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FINANCIAL SERVICES REGULATORY REFORM UPDATE

For the Week of June 7, 2010

The House-Senate conference for the “Restoring American Financial Stability Act of 2010” finally began on Thursday as members of the committee used their opening statements as an opportunity to set out the likely battles that will take place over the coming weeks, including Durbin’s interchange fee provision, and the Merkley-Levin “Volcker-Rule-plus.” The text of the base bill, all 1,974 pages, can be found here: http://financialservices.house.gov/pdf/AYO10F74_xml.pdf. The committee’s goal remains having a final bill on President Obama’s desk before the July 4th recess and it will be interesting to see how the substantive sessions, the first of which is to begin on Tuesday June 15th, will go.

HOUSE-SENATE REG REFORM CONFERENCE KICKS OFF

In order to prevent a procedural clock that could allow Republicans the opportunity to require the House to vote on politicized motions to instruct from starting, House Speaker Pelosi waited until nearly the last minute to announce the list of House conferees. In the end, twenty Democrats and eleven Republicans from the Committee on Financial Services, Agriculture Committee, Judiciary Committee, Committee on Oversight and Government Reform, Committee on Energy and Commerce, and Committee on Small Business were chosen. As expected, many chairs and ranking members of relevant subcommittees were selected, but many were wondering why Freshman such as Reps. Mary Jo Kilroy (D-OH) and Gary Peters (D-MI), were also chosen. The full list of conferees is as follows:

Committee on Financial Services

Barney Frank (MA), Chair, full committee

Paul Kanjorski (PA), Chair, Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises

Maxine Waters (CA), Chair, Subcommittee on Housing and Community Opportunity

Carolyn Maloney (NY), Member of Committee

Luis Gutierrez (IL), Chair, Subcommittee on Financial Institutions and Consumer Credit

Mel Watt (NC), Chair, Subcommittee on Domestic Monetary Policy and Technology

Gregory Meeks (NY), Chair, Subcommittee on International Monetary Policy and Trade

Dennis Moore (KS), Chair, Subcommittee on Oversight and Investigations

Mary Jo Kilroy (OH), Member of Committee

Gary Peters (MI), Member of Committee

Democratic Conferees on specific portions of the legislation on which their committees have jurisdiction:

Committee on Agriculture

Collin Peterson (MN), Chair, full committee

Leonard Boswell (IA), Chair, Subcommittee on General Farm Commodities and Risk Management

Committee on Energy and Commerce

Henry Waxman (CA), Chair, full committee

Bobby Rush (IL), Chair, Subcommittee on Commerce, Trade, and Consumer Protection

Committee on the Judiciary

John Conyers (MI), Chair, full committee

Howard Berman (CA), Member of Committee

Committee on Oversight and Government Reform

Edolphus Towns (NY), Chair, full committee

Elijah Cummings (MD), Member of Committee

Committee on Small Business

Nydia Velazquez (NY), Chair, full committee

Heath Shuler (NC), Chair, Subcommittee on Rural Development, Entrepreneurship and Trade

Republican Conferees Appointed by Minority Leader John Boehner (OH):

Spencer Bachus (AL), Ranking Member on the House Financial Services Committee

Joe Barton (TX), Ranking Member of the House Energy and Commerce Committee

Sam Graves (MO), Ranking Member of the House Small Business Committee

Darrell Issa (CA), Ranking Member of the House Oversight and Government Reform Committee

Frank Lucas (OK), Ranking Member of the House Agriculture Committee

Lamar Smith (TX), Ranking Member of the House Judiciary Committee

Ed Royce (CA), member of the House Financial Services Committee

Judy Biggert (IL), member of the House Financial Services Committee

Shelley Moore Capito (WV), member of the House Financial Services Committee

Jeb Hensarling (TX), member of the House Financial Services Committee

Scott Garrett (NJ), member of the House Financial Services Committee

Senate Banking, Housing and Urban Affairs Committee

Christopher Dodd (D-CT), Chair, full committee

Richard Shelby (R-AL), Ranking Member, full committee

Tim Johnson (D-SD), Chair, Subcommittee on Financial Institutions

Jack Reed (D-RI), Chair, Subcommittee on Securities, Insurance and Investment

Charles Schumer (D-NY), member

Bob Corker (R-TN), Ranking Member, Subcommittee on Security, International Trade and Finance
Michael Crapo (R-ID), Ranking Member, Subcommittee on Financial Institutions
Judd Gregg (R-NH), member

Senate Agriculture Committee

Blanche Lincoln (D-AR), Chair, full committee
Saxby Chambliss (R-GA), Ranking Member, full committee
Patrick Leahy (D-VT), member
Tom Harkin (D-IA), member

The official melding of the Senate and House versions of financial regulatory reform began this past Thursday afternoon, with conferees making their opening statements, though backroom conversations have been going on for weeks. Of note, Dodd promised that he would push back against any attempts to weaken the bill, and Shelby countered that the reform bill was a mere “Democrat experiment in Big Government and central management.” Lincoln continued to defend her contentious derivatives desk spin-off provision, stating that it will “ensure our community banks on Main Street won’t pay the price for reckless behavior on Wall Street.” Despite the fact that Lincoln’s counterpart on the Ag Committee, Sen. Chambliss, responded that her derivatives provision is overreaching, and would interfere with legitimate uses of derivatives, it is looking more and more likely that the final derivatives language is going to be closer to Lincoln’s proposal than other, more modest efforts.

After boasting that this would be the most transparent conference in recent memory, Chair Frank acknowledged that parts of the conference would take place behind closed doors. Republicans criticized Democrats for releasing the starting-point bill only hours before the conference began. The baseline draft is essentially an expanded version of the Senate bill (now 1,974 pages long), and notably contains new provisions that would require lenders to ensure borrowers can repay mortgages before offering a loan, restrict prepayment penalties and add restrictions to refinanced loans. Another new addition to the working text is the preservation of the federal thrift charter, which has the potential to create greater preemption from state laws, and fewer restrictions on interstate branching. Both the House and Senate bills would abolish the Office of Thrift Supervision, but the base conference text would create a deputy controller for thrifts within the Office of the Comptroller of the Currency.

The majority of negotiations are expected to take place between the White House and the two leading lawmakers – Rep. Frank and Senate Banking Committee Chair Dodd, but the entire conference committee will also be debating and voting on specific revisions to the final bill. Although the conference generally tilts to the left, the conferees have to be cognizant of the fact that they still need to get this bill through the full Senate, and even though some Senators voted on issues as recently as a month ago, some of these votes, like Scott Brown or Chuck Grassley could change depending on the final language of the report.

After the opening statements, Committee Chair Frank jumped right into the meat of financial regulatory reform by opening up with one of the hottest topics: a proprietary trading ban. Much to the chagrin of Wall Street, Frank proposed that conferees use something similar to the Merkley-Levin amendment, which is a tougher version of the Senate bill’s Volcker Rule. The Senate bill would have left the matter entirely

up to future regulators after a period of study. Some in the financial services industry are incredulous that Merkley-Levin is still being considered, after never having been voted on in the Senate.

Six House legislators, including conferee and House Judiciary Committee Chair Conyers, wrote a letter to Frank on Thursday, June 10th, urging him to include the proprietary trading ban, but to leave out the in-depth study before its implementation because of the unnecessary delay that would result. Banking industry analysts continue to believe that this Volcker Rule-plus language could be used in lieu of Lincoln's much stricter derivatives desk spin-off provision. The inclusion of Lincoln's amendment is still up in the air, after her recently increased leverage – winning her election on Tuesday and getting backing on the provision from Dodd.

Chair Frank also stated that Sen. Durbin's interchange fee language – allowing the Fed to determine a "reasonable and proportional" amount for the fees that retailers pay to card companies for use of their debit cards – will likely remain in the final version of the reg reform package. Frank added that it had a "strong vote" in the Senate, and he did not believe the House would resist that, though it might be subject to some amendment. However, a non-conferee – Rep. Wasserman Schultz (D-FL) – circulated a letter among House members opposing the interchange fee provision, stating that it would "devastate credit unions and community banks, while providing no discernible benefit for consumers."

One note in terms of process, at the conclusion of the conference, a majority of both the House and Senate conferees must sign off on the conference report, though it would seem that a majority of the House conferees have to sign off for the report to go to the House and a majority of the Senate conferees to go to the Senate. As indicated above there are only 12 Senate conferees, 7 Democrats and 5 Republicans, and while unlikely, this procedural requirement provides someone like Senator Lincoln with incredible leverage in her negotiations. Finally, both bills, which cannot be amended on the floor, still have to pass both chambers of Congress, before going to the President.

SEC APPROVES CIRCUIT BREAKER RULE

In response to the May 6th stock market plunge, for which there is still no agreed-upon explanation, the SEC approved a new rule changes this past Thursday. National securities exchanges and the Financial Industry Regulation Authority will now be required, potentially as soon as Friday, June 11th, to implement circuit breakers that will temporarily halt trading in an individual stock if the price moves ten percent or more in a five-minute period. SEC Chair Mary Schapiro made a statement about the new rule, stating that these circuit breakers will "uniformly pause[] trading in a given security across all venues... [and] ensure that all markets pause simultaneously and provide time for buyers and sellers to trade at rational prices."

For now, the circuit breaker implementation will be on a pilot basis until December 10th, and when used will halt trading on an affected stock for a period of five minutes to allow new trading interests to be attracted and a reasonable market price to be established. Although many called for circuit breakers to apply to exchange-traded funds ("ETF's"), which were disproportionately impacted on May 6th, the SEC is holding off until the pilot program is fully evaluated. In the meantime, SEC staff will also be studying the risks of market orders and "stub" quotes (bids not intended to indicate actual trading interest because of

their large deviation from an exchange's best offers. SEC staff plans to study trading protocol at other exchanges, and will be working with FINRA as well.

FCIC SUBPOENAS GOLDMAN

On Monday, the Financial Crisis Inquiry Commission (FCIC) announced that it subpoenaed Goldman Sachs Group Inc., because the bank holding company ignored the FCIC's initial request for documents and interviews. The announcement did not specify the nature of the information being sought. The FCIC began its analysis of the financial crisis in May 2009, and since then has been criticized for its lack of actual impact or vindication for those adversely affected by the crisis.

The FCIC's subpoena comes on the heels of the Senate Permanent Subcommittee on Investigations recent scrutiny into Goldman's actions leading up to the financial crisis. Goldman CEO had testified before that Subcommittee earlier this year, at which point he defended his firm as being a market maker and acting in its clients' best interests. The Subcommittee also published emails and other documents as evidence that Goldman took short positions against the housing market, as it was simultaneously selling mortgage-backed securities to its customers.

G-20 REMAINS COMMITTED TO NEW CAPITAL FRAMEWORK

After meeting in Busan, South Korea, a public statement was released by the G-20 on June 5th, asserting that the member countries remain committed to stronger capital and liquidity standards. The group called on the Basel Committee on Banking Supervision to create draft capital, liquidity and leverage rules before the G-20 meets again in Seoul, this November. The G-20 could not reach agreement on an across-the-board bank bailout tax, but Treasury Secretary Timothy Geithner stated that progress was still made at the summit. He also said that the new rules would be implemented over a transition period through 2012.

Aside from the new capital and liquidity standards, the G-20 also reached agreement on the need for global accounting standards; the need for more transparency, regulation and supervision of hedge funds, credit rating agencies, pay packages and derivatives; and the need to address non-cooperative jurisdictions. Geithner specifically singled out countries in a post-summit statement, asserting that "the ongoing shift toward higher saving in the United States would need to be complemented by strong domestic demand growth in Japan... together with a more flexible exchange rate policy, in China.

The G-20 will be meeting again later this month in Toronto, and the fiscal and economic agendas for that summit were laid out in Busan.

UPCOMING HEARINGS

On Tuesday, June 15th at 10am, the House of Representatives will meet on the floor to address legislative business, and following that, it could consider H.R. 5297, the Small Business Lending Fund Act of 2010, and H.R. 5486, the Small Business Jobs Tax Relief Act of 2010.

On Tuesday, June 15th at 11am, in 2128 Rayburn, the House and Senate conferees will meet to consider legislation that would revise financial regulation. The conference will be ongoing until a resolution is reached.

On Tuesday, June 15th at 2pm, in 1100 Longworth, the House Ways and Means Subcommittee on Select Revenue Measures will hold a hearing on H.R. 4337, the Regulated Investment Company Modernization Act.

On Wednesday, June 16th at 2:30pm, in 192 Dirksen, the Senate Appropriations Subcommittee on Financial Services and General Government will hold a hearing on federal payment of interchange fees, focusing on how to save taxpayer dollars.