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## FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

July 23, 2012

### Leading the Past Week

Last week marked the second anniversary of the Dodd-Frank Act, but instead of presents, the House of Representatives marked the occasion with a continuing series of hearings aimed at exposing the flaws of the measure. Bookending this was the admission of Goldman Sachs CEO Lloyd Blankfien that the law did more good than bad. Regardless of one's perception of the impact of Dodd-Frank, the fact remains that the law has been implemented slowly. As we hit the two year mark, 221 rulemaking deadlines having passed, but only 85 of those rulemakings have concluded with final rules being implemented, as 136 of the deadlines have been missed. Outside of Dodd-Frank the threat of sequestration and the looming "fiscal cliff" continued to dominate as Fed Chairman Ben Bernanke appeared before both Chambers to provide his semiannual report to Congress, and spent considerable time touching on the need for Congressional action on the fiscal cliff, continued stressors from Europe and the need for LIBOR reforms. Interestingly as scrutiny intensifies over the LIBOR rigging scandal, it came to light that Congress appears to have neglected to call on the three US banks (Bank of America, Citigroup and JPMorgan Chase) as part of its investigation into the manipulation of the benchmark rate.

### Legislative Branch

#### **Senate**

*Bernanke Sours on Economy, Reiterates Call for Congress to Act Before Driving Country off Fiscal Cliff in Semiannual Report*

On July 17<sup>th</sup>, Fed Chairman Ben Bernanke **offered** an increasingly unoptimistic assessment of the US economy, citing reduced job creation, diminished consumer spending, slowing manufacturing sector output and weaker business conditions. Underscoring the signs of an economic slowdown, Bernanke reiterated his earlier calls for Congress to act to resolve the looming fiscal cliff. And while Bernanke deferred from indicating whether the Fed would be

implementing more quantitative easing to boost the recovery, it did not prevent lawmakers from offering guidance in advance of the next FOMC meeting at the end of the month, as Democrats on the Banking Committee expressed hope for more easing, pointing to high unemployment and low inflation as rationale for further Fed action. While the Fed recently updated forecasts to reflect unemployment hovering at 7 percent or more through 2012, Bernanke warned that things could still worsen if the European sovereign debt crisis deepens.

In addition to insisting Congress act to resolve the fiscal cliff, Bernanke said he would like to see additional reforms aimed at the “structurally flawed” LIBOR rate standard. Acknowledging that LIBOR is a critical benchmark for many financial contracts, he did note that there were alternative benchmarks, such as repo rates, the overnight index swap rate or other types of interest rates could be used in lieu of LIBOR. Moreover he noted that reforming LIBOR will require a concentrated international effort focused on increasing transparency and monitoring and reducing the ability of banks to affect the rate. (More below on Bernanke’s House testimony)

#### *Gensler Testifies on Peregrine Financial Scandal*

On July 17<sup>th</sup>, CFTC Chairman Gary Gensler appeared before the Senate Agriculture Committee to discuss Peregrine Financial Group and the alleged embezzlement of nearly \$220 million in segregated customer funds. The hearing, originally intended to focus on the implementation of the Dodd-Frank Act, instead turned to Peregrine and possible parallels to MF Global scandal earlier in the year. Describing the CFTC’s response to the scandal, Gensler told lawmakers the CFTC still is reviewing the National Futures Association’s (NFA) handling of its oversight duties and CFTC’s oversight of the SRO. Gensler also clarified that the misappropriation of funds at Peregrine was a crime, involving falsified bank statements and forged signatures.

Lawmakers expressed concern that the Peregrine case, on the heels of MF Global, was indicative of regulatory shortcomings and gaps. Even traditionally strong supporters of the CFTC, such as Chairman Debbie Stabenow (D-MI), noted that the cases “point to regulatory gaps” at the NFA and CFTC. While Senator Tom Harkin (D-IA) criticized the NFA by saying it was “mind-boggling” that regulators and the SRO were unable to uncover years of fraud. In response to such criticism, Gensler noted that while the SRO system is embedded in the Commodity Exchange Act (CEA), the Commission is not funded to sufficiently serve as the regulator in place of the dues-funded NFA. When asked by Senator Amy Klobuchar (D-MN) whether he has confidence in NFA, Gensler responded that there was room for improvement. Finally, in a question related to the hearing’s original scope, Gensler clarified for Ranking Member Pat Roberts (R-KS) that the CFTC, in response to public comment, is seeking to clarify through interpretive guidance how Dodd-Frank derivative rules will impact non-US entities and activities outside the US.

Lawmakers on the panel also heard from private sector witnesses who demonstrated a divide between industry groups and consumer organizations. Two futures industry groups, the International Swaps and Derivatives Association (ISDA) and Bunge North America, stressed to lawmakers that the length of the implementation process, contradictory rulemakings and

treatment of certain issues, such as inter-affiliate swap transactions, recordkeeping requirements and position aggregation have been “problematic.” CEO of ISDA Robert Pickel told lawmakers the rulemaking process could be improved by: prioritizing “systemically important” rules; better sequencing rules; ensuring international harmonization; and requiring adequate cost-benefit analysis. Meanwhile, consumer groups such as Better Markets cautioned lawmakers against looking at “a couple of discrete parts” of the financial reform and considering them out of context with the full law.

#### *Report Shows only \$51 Billion Separates Parties on Tax Plan*

Even as the Joint Committee on Taxation released new information indicating Democrats and Republicans differences on taxes is a mere \$51 billion apart, Senate Democratic leaders announced they are eliminating a provision that would tax wealthy estates. The move is being characterized as an effort to increase support for President Obama’s election year tax plan as Democratic Caucus members were divided over the level at which to tax estates transferred after a person’s death. The move means that the debate over taxes will focus primarily on the question of whether to extend Bush era tax at 35 percent for the top 2 percent of earners or let them increase to the 39.6 percent level. Based on the cross speak of the rhetoric, it doesn’t appear that either side is read for a deal as Senator Orrin Hatch (R-UT) said the President is threatening “to melt down our economy for what amounts to less than three days of federal spending;” while Democrats maintain that Republicans are holding the middle class “hostage” while supporting tax cuts for the wealthy.

#### *Investigations Subcommittee Examines Money Laundering and HSBC*

On July 17<sup>th</sup>, the Senate Homeland Security and Government Affairs Permanent Subcommittee on Investigations met to hear testimony from HSBC officials on money laundering vulnerabilities. The hearing came the day after the panel released a report documenting eight years of anti-money laundering (AML) shortcomings at HSBC Bank USA, HSBC affiliates in Mexico and the Middle East and at the London global headquarters. The report highlights that HSBC established a US branch so as to service non-US clients—which Chairman Carl Levin (D-MI) pointed out opened the door to money laundering, drug trafficking and terrorist financing threats. Echoing Levin’s comments, Ranking Member Tom Coburn (R-OK) stressed that customers should be guaranteed privacy and safety when banks grow. In his testimony, HSBC Global Compliance Chief David Bagley told lawmakers that there were “significant errors” and in a stunning turn of events announced his resignation. Still, not all of the HSBC witnesses were as contrite, as Christopher Lok, former head of Global Bank Notes at HSBC USA, defended his decision to override AML compliance and staff recommendations when opening an account for a Chinese bank.

#### *Levin Calls on SEC to Reject Copper ETF Proposal*

In a July 16<sup>th</sup> [comment letter](#) to the SEC, Senator Carl Levin (D-MI) voiced strong concerns about NYSE Arca Inc.’s proposal to list and trade shares of copper-linked exchange traded fund (ETF). Levin asked the SEC to deny the [proposed change](#), citing “ample evidence that the proposed ETF will disrupt the market supply of copper by removing from the market a substantial percentage of the copper available for immediate delivery.” Levin, a vocal critic of

commodity speculators, expressed his fears that the ETF would result in a reduction of the supply of copper which would impact the cash and futures market for copper with attendant increases in volatility and price.

## **House of Representatives**

### *Bernanke Presents Assessment of US Economy Before House*

The venue may have changed but the message stayed the same on July 18<sup>th</sup>, the day after he appeared before the Senate Banking Committee, Bernanke testified in front of the House Financial Services Committee, where he reiterated his concerns about slowed economic growth. Bernanke's defenses of the Fed's bond-buying stimulus lead some economists to speculate that a third round of quantitative easing could be on the way. Similar to his previous testimony from the Senate, Bernanke pointed to federal budget uncertainty and economic risks from Europe as the two primary causes of slowdown and future risk to the US economy. In other remarks, Bernanke spoke against legislation (H.R. 459) sponsored by Representative Ron Paul (R-TX) that would expand audits of the Fed's books. Nonetheless, this bill is scheduled to be before the House this week, and it will be considered under the suspension calendar—generally reserved for “non-controversial” issues.

### *Financial Services Subcommittees Meet to Examine Dodd-Frank and the CFPB's Effect on Credit*

On July 19<sup>th</sup>, Raj Date, Deputy Director of the CFPB, testified before the Financial Institutions and Consumer Credit Subcommittee, assuring lawmakers that the Bureau will be issuing a “sensible” qualified mortgage (QM) rule, taking into account the still struggling housing market. Date stressed the Bureau is seeking to “minimize compliance burdens” while encouraging a competitive market that appropriately calibrates risk and price. Date's appearance came one week after Chairwoman Shelley Moore Capito (R-WV) and Representative Brad Sherman (D-CA) wrote to the CFPB requesting that the CFPB include a “safe harbor” for home loans meeting QM standards. Deputy Director Date touched on the market implications of the QM rule and the need to preserve access to mortgage credit. Similarly, Representative Sean Duffy (R-WI) expressed concern about the impact of the QM rule and other mortgage regulations on smaller lenders. However, while many remain skeptical of the QM rule, Democrats criticized their Republican peers for organizing hearings aimed at tearing down the benefits of the Dodd-Frank Act. Specifically, Representative Brad Miller (D-NC) lauded the QM rule for ending abuses in the housing market.

The hearing came that same day as the House Financial Services Subcommittee on Oversight and Investigations heard from community bank officials on their concerns with the rule's impact. Eight community banker executives testified at the Subcommittee hearing, all save one testifying that the compliance burden as a result of the Dodd-Frank Act has been “overwhelming”

### *House Financial Services Subcommittee Examines Impact of Dodd-Frank on Municipal Finance*

At a July 20<sup>th</sup> House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises hearing, witnesses spoke to concerns with the definition of “municipal adviser.” The SEC has proposed a [rule](#) requiring the registration of municipal advisors; however,

several witnesses at the hearing urged the SEC to consider narrowing the definition. Specifically, a witness from the Securities Industry and Financial Markets Association (SIFMA) stressed that “the SEC has not provided any justification or basis for treating investment banking services as municipal adviser activity.” Representative Robert Dold (R-IL) has already introduced legislation (H.R. 2827) to amend Dodd-Frank Section 975 and clarify the statute regarding the definition of municipal advisor.

#### *House Approves Sequester Report Legislation*

In an overwhelmingly favorable vote, the House advanced legislation that would require the President to report to Congress the estimates of the needed dollar and percentage cuts for each budget account necessary to meet sequestration targets. The Sequestration Transparency Act (H.R. 5872) passed the Chamber in a 414 to 2 vote. A somewhat similar provision was approved in the Senate by voice vote as part of the farm bill (S. 3240) and would require more detail on the potential impact of defense and non-defense sequestration cuts. Nevertheless, the fate of the House bill is uncertain in the Senate. Senator John McCain (R-AZ) who, with Senator Patty Murray (D-WA) is a supporter of the provision expressed preference for the Senate’s language. Speaking on the impasse, a Republican House aide said the Senate provision may ask for more than can be provided in a timely manner. However, with the farm bill not moving before the end of the fall harvest, it is unclear whether there will be any substantive effort to move this measure further.

#### *McHenry Calls on Industry to Address Crowdfunding Rule with SEC*

On July 13<sup>th</sup>, Representative Patrick McHenry (R-NC), author of the crowdfunding provisions in the Jumpstart Our Business Startups (JOBS) Act, spoke to industry leaders at a Crowdfund Intermediary Regulatory Advocates Conference where, among other things, he urged industry leaders to reach out to the SEC to “inform” the rulemaking process. McHenry also stressed that his crowdfunding measure was meant to encourage “light-touch regulation” that would ensure low costs but the Senate added “cumbersome and unnecessary language that runs counter to a vibrant crowdfunding marketplace.” Specifically, McHenry cited concerns with a provision requiring background checks for the officers and directors of crowdfunding issuers and a provision on how much an individual investor can invest in a crowdfunded security—expressing fears the SEC will have to clarify the requirement so that investors know how much they may invest: \$2,000 or 5 percent of annual income. McHenry also expressed fears that the SEC could hamper the market by promulgating rules that are too stringent and pledged to work toward “technical correction” to the law in addition to seeking a higher cap for crowdfunding transactions. Finally, McHenry warned that there are likely to be delays in SEC implementation.

### Executive Branch

#### **Treasury**

##### *FSOC Designates Eight Financial Market Utilities as Systemically Important*

On July 18<sup>th</sup>, the Financial Stability Oversight Board (FSOC) voted to designate eight financial market utilities as systemically important. The designations are the first to be made by the Council and include: The Clearing House Payments Company LLC, CLS Bank International, Chicago Mercantile Exchange, The Depository Trust Company, Fixed Income Clearing

Corporation, ICE Clear Credit LLC, National Securities Clearing Corporation, and The Options Clearing Corporation. The move was not a surprise, as witnessed by the public comments of those impacted. For example, Chip Savidge, Vice President of Marketing and Communications for the Clearing House Interbank Payments System (CHIPS) noted that “CHIPS has long been considered to be a systemically important payment system.” Future designations of other financial services institutions, such as insurance companies and mutual funds, are likely to be more controversial.

## **CFPB**

### *Bureau Finalizes Supervision Authority over Credit Reporting Market*

In a [final rule](#) released July 16<sup>th</sup>, credit reporting companies that track consumer credit history and other transactions will be subject to regular examinations and data reporting requirements. Under the final rule, the CFPB will have authority to supervise consumer reporting agencies with more than \$7 million in annual receipts from consumer reporting activities. Regulations allowing monitoring and sit examinations by the Bureau take effect September 30<sup>th</sup>. The rule is the first in a series of rulemakings to define “larger participants” in certain nonbank markets. In February 2012, the CFPB proposed supervising the “larger participants” in the consumer and reporting and debt collection markets and the Bureau is expected to finalize additional “larger participant” rules in place by the end of the year. Speaking on the rule at a credit reporting field hearing in Detroit, Bill Sermons, Director of Research at the Center for Responsible Lending, told Director Richard Cordray that, given the “significant risk” credit reports can pose to consumers, the CFPB should “set the expectation of zero errors.”

### *CFPB Issues First Enforcement Order Using UDAP Authority: Capital One Hit With \$25m Fine*

On July 18<sup>th</sup>, the CFPB [announced](#) its first [enforcement action](#) targeting Capital One Financial Corporation for deceptive marketing practices related to certain credit card ‘add-on’ features such as payment protection and credit monitoring. The enforcement order was derived from the Bureau’s authority under Section 136 of the Dodd-Frank Act to take action against “unfair, deceptive, or abusive practices.” The enforcement action was coordinated with the OCC, who released a separate [consent order](#) requiring Capital One Bank to stop the sale and marketing of added services and assessed a \$35 million penalty. Notably, in announcing the consent order, CFPB officials indicated that similar enforcement actions will likely be forthcoming.

## **CFTC**

### *CFTC Technology Advisory Panel to Meet on Segregated Customer Accounts*

On July 26<sup>th</sup>, the CFTC’s Technology Advisory Committee will hold a [public meeting](#) to explore technology challenges and possible solutions to the ability of regulators and futures merchant customers to verify the location and status of funds in segregated customer accounts. The problem of customer segregated funds protection first came to light following the MF Global failure and has continued to be a point of contention in the Peregrine Financial Group case. Announcing the meeting, Commissioner O’Malia, chair of the Committee, said regulators “need to develop technological solutions that enable real-time detection and automated alerts of unauthorized transfers of customer funds.”

## **Federal Reserve**

### *Fed Says Payment and Settlement Regulation Deserve “Rigorous” Supervision*

On July 19<sup>th</sup>, following the FSOC’s designation of eight financial market utilities as systemically important, the Fed **announced** that it will recognize critical reserve bank payments and settlement services should be subject to rigorous supervision. The announcement served to reaffirm, the Fed’s policy of applying relevant international risk-management standards to reserve banks’ Fedwire funds and securities services, or electronic payments and securities transfer services that banks, businesses and government rely on for same-day transactions. The Fed also affirmed that the examination framework used for Fedwire is consistent with the framework it will apply to the designated financial market utilities it will supervise.

## Miscellaneous

### *Credit Card Issuers and Retailers Reach Settlement on Interchange Lawsuit*

Last week, major credit card issuing banks, including Visa and MasterCard, agreed to settle a lawsuit alleging violation of antitrust laws when setting credit card interchange fees. Card issuers will pay retailers \$6.05 billion in the out-of-court settlement, which also includes a 10 basis point reduction in credit card interchange rates for eight months—an additional \$1.2 billion to retailers. The settlement also eliminates network prohibitions on retail surcharging customers for use of credit and charge cards at the point of sale, allowing a retailer to impose a checkout fee for the use of the card. Finally, the settlement would eliminate the ability of retailers to challenge network rules on point-of-sale issues—such as interchange price setting. Changes will likely go into effect late in 2012 or early in 2013.

## UPCOMING HEARINGS

On Tuesday, July 24<sup>th</sup> at 10am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Committee will hold a hearing titled “Housing Partnerships in Indian Country.”

On Tuesday, July 24<sup>th</sup> at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit will meet for a hearing titled “Examining Consumer Credit Access Concerns, New Products and Federal Regulations.”

On Tuesday, July 24<sup>th</sup> at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Insurance, Housing, and Community Opportunity will meet for a hearing titled “The Impact of Dodd-Frank’s Insurance Regulations on Consumers, Job Creators, and the Economy.”

On Tuesday, July 24<sup>th</sup> at 2:30pm, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Subcommittee on Financial Institutions and Consumer Protection will meet for a hearing titled “Private Student Loans: Providing Flexibility and Opportunity to Borrowers.”

On Wednesday, July 25<sup>th</sup> at 9:30am, in 2128 Rayburn, the House Financial Services Committee will hold a hearing titled “The Annual Report of the Financial Stability Oversight Council.”

On Wednesday, July 25<sup>th</sup> at 9:30am, in 1100 Longworth, the House Ways and Means Subcommittee on Oversight

On Wednesday, July 25<sup>th</sup> at 10am, in 1300 Longworth, the House Agriculture Committee will hold a hearing titled “Oversight of the Swaps and Futures Markets: Recent Events and Impending Regulatory Reforms.”

On Wednesday, July 25<sup>th</sup> at 1pm, in 2360 Rayburn, the House Small Business Committee will hold a hearing titled “Tales of Resilience: Small Business Survival in the Recession.”

On Thursday, July 26<sup>th</sup> at 10am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Committee will hear from Treasury Secretary Timothy Geithner, who will present the Financial Stability Oversight Council Annual Report to Congress.

On Wednesday, August 1<sup>st</sup> at 9am, in 328A Russell, the Senate Agriculture, Nutrition and Forestry Committee will hold a hearing on MF Global Holdings Ltd., a financial derivatives broker that filed for bankruptcy in 2011, focusing on accountability in the futures markets.