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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

June 4, 2012

Leading the Past Week

The downward spiral of negative news continued to pick up steam last week. First, there were growing concerns about the future stability of the Euro zone as the economies of Greece and now Spain continue to raise red flags. Next, following the problems associated with Facebook's much ballyhooed IPO, concerns about the general health of global equity markets surfaced as other IPOs were postponed or indefinitely delayed. Then on Friday, an anemic jobs report hit the wires, compounded by the first downward revision of the previous month's report in some time, only further served to depress markets.

Legislative Branch

House of Representatives

House Financial Services Committee Examines Cybersecurity Concerns for Industry:

On Friday, June First, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises held a hearing on cyber security, focusing on the threats to capital markets and corporate accounts. Chairman Garrett expressed his strong support for preventing cyber-attacks while protecting consumer's privacy rights. The hearing focused on the various types of cyber-attacks that could impact capital markets and corporate accounts, the differences between those attacks and what steps could be done, both by government and the private sector to address and prevent them. In addition, because one of the witnesses was the Chief Information Security Office for NASDAQ OMX, the panel briefly delved into the Facebook IPO, allowing NASDAQ to once again announce that a technical glitch and not a cyber-attack, was the cause of the problems associated with Facebook's IPO last month.

House Financial Services Committee Passes Technical Correction to Benefit Emigrant Bank:

On Thursday, the House Financial Services Committee voted 35-15 for H.R. 3128, which would adjust the date regulators must use for determining whether a bank falls under the exemption

from a Dodd-Frank section that prevents larger lenders from counting certain securities as part of their tier 1 capital. The bill generated some media attention because it appears to only benefit one institution, Emigrant Bank, of New York City. According to the sponsor of the legislation, Republican Committee member Michael Grimm, this measure prevents the bank from having its tier 1 capital fall by \$300 million. The bill amends Section 171 of Dodd-Frank, known as the Collins Amendment, which lets banks use trust preferred securities as tier 1 capital only if they have assets below a \$15 billion threshold. Under Dodd-Frank they need to have met this threshold by December 31, 2009, while H.R. 3128 would push the date to March 31, 2010. It is unclear when and if, either the full House or the Senate will take up this legislation.

Frank Introduces Legislation to limit “Clawback Insurance” -- is Legislation to Increase SEC Penalties Next: On May 30th House Financial Services Committee ranking member Barney Frank (D-Mass.) introduced, H.R. 5860, which if enacted would bar executives of financial firms subject to compensation clawbacks or civil penalties from insuring or otherwise “hedging” against personally fulfilling their obligations to comply with such remedies.

Congressman Frank was joined by Congressman Waxman and Congressman Collin Peterson, the top Democratic members on the Energy and Commerce and Agriculture Committees respectively, in introducing a bill to “protect the intent” of the Dodd-Frank Act which requires, or authorizes regulators to require clawbacks of compensation and the imposition of fines against those found to violate the law. There are several provisions in Dodd-Frank that specifically address executive compensation, including Section 954 which requires public companies to craft compensation clawback policies or be barred from listing on an exchange and Section 956, which prohibits incentive-based executive compensation that exposes financial firms to risk.

While it is unlikely that the Republican controlled House will take up this legislation it is also unclear whether Frank is done legislating in this area. A Bloomberg report in advance of the introduction of the claw back bill indicated that Frank may also be working on legislation to increase and stiffen the penalties that the SEC can issue in response to complaints by some that the current SEC penalty structure is not strong enough to deter nefarious activity.

Senate

Was not in Session

Executive Branch

CFPB

CFPB Seeks Additional Comments on “Ability to Repay” Component of QM Rule:

The CFPB announced it is seeking public comment on new data and information that it has received in a rulemaking to require lenders to assess consumers’ ability to repay mortgage loans before extending them credit. Among other things, the notice indicated that the CFPB is seeking data on the relationship between ability to repay and other potentially relevant factors such as borrowers’ cash reserves. The CFPB received approximately 1,800 comments during the initial comment period that had ended— and several more letters from industry groups and lawmakers since then— however, the bureau has decided to request additional public comments

until July 9. The CFPB has said it expects to issue the final rule before the end of the year in order to comply with Dodd-Frank's requirements that it be completed by January 2013.

US PIRG Urges CFPB to Pay Closer Attention to Relationship Between Universities and Card Companies:

On May 30th the U.S. Public Interest Research Group (US PIRG) related a [report](#), identifying nearly 900 payment card partnerships between colleges and financial services providers that it says demand closer scrutiny by the Consumer Financial Protection Bureau (CFPB) and other regulators because of excessive account fees and other practices. The report noted that "co-branding" arrangements, in which checking accounts and prepaid debit cards are linked to student IDs, are becoming increasingly common at schools for the disbursement of financial aid and other student activities, with a current market of about 9 million students. US PIRG expressed concern about such arrangements, particularly what they viewed as the lack of transparency about the terms and fees associated with the products, as well as the contracts between the schools and card providers in which fee revenue is often shared.

The report noted that unlike previous arrangements where students received their aid by check, students who now receive their aid via cards are charged fees, including per-swipe fees of \$0.50, inactivity fees of \$10 or more after 6 months, and overdraft fees of up to \$38. Currently, the Department of Education requires banks that disperse federal student aid to provide conveniently located ATMs with no fees, but according to US PIRG, neither of those terms are appropriately defined, and they note that often schools have just one ATM from the card-issuing bank, resulting in long lines and no alternatives if the teller breaks or runs out of cash.

The report concludes that the CFPB should strengthen protections to students under the Electronic Funds Transfer Act (EFTA) and Truth in Lending Act, an action that the Bureau may ultimately engage in since it recently issued an advanced notice of proposed rulemaking on a broad range of prepaid cards, including Reg E.

CFTC

CFTC Holds First Volcker Rule Implementation Meeting Since JP Morgan Event:

On Thursday the CFTC held its first meeting to discuss the implementation of section 619 of the Dodd-Frank Act, more commonly known as the Volcker rule. This was the first meeting since JP Morgan Chase announced it had lost at least \$2 billion dollars on a single trade. The hearing was planned before the news about JP Morgan transformed the debate on the Volcker rule, and interestingly, representatives from JP Morgan, Goldman Sachs and Morgan Stanley were originally scheduled to participate but then subsequently declined, instead allowing SIMFA to testify instead. Ultimately, there were two panels, with one including Sheila Bair, who indicated that in crafting the final rule regulators must be able to ensure that Banks separate risk-taking from compensation and continued to take swipes at a broad exemption for hedging. Following the meeting, it was announced that a staff-led roundtable discussion would take place on June 5th to continue the discussion on how to best implement the Volcker rule.

Despite Rampant Speculation, O'Malia Hasn't seen Extra-Territorial Guidance:

Although there has been rampant speculation, especially in the aftermath of the JP Morgan trading loss, that the CFTC would strengthen its extraterritorial reach, during a speech to the MarkitSERV2012 conference on May 31st, Commodity Futures Trading Commissioner Scott O'Malia stated he hadn't seen any guidance, and in fact, he had not "even reviewed a draft" of any document that would provide insight into how the Commission intends to implement its Dodd-Frank rules overseas.

Nonetheless, O'Malia offered some of his own insight into how he expects the proposed interpretive guidance to be among the next actions taken by the commission, and offered several predictions about what will be addressed. Specifically, he said he expected the commission to propose language covering; (1) which foreign persons will have to register as swap dealers and major swap participants; (2) what Dodd-Frank requirements will apply to swap dealers and major swap participants; (3) when the commission will defer to comparable foreign regulatory regimes and permit swap dealers and major swap participants to be overseen through substitute compliance; and (4) how certain Dodd-Frank mandates—including those involving clearing, trade execution, and certain provisions—will apply to cross-border transactions involving non-swap dealers and non-major swap participants. O'Malia also said the proposal, when released, should focus on four key areas: principles of international comity, international harmonization, a sound cost-benefit analysis; and ensuring U.S. competitiveness.

National Futures Association Proposes New Financial Requirements for Futures Commission Merchants:

On May 29th, the National Futures Association ("NFA") issued a press release announcing that it had submitted a new proposal to the CFTC for how to set the financial requirements for its members. The changes were made in response to the MF Global bankruptcy and contained four major changes. First, each merchant would have to "target" an amount, either on a percentage or a dollar basis that it seeks to maintain as a residual interest in its customer segregated funds. Second, unless a merchant had obtained written pre-approval by a high-ranking firm officer, they will be precluded from withdrawing, transferring, or otherwise disbursing funds from any customer segregated account in an amount exceeding 25 percent of the firm's residual interest amount. Moreover, in the event of any approval, the firm would be required immediately to file a notice regarding the disbursement with NFA. Third, the proposed rule sets forth an increased notification requirement on the firm when notifying NFA of this transfer, and finally, all futures commission merchants would have to provide NFA with certain financial and operational information on a monthly or semi-monthly basis. According to the proposed rule, the NFA intends to make some of that information available to the public. All of these proposed requirements would also apply to foreign futures and options customer secured amount funds accounts.

SEC

Schapiro Rumored to be Open to Allowing Money Market Mutual Funds to Charge Fees for Withdrawals made During Liquidity Crisis:

Bloomberg reported that SEC Chairwoman Mary Schapiro was considering allowing money-market mutual funds to charge a fee on customers who take out money from the funds during a liquidity crisis as an alternative to a pending SEC proposal that would completely prevent redemptions for thirty days should the fund face a liquidity crisis. If enacted, this fee could be seen as a compromise that would allow the SEC to move forward with one of its pending proposals dealing with money market funds, as the Commission has struggled to come to a majority decision on the issue, although Democratic Commissioner Luis Aguilar, who is viewed as uncommitted on many of the pending money market regulations has not indicated whether or not he would support this fee proposal. In addition, it is unclear how this compromise, if enacted, would impact efforts by the Chamber and others to beat back all of Chairwoman Schapiro's proposed regulations on money markets.

GAO urges SEC to Make Improvements Regarding its Oversight of FINRA While POGO Criticizes Legislation to Create SRO for Investment Advisers:

On May 30th the Government Accountability Office (GAO) released a report that concluded that the Securities and Exchange Commission should encourage the Financial Industry Regulatory Authority to examine its existing regulations, and should establish a plan for monitoring the self-regulatory organization's efforts. According to GAO, the SEC's oversight of FINRA has varied, with some programs and operations receiving regular oversight and others receiving limited or no oversight." For example, GAO said that while the commission regularly reviews FINRA rule proposals subject to its approval, neither the SEC nor FINRA conducts retrospective review of FINRA regulations. However, the report was particularly critical with regard to the SEC's oversight of FINRA's work in governance and executive compensation.

Also this week, the Project on Government Accountability (POGO) sent a letter to leaders of the House Financial Services Committee criticizing legislation, H.R. 4624 that would make FINRA or another organization a self-regulatory organization (SRO) for investment advisers. Stating that "POGO believes there is no substitute for governmental regulation of the investment adviser industry," the group went out to echo some of the concerns of the GAO report, saying that "instead of delegating additional authority to private self-regulatory groups, Congress should reduce the SEC's current reliance on FINRA and other SROs, work to improve FINRA's transparency and accountability policies, and provide sufficient funding to the SEC to ensure that it is able to carry out its important regulatory duties on its own."

The underlying legislation, which is sponsored by Committee Chairman Bachus and Rep. Carolyn McCarthy (D-NY) is predicated on an SEC study that found that it lacked the appropriate resources and that there should either be a SEC oversight mechanism funded through user fees or a self-regulatory oversight authority for investment advisers and is scheduled for a legislative hearing this coming week.

Federal Reserve Board

Fed to hold meeting on Regulatory Capital Framework:

This past week the Federal Reserve announced it will hold a public meeting on June 7th at 3:30 p.m. to discuss proposed interagency rulemakings on strengthening and harmonizing the regulatory capital framework for banking organizations, including proposed rules for implementing Basel III for banking organizations and proposed consolidated capital requirements for savings and loan holding companies. It was also announced that during this meeting the agency will discuss final interagency rulemaking on market risk capital rule.

International

European Commission Proposes "Banking Union" to Solve Financial Crisis:

On May 30th, the European Commission proposed that the Eurozone should evolve into a "banking union" with joint supervision and a common deposit guarantee as a way to keep the euro zone together. However, to cut the links between banks and governments, the Commission also proposed that the euro zone's bailout fund, the European Stability Mechanism, should be allowed to recapitalize European banks directly, avoiding the current obligation of channeling rescue aid through governments. The proposal came amid a growing crisis in Spain and Cypress, and a closely watched election in Ireland about whether to support an EU deficit fighting treaty.

UPCOMING HEARINGS

On Wednesday, June 6th at 10am in 2128 Rayburn the House Financial Services Committee will hold a hearing on H.R 4624, the Investment Adviser Oversight Act of 2012.

On Wednesday June 6th, at 10am in 538 Dirksen the Senate Banking Committee will hold a hearing on "Implementing Wall Street Reform: Enhancing Bank Supervision and Reducing Systemic Risk

On Wednesday, June 6th at 2:00pm in 2128 Rayburn the House Financial Institutions Subcommittee will hold a hearing on "An Examination of the Federal Reserve's Final Rule on the CARD Act's 'Ability to Repay' Requirement."