank, and President Obama nominated its first director, who is *not* named Elizabeth Warren. Finally, the House Energy and Commerce Committee advanced a data security bill that would impose new requirements on how companies protect personal information and notify customers in the event of a breach.

Leading the Week

Although initial reports indicated otherwise, House Speaker Boehner (R-OH) announced on Friday evening that he was ending his negotiations with President Obama in order to "being conversations with the leaders of the Senate in an effort to find a path forward." Before informing Obama, he wrote a letter to House Republicans, stating that "in the end, we couldn't connect… not because of different personalities, but because of different visions for our country. The president is emphatic that taxes have to be raised. The president is adamant that we cannot make fundamental changes to our entitlement programs." Boehner stated his belief that both sides of the aisle want to avoid default, and there is a "shared commitment… to producing legislation that will serve the best interests of our country in the days ahead." There continues to be no legislative line of attack.

Less than 2 weeks remain until the Treasury's August 2nd deadline for the debt ceiling to be breached, and significant time will be needed beforehand to finalize the details and text of any substantial authorizing legislation upon which the two chambers of Congress can agree. As a result, it seems that both the President and the Speaker's news conferences were intended to position them, and their respective parties, in the best possible position if default occurs. We expect talks to continue through the weekend and into next week, with renewed cries for a short-term "clean" extension, as well as a push for the "big deal" or "grand bargain" depending on one's politics. Senior GOP staff reported that Boehner will have two goals in his negotiations going forward – creating a bill that raises the debt ceiling and contains spending cuts to exceed the amount by which the ceiling is increased, with no tax hikes.

Ultimately, regardless of whether the ceiling is breached or a deal is made, it seems that the damage has been done as both S&P and Moody's have indicated that they intend to reconsider the US government's credit rating in light of the current situation and S&P's has repeatedly warned that it could downgrade the government's rating if it believes that any deficit-reduction deal isn't robust enough to alter America's trajectory of future debt growth.

Legislative Branch

House of Representatives

House passes "cut, cap and balance" bill: As a symbolic measure (because the Senate was not expected to, and indeed voted against this bill), on Tuesday the House of Representatives voted 234-190 in favor of the Republican "cut, cap and balance" bill. The proposed legislation gave conservative GOP members an opportunity to tout its dream budget plan, calling for $111 billion in spending cuts for FY2012, a graduated cap on federal spending for just under 20% of GDP through 2021, and constitutional amendments requiring a two-thirds supermajority for any tax increases as well as a balanced budget, all in exchange for a $2.4 trillion increase in the debt ceiling. The Senate voted on the bill on Friday, rejecting it along party lines at 51-46.

Senate Majority Leader Harry Reid (D-NV) called the bill "one of the worst pieces of legislation to ever be placed on the floor of the United States Senate," and Senate Budget Committee Chairman Kent Conrad (D-ND) quoted a Reagan advisor who said "This is quite possibly the stupidest constitutional amendment I think I have ever seen. It looks like it was drafted by a couple interns on the back of a napkin." Reid also stated that he is awaiting action from the House – "the path to avert default now runs first to the House of Representatives" – because revenue measures must originate there, and presumably a deficit deal will involve taxes.

House Ag Committee examines impact of Dodd-Frank: On Thursday, the House Agriculture Committee (which has jurisdiction over the CFTC) convened a hearing titled "Derivatives Reform: The View From Main Street." CFTC Chairman Gary Gensler testified in the first panel, and was followed by representatives from community banks and other "Main Street" representatives. Witnesses in the latter panel were especially concerned about Dodd-Frank rule-making that would make end-users of swaps (non-financial firms who use these derivatives for non-speculative, hedging purposes) post collateral on certain transactions, which could cut into their bottom lines. These witnesses emphasized the importance of an "effective and meaningful" end-user exemption, without which businesses might be deterred from hedging – an important tool in preventing "significant volatility risk" – and might have to raise rates on customers.

Gensler sought to appease these concerns by stating that the CFTC's proposed rule does not, in fact, require swap dealers to collect margin from their end-user counterparties. Neil Schloss, the Vice

President-Treasurer of Ford Motor Co. explained that language of the CFTC proposal is not clear on the end-user exemption, which puts congressional intent "in jeopardy." The CFTC rules have not yet been finalized, and Gensler noted that the CFTC is "trying to clarify the rules to lessen any uncertainty."

House Ag Committee Chair announces intent to introduce another bill reining in CFTC Dodd-Frank rulemaking: At a Chamber of Commerce Center for Market Competitiveness talk earlier this week, House Agriculture Committee Chairman Frank Lucas (R-OK) stated that he will be introducing in the near future related to concerns with proposed derivatives rules by the CFTC. Lucas expressed his fears that these rules could put U.S. businesses at a competitive disadvantage by requiring end users, such as "community and farm credit banks that played no part in the financial crisis" to follow rules that were actually intended for the largest financial institutions. Lucas clarified that his goal was not to go so far as overturning Dodd-Frank, but rather that "we need to make some changes." He spoke about requiring the CFTC to consider in its rulemaking the financial costs to businesses and the larger impact on the U.S. economy. He and fellow committee member Rep. K. Michael Conaway (R-TX) had also written a letter to CFTC Chairman Gensler earlier in the month, delineating 8 steps "to improve the rule-making process and facilitate a more orderly implementation of Dodd-Frank."

House passes bill to curtail CFPB's power: On Thursday, the same day that the CFPB opened its doors, the House of Representatives passed H.R. 1315, the Consumer Financial Protection Safety and Soundness Improvement Act of 2011, by a vote of 241-173. The bill was initially introduced in April by Rep. Sean Duffy (R-WI) along with Reps. Spencer Bachus (R-AL), Shelley Moore Capito (R-WV), John Carter (R-TX) and David McKinley (R-WV). No Republicans voted against the bill, although 10 Democrats crossed the aisle to vote in favor, all from endangered districts: Reps. John Barrow (D-GA), Dan Boren (D-OK), Bill Owens (D-NY), Nick Rahall (D-WV), Ben Chandler (D-KY), Henry Cuellar (D-TX), Mike McIntyre (D-NC), Jim Matheson (D-UT), Mike Ross (D-AR) and Kurt Schrader (D-OR). Specifically, the bill would change the governing structure of the CFPB by establishing a 5-member bipartisan panel of commissioners in lieu of one all-powerful director. The bill would also strengthen the review authority of the Financial Stability Oversight Council (FSOC) over regulations the new bureau issues by allowing for a simple majority (rather than two-thirds) vote to overturn CFPB regulations, and by requiring all of these FSOC meetings to be open to the public.

The Democrat-controlled Senate is not likely to pass this bill, and the Obama administration has stated that the President would veto the bill if it makes it to his desk. In introducing his CFPB director nominee (discussed below), Obama also asserted that he would actively oppose any changes to the new agency. Some Senators have also stated that they would not approve Obama's nominee until the House bill's demands are met, which would render the CFPB almost powerless. Without a director, the bureau cannot write rules or regulate non-financial lending institutions.

Bipartisan House members introduce bill to redefine "swap execution facility": On Tuesday, Reps. Scott Garrett (R-NJ), Robert Hurt (R-VA), Carolyn Maloney (D-NY) and Gregory Meeks (D-NY) introduced H.R. 2586, the Swap Execution Clarification Act, which would redefine "swap execution facility" (SEF) as it is currently circumscribed in Title-VII of the Dodd-Frank Act. The bill would specifically mandate that the CFTC and SEC may not require SEFs to have a minimum number of participants to receive a bid or offer, nor to display or delay bids, nor limit the means of interstate commerce by which market participants enter into swap transactions, nor to have bids or offers on one trading platform interact with those of another platform operated by the SEF. The bill has been referred to the House Agriculture Committee, and we have yet to see if a hearing or mark-up will be held in the near future.

House Energy and Commerce Subcommittee marks up "SAFE Data Act": On Wednesday, the House Energy and Commerce Subcommittee on Commerce, Manufacturing and Trade, marked up and favorably reported by a voice vote, H.R. 2577, the SAFE Data Act. Only three of the thirteen amendments offered were successful and all of them were agreed to by voice vote. The first was an amendment introduced by Representatives Olson and Blackburn to limit the FTC's ability to conduct rulemakings to alter the definition of "personally identifiable information." The second was an amendment offered by Representatives Stearns and Pompeo to ensure that the ability to write additional language for the bill resides with Congress and not with the FTC. The third successful amendment was introduced by Representative Rush and ensures that paper records must also be secured by companies. Although the measure was reported on a voice vote, Democrats expressed serious concerns about the legislation's definition of "personal" information and how companies who suffer from data breaches are required to inform consumers. Under the bill as written, consumers would only be notified in the event that their names, addresses or phone numbers were captured along with one or more unique identifiers, such as a Social Security number, financial account number or driver license number. Subcommittee Chairman Bono Mack said she expects the full committee will consider the legislation in the next week or two and in the interim we expect discussions about this legislation to continue.

Senate

***Senate Banking Committee "celebrates" Dodd-Frank one year anniversary*:** In a hearing titled "Enhanced Oversight After the Financial Crisis: The Wall Street Reform Act at One Year," the Senate Banking, Housing and Urban Affairs Committee heard testimonies from Rep. Barney Frank (D-MA), Treasury Deputy Secretary Neil S. Wolin, Fed Chairman Ben Bernanke, SEC Chairman Mary Schapiro, CFTC Chairman Gary Gensler, FDIC Acting Chairman Martin Gruenberg, and OCC Acting Comptroller John Walsh. Frank was the sole witness in the first panel, and he took the opportunity to excoriate his Republican colleagues in the House for "nickel-and-diming" the SEC and CFTC. "You might think less regulation would be better, but clearly the worst of all worlds is to have regulations on the books and have regulatory authorities that aren't able to deal with them appropriately, that can't hire the right people and have the right information technology."

In the second panel, the financial regulators briefed the Committee on the progress each of their agencies has made in implementing Dodd-Frank, and Schapiro and Gensler both warned (again) that proposed funding cuts by the House Appropriations Committee for FY2012 would impede their work substantially. The two did, however, confirm that they would complete all the mandated Dodd-Frank rulemaking, though not by the required deadlines. Ranking Member Richard Shelby (R-AL) countered that the financial reform law added 4,000 jobs to the federal government, and asked sarcastically if this is a sufficient number of bureaucrats to protect the financial system.

Strong statements were also made by Committee Chairman Tim Johnson (D-SD) and Ranking Member Richard Shelby (R-AL) about the new CFPB, which was a popular discussion topic in the past week. Johnson opened by defending the new bureau's checks and balances as sufficient, because they are analogous to other financial regulators and because the CFPB sprung from bipartisan ideas leading up to the enactment of Dodd-Frank. He stated that the bureau's consumer protection work will be vital, and it will have "more checks on its authority than the regulatory agencies that fell asleep at the switch." Shelby, on the other hand, did not challenge the importance of consumer protection, but instead focused on "whether the Bureau is sufficiently accountable to the American people," and the director's "unfettered power." He believes that Congress made a mistake in "delegating its own legislative power" and called for structural changes at the CFPB in order to account for this oversight.

On a different topic, Sen. Robert Menendez (D-NJ) was particularly adamant about gaining more transparency into bank foreclosure practices, stating he "is going to be like a dog on a bone about this," and if he doesn't get answers he will "use every means possible… to get to the bottom of this." He expressed his and other members' concerns about conflicts of interest resulting from mortgage servicers choosing their own auditors, who are responsible for combing through tens of thousands of foreclosures from 2009-2010.

Menendez was one of 20 House and Senate legislators, led by Rep. Maxine Waters (D-CA), to sign a July 20th letter to the Office of the Comptroller of the Currency and Federal Reserve pushing the financial regulators to released detailed information on the foreclosure practices of 14 mortgage servicers that consented in April to fix problems (including those uncovered in the robo-signing incident earlier this year). The letter acknowledged that banks would not want their confidential information to be revealed, but asserted that "some disclosure can be done on a bank by bank basis without compromising proprietary information." Financial regulators disagreed, and OCC Chief Counsel Julie Williams testified before a House Financial Services hearing earlier in the month that "what we would not anticipate doing is disclosing bank-specific information because that is confidential bank supervisory information." Bernanke and Walsh both stated in the Senate hearing on Thursday, however, that they would continue to confer with their agencies' legal counsel on the request for more details.

Senators discuss one year anniversary of Dodd-Frank at Aspen Institute: In honor of Dodd-Frank's one year anniversary, the Aspen Institute also hosted a panel all throughout the Thursday morning. Senators Jack Reed (D-RI) and Carl Levin (D-MI) were both present to speak and the moderator noted that Republicans were invited as well but none were able to attend. Reed was mostly positive about Dodd-Frank's impact, but stressed the importance evaluating the economic impact of certain decisions. He also criticized Republicans for holding up the confirmations process, calling this an improper means of dissent. Levin discussed the findings of the Permanent Committee on Investigations' (which he chairs) report, which shed light on the unchecked greed, deregulation and conflicts of interest that were all sources of the financial crisis. He stated the significance of Dodd-Frank in restoring cleanliness and credibility to the market, which is necessary for the U.S.'s economic health.

Executive Branch

CFPB

Obama nominates first director of CFPB: Although many liberals were hoping that the President would pull the trigger and finally nominate Elizabeth Warren, President Obama ultimately decided to go in a different direction and nominate Ohio Attorney General Richard Cordray to be the first director of the CFPB. Some questioned the President's decision because although Senate Republicans would undoubtedly have blocked Warren's nomination because of her liberal leanings and strong views on consumer protection, her nomination would have been applauded by the President's liberal base, and at this rate they are likely to block any nomination by the President because of their opposition to the CFPB's mere existence, so he could have scored some political points.

Cordray is currently serving as the CFPB's chief of enforcement, was referred to by Obama as an advocate for middle class families, and during his tenure as Ohio AG, he notably went after Merrill Lynch and AIG. He was hired directly by Warren for his current position, and there is now some speculation that Warren will take this opportunity to run for a Senate seat against incumbent Senator Scott Brown (R-MA).

CFTC

***CFTC unanimously approves three uncontroversial final rules; proposes two others*:** The Commodity Futures Trading Commission finalized its sixth, seventh and eighth Dodd-Frank rules, all adopted unanimously by the five commissioners. The three uncontroversial rules will remove references to credit rating agencies in certain regulations, and delineate the processes for reviewing swaps for mandatory clearing and by which swap executive facilities will certify new products. A fourth rule on whistleblower bounties was intended to be finalized on Tuesday as well, but the CFTC is awaiting feedback from another federal agency before bringing the proposed rule to a vote. The Commission also proposed two new rules that were more controversial – related to clearing-customer documentation, the timing of acceptance for clearing, and clearing member risk management - with Commissioners O'Malia and Sommers dissenting. Commissioner Dunn noted that he voted in favor of the proposals to get the debate started and public comments rolling in. He wasn't necessarily in support of the rules as written.

Financial Stability Oversight Council

FSOC approves final rule on risk rating: On July 18th, the Financial Stability Oversight Council (FSOC) approved a final rule to clarify how to designate firms that handle clearing, payment and settlement of financial transactions as risky to the US financial sector. The 'risk rating' rule takes effect in thirty days and creates a two stage process for weighing threats posed by "financial market utilities" (FMUs) In the first stage, the FSOC will use quantitative data to identify a preliminary list of FMUs. In the second stage FSOC will narrow the list using qualitative data about specific characteristics of the firms in question. While the rule is very similar to the proposed rule released in March, there were several key changes including a provision giving FMUs the ability to challenge an FSOC designation. Despite progress on the 'risk rating' rule, the FSOC has yet to issue a final rule on the related systemically significant financial institution (SIFI) rule.

<u>International News</u>

Sarkozy drops bank tax idea to fund Greek bailout: Earlier this week, European leaders and the International Monetary Fund agreed to a second rescue package worth $155 billion for a financially struggling Greece. A similarly valued bailout was also given to the country about a year ago. The private sector will also be contributing to this bailout – about $71 billion in rolled over Greek bonds that will be traded for new ones with lower interest rates or sold back to Greece for a lower price. Greece is still likely to go into a "selective default" in the deal, but the eurozone has agreed to back any new Greek bonds issued to these banks, which made the transaction much more appealing to the private actors.

French President Nicolas Sarkozy and German Chancellor Angela Merkel spearheaded the rescue package, which initially included a bank tax in order to partially fund the bailout. Sarkozy would have had a .0025% tax on all assets held by eurozone banks, which would have raised $71 billion per year for 5 years. Merkel and her base strongly opposed the idea, and as we expected, she was able to convince her French counterpart to concede the point on Wednesday prior to an emergency summit of European officials.

UPCOMING HEARINGS

On Tuesday, July 26th at 10am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Committee will hold a confirmation hearing on pending nominations for positions at the FDIC, Treasury and Financial Stability Oversight Council.

On Tuesday, July 26th at 10am, in 2175 Rayburn, the House Education and the Workforce Subcommittee on Health, Employment, Labor and Pensions will hold a hearing titled "Redefining 'Fiduciary': Assessing the Impact of the Labor Department's Proposal on Workers and Retirees."

On Tuesday, July 26th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Domestic Monetary Policy and Technology will hold a hearing titled "Impact of Monetary Policy on the Economy: A Regional Federal Reserve Perspective on Inflation, Unemployment and QE3."

On Wednesday, July 27th at 10am, in 215 Dirksen, the Senate Finance Committee will hold a hearing titled "CEO Perspectives on How the Tax Code Affects Hiring, Businesses and Economic Growth."

On Wednesday, July 27th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Oversight and Investigations will hold a hearing titled "Oversight of the Credit Rating Agencies Post Dodd-Frank."

On Thursday, July 28th at 1:30pm, in 2360 Rayburn, the House Small Business Subcommittee on Investigations, Oversight and Regulations will hold a hearing titled "Open for Business: The Impact of the Consumer Financial Protection Bureau on Small Business."

On Thursday, July 28th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Insurance, Housing and Community Opportunity will hold an oversight hearing titled "Insurance Oversight: Policy Implications for U.S. Consumers, Businesses and Jobs."

On a date TBD, in 2154 Rayburn, the House Oversight and Government Reform Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs will hold a hearing titled "What Went Wrong at the Financial Crisis Inquiry Commission?"

On a date TBD, 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.

On a date TBD, in 2128 Rayburn, the House Financial Services Committee will hold a hearing on the independent study conducted by the Boston Consulting Group on a proposal to overhaul the Securities and Exchange Commission.

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. This was initially scheduled for April 6th.