Leading the Past Week

This week, Congress returned from an August recess marred by volatility in the stock market, Eurozone instability and fears that the US economy is heading towards, or even in, a double dip recession. The two major events of this past week, the first meeting of the Supercommittee and the President’s address to a joint session of Congress, perfectly highlighted the modified message for both parties over the coming months: one that includes deficit reduction and job growth. We anticipate the fall agenda in Congress will focus heavily on these themes along with a healthy dose of rhetoric about regulatory reform. Nevertheless, it is unlikely that any substantive work will be accomplished as both parties clearly have decided to focus on positioning themselves for the 2012 elections.

Supercommittee Update:

The Supercommittee formally met for the first time on Thursday and by the end of the week it seemed that group may be facing a bumpy road ahead. Notably, Senator Jon Kyl (R-AZ) publically spoke out against the deficit cutting mission of the Supercommittee—threatening to quit the committee if defense spending or the Pentagon’s budget receives cuts, and recommending that Congress amend the sequestration, or forced cuts, that will be imposed if the Committee fails to meet its $1.2 trillion dollar goal. Kyl’s ultimatum signals that the road ahead for the Supercommittee will be fraught with partisan tangles and compromise will be difficult—especially as defense spending accounts for almost half of all discretionary spending and is likely a necessary source for deficit reduction.

Additionally, tempers flared as Supercommittee Democrats and Republicans came to an early impasse over whether or not to consider several previous proposals such as Bowles-Simpson or the Biden Group’s efforts. While Democrats wished to revisit the proposals, GOP committee members balked at the prospect of considering proposals initiated by President Obama, specifically because they include revenue raisers. Democrats support returning to previous proposals in part because they have the imprint of bipartisan support and in part because of the accelerated timeline which the Supercommittee has to make its recommendations—a mere 77 days.
With the Supercommittee’s job looking all the more difficult, President Obama may be adding to their workload. The President’s proposed American Jobs Act—which includes a payroll tax break for workers and employers, assistance to states to help prevent teacher and police layoffs, funding to modernize schools, infrastructure funding, investments in vacant and foreclosed properties, workforce training, an infrastructure bank, and unemployment aid—will come in with a price tag of approximately $450 billion. The American Jobs Act spending will need to be offset by cuts made by the Supercommittee in the coming months. Senator Lieberman and others expressed concern that additional stimulus could undermine deficit reduction. Lieberman said “a short-term infusion in the economy is well-intentioned… but the most important thing we can do is to cut the debt.”

Legislative Branch

House of Representatives

House Financial Services Republicans Ask Geithner for Update on Regulation Reform: On September 8, All thirty-four Republicans on the House Financial Services sent a letter to Treasury Secretary Timothy Geithner asking for an update on regulator’s efforts to harmonize financial services rules, including how the Financial Stability Oversight Council’s (FSOCs) efforts to “identify and eliminate unnecessary or duplicative regulatory burdens.” The letter charged that it is Geithner’s responsibility as Chair of the FSOC and Treasury Secretary to “conduct a thorough analysis of the current regulatory structure, eliminate outdated or duplicative regulations; and perform a rigorous cost benefit analysis on every new regulation.”

Echoing other GOP efforts to label increased regulatory burdens as the cause of the weak economy, the letter faulted the FSOC for not already making an effort to lessen the regulatory burden. The letter also tied the narrative back to job growth, saying that the 102 Dodd-Frank regulations already promulgated will necessitate 10.8 million man-hours a year to comply with—hampering growth and productivity. Bachus asked that Geithner respond by October 1 with a list of regulations that were in place on August 2, 2010 and which have already been eliminated.

Chairman Bachus Drafts Legislation to Create SRO for Investment Advisors: On September 8, Chairman of the House Financial Services Committee, Spencer Bachus (R-AL) released a draft bill to create a self-regulatory organization (SRO) to oversee investment advisors—possibly housed at the Financial Industry Regulatory Authority (FINRA). Bachus’ Investment Advisor Oversight Act of 2011 revises the 1940 Investment Advisors Act to create “national investment advisor associations” which would have the power to enforce member compliance, examine members and submit an annual financial report to the Securities and Exchange Commission (SEC), House Financial Services Committee and the Senate Banking Committee.

In January, the SEC recommended that Congress create one or more SROs to oversee investment advisors or impose user-fees on the industry to fund continued SEC examinations. The investment advisor and hedge fund community have long opposed the creation of an SRO to oversee their activities. David Tittsworth, executive director of the Investment Advisor Association said imposing user-fees would be preferable to moving to an SRO because it would give the SEC necessary resources to boost oversight.
Senate

Senate Banking Committee Holds Nomination Hearing on CFPB Director: On September 6, the Senate Banking, Housing and Urban Affairs Committee held a hearing on the nomination of Richard Corday to be Director of the Consumer Financial Protection Bureau (CFPB). Committee Republicans took the opportunity to rehash their concerns with the structure of the CFPB and to reassert their intention to block any nominee until the Bureau’s leadership and funding structure is reconsidered.

Ranking Member Richard Shelby (R-AL) called the nomination hearing “premature” and said that President Obama’s nomination of Cordray was “regrettable” given the GOP’s staunch opposition to the Bureau’s organization. Interestingly, Cordray was largely spared from the aggressive line of questioning to which his predecessor Elizabeth Warren was subjected. Shelby made clear that Republican objections are with the Bureau and not necessarily against Cordray himself.

Chairman Tim Johnson (D-SD) expressed frustration with the Committee Republican’s stance, saying the quarrel over the CFPB is harming consumers and “putting community banks and credit unions at a competitive disadvantage to nonbank financial companies.” Without a Director the CFPB cannot assume full authority for its statutory responsibilities, including overseeing payday lenders, student loan providers and other non-bank service providers. Given the current polarized political environment, it remains likely that Congress will not only fail to nominate Cordray but will continue to leave other critical financial regulatory positions vacant—such as members of the FDIC board and a new CFTC Commissioner.

Senate Banking Committee Approves Legislation to Overhaul Flood Insurance Program: On September 8—in the wake of Hurricane Irene—the Senate Banking Committee approved by voice vote legislation to overhaul the close to insolvent National Flood Insurance Program, set to expire on September 30. The program has been operating on a series of short-term extension since 2008, due to a lack of consensus on how to reform the program. The Senate bill, similar to legislation passed by the House in July, reauthorizes the program for five years and seeks to pay down the program’s debt by gradually raising premiums over a four year period.

Eliminated from the bill was the controversial provision that would have forgiven the program’s nearly $18 billion in accumulated debt—and which would have been dead on arrival with Republican Committee members. The legislation being sent to the floor includes two successful amendments. The first introduced by Sen. Jerry Moran (R-KS) to allow downward adjustments in rates based on community improvements in repairing levees and the second introduced by Sen. Mike Johanns (R-NE) which would commission a study on the participation of Native American tribes in the program.

Despite bipartisan support for the legislation in Committee, it is likely there will be another short-term extension to avoid a lapse in the program. Sen. David Vitter (R-LA) lauded the Banking Committee’s efforts to reform the program; however, pressed the Senate to pass a temporary extension in order to avoid even a short lapse in the program and to give the Senate time for a floor vote and to allow for a conference with the House.

Executive Branch

CFPB
CFPB Seeking Comment on Financial Products Targeted at Members of Armed Forces: On September 7, Holly Petraeus, Assistant Director for the Office of Servicemembers Affairs within the CFPB announced that the Bureau is seeking public comment on the types of financial services and products that are offered to members of the military. Under the Dodd-Frank Act the CFPB is required to develop financial education and outreach programs for servicemembers. Petraeus said that the Bureau is seeking information on services tailored to military families and members of the armed forces so as to combat the “unique [financial] challenges” faced by servicemembers. Specifically, the CFPB is collecting information on: short term lending products, services designed to aid in relocations and overseas deployments, mortgage lending and how products are marketed to members of the military. The deadline for public comment is September 20.

DOL

DOL Plans Teleconference on ERISA Compliance and Best Practices: On September 28, the Employee Retirement Income Security Act (ERISA) Advisory Council will hold a teleconference to discuss challenges to and best practices of ERISA compliance. The teleconference will address compliance issues for Section 403(b) plan sponsors, hedge funds and private equity investors. The conference will also address security issues which currently affect employee benefit and other health care plans. The Advisory Council has heard testimony on these issues at several public meetings and is scheduled to report findings and recommendations to the Labor Secretary later this year.

FEDERAL RESERVE

Despite Rampant Media Hype to the contrary, Fed and Economists See Modest Positive Growth in Economy: On September 7, the Federal Reserve (Fed) released its summary of commentary on current economic conditions—known as the Beige Book—finding that economic activity is improving throughout the majority of the country despite how recent stock market volatility leading to increased skepticism about economic recovery. While the Federal Reserve Bank of New York called recovery “sluggish,” four Federal Reserve banks saw growth in the economy and with others saying the US is experiencing “modest” growth. Echoing the Fed’s analysis, a group of economists convened by the Chamber of Commerce agreed that a double-dip recession is unlikely at this point.

Despite optimism expressed by the Fed and economists at the Chamber, fears of sluggish growth and unemployment remain. San Francisco Fed President John Williams said “the recovery has lost a lot of momentum” and unemployment will likely remain high for a number of years. Likewise, the prediction of modest growth put forth by panelists at the Chamber of Commerce was tempered with warnings over continuing difficulties in the housing market, persisting low employment and “languishing” investment and trade consumption.

CFTC

CFTC Proposes Schedule for Implementation of Several Requirements and lays out Regulatory Agenda for 2012: On September 8, the Commodity and Futures Trading Commission (CFTC) proposed two rules related to the compliance schedule for swaps clearing, trade execution, documentation and margining requirements. The rules passed the commission by a vote of 4 to 1 with only Commissioner Scott O’Malia voting against the proposal.
The proposed rules lay out a compliance schedule for phasing in documentation and margining requirements and a timeline for mandatory clearing and trading requirements. Phase one covers swap dealers, major swap participants, ‘active’ funds and other sophisticated participants. Phase two entities will include commodity pools, private (not ‘active’) funds, pension plans and “persons predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature.” Phase three covers all other swap participants. A phased approach was deemed necessary to ensure time to finalize relevant rules and to give less sophisticated participants additional time to comply.

In addition to proposing rules, CFTC Chairman Gary Gensler laid out the agency’s rulemaking plans for the remainder of the year into 2012, saying the agency will be taking up rules related to clearinghouses and position limits at their September 22 meetings. The remainder of the year will see action on entity and product definitions, swap data reporting, real-time reporting, contract markets and foreign boards of trade regulations and external and internal business conduct rules.

Gensler also said he has directed staff to draft recommendations for additional relief and exemptions beyond the current December 31 extension “so market participants can have clarity and confidence going into later this year.” The CFTC must finalize a number of rules before they can become mandatory, including rules governing end-user clearing and the definition of swap, swap dealer and major swap participant.

SEC

SEC Requests Comment to Determine if Additional Regulation of Derivatives Is Needed: On August 31, the SEC issued a concept release analyzing the use of derivatives by mutual funds and other investment firms registered under the Investment Company Act of 1940. The SEC found dramatic growth in the volume and complexity of derivatives instruments in recent years. The report also found that funds have greatly increased reliance on derivatives.

The release is designed to aid the SEC in determining whether additional regulation or guidance is necessary to improve the regulation of funds using derivatives. In order to make this determination, the SEC asks for comment on: 1) costs, benefits and risks of fund’s use of derivatives; 2) restrictions on leverage; 3) portfolio diversification and concentration; 4) exposure to securities-related issues; and 5) the valuation of derivatives.

Miscellaneous

Housing Problems Continue to Hamper the Economy: Although the FHFA has filed suit, talks between large US banking institutions and state prosecutors to settle claims of improper mortgage practices remain ongoing. Recently, prosecutors reportedly offered a deal in which banks could limit their legal liability by paying a $10 to $25 billion penalty. Not surprisingly, this proposal is being called a “non-starter.” The two sides will meet again this coming week to try to come to agreement on the future role of the government in home loans, legal liability, compliance and enforcement and the dollar amount of the settlement.

Similarly, regulators and Fannie Mae and Freddie Mac are nearing a settlement over the question of whether the government-sponsored entities (GSEs) adequately disclosed exposure to subprime loans.
The SEC and Fannie and Freddie continue to discuss terms of the settlement; however, it is known that there will be no monetary penalty or admission of fraud. Negotiations will likely not conclude until later next year—a sign that the US's mortgage problems may not be put to rest for some time to come.

In light of these various negotiations and lawsuits, it is interesting to note that this past week the Congressional Budget Office (CBO) released a new study which finds there would be “little economic benefit from a new large-scale refinancing program for millions of underwater mortgages backed by government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac and the Federal Housing Administration.” The report states that the Administration’s Home Affordable Refinance Program (HARP) would cost the government approximately $.6 billion. Moreover, such a program would yield even greater losses of $13 to $15 billion to private investors as wealth is transferred to borrowers in the form of lower payments. Supporters of refinancing reforms such as HARP posit that savings on mortgages would lead to increased consumer spending elsewhere; however, the CBO estimated that “any such benefit would likely be small relative to GDP and do little to help the housing market itself.”

UPCOMING HEARINGS

On Tuesday, September 13th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing titled “Regulation and Oversight of Broker-Dealers and Investment Advisors.”

On Tuesday, September 13th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Domestic Monetary Policy and Technology will hold a hearing on the Free Competition in Currency Act.

On Tuesday, September 13th at 10am, in 2154 Rayburn, the House Oversight and Government Reform Subcommittee on Regulatory Affairs, Stimulus Oversight and Government Spending will hold a hearing titled “Take Two: The President's Proposal to Stimulate the Economy and Create Jobs.”

On Tuesday, September 13th at 10am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Committee will hold a hearing on housing finance overhaul, focusing on the issue of government guarantees.

On Tuesday, September 13th at 10am, in 215 Dirksen, the Senate Finance Subcommittee on Fiscal Responsibility and Economic Growth will hold a hearing titled “Examining Whether There is a Role for Tax Reform in Comprehensive Deficit Reduction and U.S. Fiscal Policy.”

On Wednesday, September 14th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit will hold a hearing on combating cybercriminals.

On Wednesday, September 14th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Insurance, Housing and Community Opportunity will hold a hearing on the Department of Housing and Urban Development's housing counseling program.

On Wednesday, September 14th at 9:30am, in 2154 Rayburn, the House Oversight and Government Reform Committee will hold a hearing titled “How a Broken Process Leads to Flawed Regulations.”
On Wednesday, September 14th at 9:30am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Subcommittee on Securities, Insurance, and Investment will hold a hearing titled “Emerging Issues in Insurance Regulation.”

On Wednesday, September 14th at 2pm, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Subcommittee on Housing, Transportation, and Community Development will hold a hearing on new ideas for refinancing and restructuring mortgage loans.

On Wednesday, September 14th at 10am, in 215 Dirksen, the Senate Finance Committee will hold a hearing on options for overhauling the tax system focusing titled “Marginal Rates on High-Income Taxpayers, Capital Gains and Dividends.”

On Thursday, September 15th at 10am, in 2128 Rayburn, the House Financial Services Committee will hold a hearing titled “Fixing the Watchdog: Legislative Proposals to Improve and Enhance the Securities and Exchange Commission.”

On Thursday, September 15th at 2pm, in 2128 Rayburn, House Financial Services Subcommittee on International Monetary Policy and Trade Panel will hold a hearing on the impact that multi-lateral development banks have on America’s national security.

On Thursday, September 15th at 9:30am, in 2154 Rayburn, the House Oversight and Government Reform Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs will hold “Crowdfunding: Connecting Investors and Job Creators.”

On Thursday, September 15th at 9:30am, in 608 Dirksen, the Senate Budget Committee will hold a hearing on policy prescriptions for the economy.

On Thursday, September 15th at 10am, in 215 Dirksen, the Senate Finance Committee will hold a hearing on options for overhauling the tax system focusing titled “Promoting Retirement Security.”

On a date TBD, the House Financial Services Committee will hold a hearing to receive Treasury's annual report on the state of the international financial system.

On a date TBD, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit will hold a hearing on the Small Business Lending Fund (SBLF).

On a date TBD, the House Financial Services Committee will hold a hearing on exposure of U.S. banks to the European Union's debt crisis.

On a date TBD, the House Financial Services Subcommittee on International Monetary Policy and Trade Panel will hold a hearing on the relationship between the health of the U.S. housing finance system and global financial stability.

On a date TBD, the House Oversight and Government Reform Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs will hold a hearing titled "Small Business Lending Fund: TARP [Troubled Asset Relief Program] Dollars Redistributed to Incentivize Culture of Risk."
On a date TBD, 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?”