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FINANCIAL SERVICES REGULATORY REFORM UPDATE

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The growing chorus of those voicing concerns about the short deadlines and voluminous amounts of rulemakings necessary to implement the law appear to only be growing louder and stronger as the one-year anniversary approaches. Acting somewhat as a counterweight to those critics are those within both the Administration and Congress who have spoken about the potential consequences that could result from a hasty rulemaking process. However, this week saw a dramatic increase in the public statements from elected officials urging regulators to slow down and assess the impact on the financial industry before plowing forward. Despite the rise of this chorus, there have been no steps actively taken toward legislatively altering the Dodd-Frank mandated deadlines, leading some to conclude that certain Dodd-Frank deadlines may come and go without either final regulatory action or legislative relief.

Congress's attention continues to be focused on the economy and jobs, and House Republicans unveiled another continuing resolution (CR) proposal (a "stopgap funding" bill to keep the government running, until Congress can agree on an actual budget plan) earlier this afternoon. The current CR will fund the government through March 18th, at which point if Congress is unable to pass another CR or a full year funding bill it will shut down. Although the White House and Congress continue to negotiate a bill to keep the government operating for the rest of the year, it is likely that another short-term funding extension will be required to allow legislators and the Obama administration more time to negotiate a final agreement for the rest of FY2011 (which is nearly half over). We believe that both sides are using the need to clear a "debt ceiling" measure in mid-April to early May as the wall necessary to push for final passage of a year long budget measure.

OBAMA ATTEMPTS TO ALLAY FEARS ON OIL SUPPLY

In the past month, oil costs have increased by 40-cents per gallon, as a result of the turbulence in the Middle East and North Africa. In response, President Obama held a press conference on Friday to quell apprehension in both the public and the markets, stating his confidence in the United States' ability to "fill any potential gaps in supply." He clarified that rising costs are a result of political uncertainty in oil-rich regions, and not a result of a shortage in supply. Some Democrats have urged Obama to tap into the Strategic Petroleum Reserve in order to bring oil prices down, but the President does not believe that there has been a supply disruption or severe enough price increase to merit this release (analysts agree). Tapping into the reserve was created as an option after the 1973 oil crisis, and carries substantial economic and political risk. If utilized too soon, it could leave the Administration with few options in the future, and could spook oil markets, causing prices to increase even more. Republicans have taken this opportunity to criticize Obama's energy policies and their potential to harm the economy further, while Obama defended his administration's commitment to domestic oil production.

BACHUS TROUBLED BY "VOLUME AND PACE" OF DODD-FRANK RULEMAKING

House Financial Services Chair Spencer Bachus (R-AL) sent a letter to the heads of the Treasury, Federal Reserve, CFTC, SEC, FDIC and OCC on Wednesday, stating his concern with the "volume and pace of rulemakings under" Dodd-Frank. He asked each regulator to respond with the steps that their agencies are taking to ensure that the proposed rulemakings:

1. Provide comment periods sufficient to address the number of proposed rules and breadth of issues addressed by the rules,
2. Ensure consistency across agencies, and
3. Provide regulatory flexibility for small entities.

Bachus added eight lengthier questions to the end of the letter, requesting that the regulators address issues such as management challenges, the Paperwork Reduction Act, the length of comment periods and rulemaking deadlines.

Similarly, SEC Commissioner Troy Paredes spoke at a National Association for Business Economics conference on Tuesday, expressing his concern with SEC rulemaking that "to do so much so quickly is fraught with risk." He advocated for slowing down some of the Dodd-Frank rulemaking so that the agency can consider how the private sector is adjusting to all the reforms. Paredes was especially apprehensive about the SEC going too far, stating that "nobody benefits if the commission meets deadlines but the rules do more harm than good." He offered three suggestions for the SEC:

1. Solicit a full range of ideas and perspectives from interested parties, so that the agency can fully evaluate the practical consequences of choosing one course over another.
2. Ensure that regulations are supported by data, as a "way of disciplining regulatory decision-making."
3. Fashion a more incremental approach to regulatory reform, perhaps by delaying some measures to fully understand the effects on the private sector.

He made other suggests all with the goal of ensuring "that our regulatory initiatives do not introduce more problems than they solve."

CFTC COMMISSIONER CONCERNED ABOUT RULEMAKING INCONSISTENCIES WITH SEC

Jill Sommers, one of the Commodity Futures Trading Commissioners, spoke earlier this week about her fear that the CFTC's proposed swap execution facility (SEF) rule is "out of step" with the SEC and international regulators. As mandated by Dodd-Frank, the CFTC proposed a requirement on December 16th that SEFs establish systems or platforms giving market participants the ability to transmit a request for a quote when buying or selling a swap to five or more market participants. Weeks later, however, the SEC proposed a rule for SEFs to accommodate systems that provide market participants with the ability to send a single request for a quote to all participants in that system.

According the Sommers, the EU model, which is still under discussion, looks similar to the SEC's "single quote" system (which she favors). Sommers added that the CFTC is conflicting with other regulators with regard to position limits and conflicts of interest at derivatives clearinghouses and other entities. She joined the chorus of critics who have recently stated their frustration with the short deadlines imposed by

Dodd-Frank. She suggested extending comment periods for proposed rules that refer to terms that haven't been defined yet, and also advocated for a phasing-in of the implementation of final rules.

HOUSE STANDS READY TO ADDRESS INTERCHANGE FEES WAITING FOR SENATE TO ACT FIRST

House Financial Services Chair Spencer Bachus (R-AL) stated earlier this week that the House is ready to progress on a debit interchange fee bill, so long as the Senate is willing to engage as well. The Federal Reserve is required by Dodd-Frank to ensure "reasonable and proportionate fees" and broader network access for debit transactions, and thus proposed a set of rules including a 12-cent transaction fee cap. Banks and credit unions have responded with outrage, arguing that if the rules are finalized in April as planned, their industry stands to lose a hefty portion of its revenue streams. Because Senator Durbin and the filibuster remain a significant impediment to moving any legislative, Bachus is deferring to the Senate to act first. We are hearing that Senator Tester and Senator Corker are prepared to introduce a measure that will delay the interchange rule for two years and require the Fed to conduct a new study of the proposal. In the House, Rep. Shelley Moore Capito (R-WV) has appeared to have taken the lead, and may introduce her companion measure concurrently with Tester and Corker, but it is clear that the Senate will have to move something before the House will take up the issue.

Meanwhile, another campaign is mounting against the Fed's proposed rules. Legal and economic experts from the American Enterprise Institute and George Mason University School of Law are contending that the Fed has not conducted required competitive impact analysis under the 1978 Electronic Funds Transfer Act (EFTA). In a comment letter to the Fed, the authors stated that "this dramatic statutory and subsequent regulatory change will undoubtedly trigger a complex set of consequences for all firms participating in the payment system as well as for consumers purchasing both retail goods and financial services," thus requiring the Fed to conduct proper analysis.

The Office of the Comptroller of the Currency has also advocated for a more flexible approach by the Fed, because of the potential impact of the rules as enacted. The Acting Comptroller of the Currency sent a letter to the Federal Reserve last week, stating concern about the "long-term safety and soundness… for banks of all sizes," noting that Dodd-Frank gives the Fed much more room to maneuver in its rulemaking. The FDIC plans to send a letter to the Fed as well. The Fed, for its part, has also stated that it may not even be able to finalize the rule by April.

ATTORNEY GNERAL MARTHA COAKLEY CRITICIZES SEC FOR LAX ENFORCEMENT

Massachusetts Attorney General Martha Coakley sent a letter to the SEC last week, questioning the SEC's decision to issue two no-action letters to Ford Motor Credit Co in July and November of last year. She urged the Commission to fully enforce Regulation AB of the 1933 Securities Act, which requires issuers of asset-backed securities (ABS) to make certain disclosures. Last July, the SEC Division of Corporation Finance allowed ABS issuers to omit, for six months, certain credit ratings on their registration statements, and then in November the Division extended this relief indefinitely. According to Coakley, "the Dodd-Frank financial reform law rightly addressed [credit rating failures leading up to the financial crisis] by holding credit rating agencies to the same standards as accountants and lawyers… We are calling on the SEC to enforce these regulations as a way to protect investors and help prevent a future lending crisis." The SEC declined to comment before it responds to Coakley's letter.

SENATE BANKING COMMITTEE GRILLS SCHAPIRO ON FY2012 BUDGET

On Thursday, SEC Chair Mary Schapiro testified before the Senate Banking Committee's Securities, Insurance and Investment Subcommittee on the proposed FY2012 budget for her agency. Notably, Schapiro stated that if the SEC budget is rolled back to 2008 levels, as House Republicans have proposed, the agency would have to limit crucial travel, curtail the SEC's Dodd-Frank enforcement capabilities, halt technology transfer initiatives, and impose furloughs on a "significant number" of staff. The SEC's current budget (based on FY2010) is $1.111 billion, the White House requested $1.407 for FY2012, and the House spending bill (passed out of that chamber but rejected by the Senate) would only allocate $1.086 billion through FY2011.

Senator Jack Reed (D-RI), the second most senior member of the committee behind Chairman Johnson was one of 12 Democrat Senators to send a letter earlier this week to the Senate Appropriations Committee, requesting that the SEC and CFTC be funded for the rest of 2011 at least at the level approved by that committee in 2010 ($1.3 billion for the SEC and $261 million for the CFTC). In Thursday's hearing, he emphasized the importance of the SEC having the appropriate resources, although cautioning that the SEC must use these resources wisely. Ranking Member Michael Crapo (R-ID) was more equivocal, acknowledging that the SEC has been underfunded in the past, but adding that the debt crisis is requiring the entire federal government to be more efficient. He suggested an agency-wide review to determine how resources are being spent and whether any of them can be better utilized.

HOUSE COMMITTEE EXAMINES COVERED BONDS

The House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises held a hearing on Friday to consider legislative proposals to create a covered bond market in the U.S. Representatives from the U.S. Covered Bond Council, Ely & Company, the International Capital Market Association, the American Securitization Forum and the Bank of Alameda all testified, and the FDIC entered a statement for the record. The last panelist, from Bank of Alameda (a community bank), was the only one to testify in opposition to the covered bond market idea. Covered bonds are considered by many to be very safe investments because unlike mortgage-backed securities, they do not transfer ownership of specific mortgages to investors. A legal framework for this market was almost established in the Dodd-Frank Act, but Senate Democrats balked during the conference process because of concerns elucidated by the FDIC. The FDIC's main concern is that pools of mortgages would hamper its ability to carry out the resolution process for any individual mortgage. The Alameda CEO's main concern was that a covered bond market would favor big banks, but the other witnesses countered this by noting that community banks can create multi-bank cover pools to compete effectively, which is fairly common in Europe.

HOUSE GOP WORKING TO END FEDERAL HOUSING FINANCE AID

On Friday, House Republicans passed the Emergency Mortgage Relief Program Termination Act, by a nearly straight party-line vote of 242-177. Two Republicans crossed the aisle to oppose the bill, while eight Democrats supported it. The controversial legislation would shut down the Department of Housing and Urban Development's (HUD) Emergency Homeowner Loan Program, and would rescind all allocated but unobligated funds. A provision in the bill would redirect those funds to pay down the national debt. The Program was just created this past July in the Dodd-Frank Act, and allocated $1 billion for HUD to make zero-interest emergency mortgage-relief loan payments to unemployed homeowners who face foreclosure for up to one year (with the potential for HUD to extend the benefits for an additional year). According to bill sponsor Rep. Jeb Hensarling (R-TX), "the best foreclosure mitigation program in America is a job."

Although the House easily garnered the majority vote, the bill is not expected to move forward in the Democrat-controlled Senate, and President Obama has already stated that he would veto the bill if it ever came to his desk. Rep. Barney Frank (D-MA) plans to introduce an alternative bill next week that would resuscitate the Emergency Mortgage Relief Program by requiring the largest financial institutions foot the bill. He asserted that those responsible for the financial crisis and high unemployment should also be accountable for the ensuring foreclosures. Three other Republican bills are also on the table, including one that passed the House on Thursday, putting an end to the Federal Housing Administration's Refinance Program. The other two are expected on the House floor next week: one that would end the Home Affordable Modification Program (HAMP) and another that would lapse the Neighborhood Stabilization Program.

SEC OFFICIAL SAYS INVESTMENT ADVISOR EXAMINATIONS TO BE MORE EFFICIENT

At an Investment Advisers Association earlier this week, an SEC official (John Walsh, the chief counsel to Office of Compliance Inspections and Examinations) spoke about the more efficient and effective investment adviser examination process that was mandated by Dodd-Frank. Although rumors abound that a lack of resources will water down the quantity and quality of examinations, Walsh clarified that a newly efficient process will actually make on-site examinations *more* frequent. For example, new authority granted by Dodd-Frank gives SEC the ability request confirmation of an adviser's assets directly from entities subject to federal financial regulation that the adviser has a custodial relationship with.

Walsh noted that the SEC has a new deadline of 180 days to deliver examination results for on-site examinations, and that the SEC will be taking its document request compliance requirements very seriously. He forewarned advisers to pay attention to governance, conduct current compliance risk assessments, ensure employees understand their obligations, engagement senior management and/or the board of directors in compliance matters, and have a robust compliance program in place. The SEC is expected to release a manual to examiners in the near future, and plans to make the manual publicly available shortly afterwards.

TREASURY IN SLOW PROCESS OF CREATING OFFICE OF FINANCIAL RESEARCH

As required by Section 152 of Dodd-Frank, the Treasury Department is in the process of opening the Office of Financial Research (OFR), albeit at a slower speed than expected. The OFR will be an independent unit within the Treasury, conducting data collection and analysis in order to help policymakers determine risks to financial stability. Specifically, the OFR is charged with keeping the Financial Stability Oversight Council (FSOC) up to speed on any noteworthy activities by banks and nonbank financial firms, if the information might impact systemic risk. The firms subject to scrutiny have expressed concern with the new unit because of its authority to create new reporting and disclosure requirements. The disclosed information, while confidential, will also be subject to Freedom of Information Act requests.

Costs are also a concern for firms falling under the jurisdiction of the OFR. The new unit will be funded fully by the Federal Reserve Board until July 21, 2012, at which point funding sources will shift to assessments on bank holding companies with $50 billion or more in assets, and nonbank financial firms placed under Fed oversight by the FSOC. In the meantime, there are many questions to be answered about the set-up of the OFR, including its director and how it will fit into the operations of the Treasury Department. Dodd-Frank set no specific timelines for the unit's creation, and the FSOC may act without input of the OFR, so there may be no haste to set it up. We expect other Dodd-Frank mandates may take priority, though the OFR will serve an important role once it is fully functioning.

EU EXPECTED TO BAN NAKED SHORT SELLING AND SOME CREDIT DEFAULT SWAPS

On Monday, the European Parliament Committee for Economics and Monetary Affairs approved a report supporting a ban on naked short selling and the sale of non-collateralized credit default swaps (CDS) on sovereign debt. The financial services industry has lobbied heavily against these rules, which were not even present in the European Commission's over-the-counter derivatives regulatory proposal in 2010. However, both measures were widely supported in the Committee and are expected to be approved at the European Parliament General Assembly meeting in May. A Green Party member of the European Parliament defended the proposed regulations as necessary because of the havoc wreaked by sovereign debt speculation and the "damaging volatility and market disruption" caused by naked short selling.

If the measures garner a sufficient number of votes at the General Assembly meeting, they would then move on for a vote by EU member states in the Council of Ministers. Any differences between the Council and General Assembly versions of the laws would have to be resolved by a Conciliation Committee.

KPMG EXPRESSES CONCERN WITH NUMEROUS TAX IMPLICATIONS FOR NEW LAWS

KPMG released a survey of Fortune 1000 firm executives earlier this week, in which it found that many in the financial service industry are concerned with all the new responsibilities for banks and broker-dealers. KPMG cited the Foreign Account Tax Compliance Act (FATCA) and the Regulated Investment Company Modernization Act (RICMA), combined with the Dodd-Frank Act as "creat[ing] significant compliance, reporting and monitoring risks and consum[ing] resources as companies continue to move toward economic recovery." Specifically, FATCA creates cost basis reporting for mutual funds, stock brokers and others, which according to experts will make securities classification a crucial issue. Dodd-Frank will also carry many tax ramifications because of its new treatment of derivatives, bank capital requirements, securitization reform, and even say-on-pay.

UPCOMING HEARINGS

On Tuesday, March 15th at 10am, in 2128 Rayburn, the House Financial Services Committee will meet to consider its "Views and Estimates" report to the House Budget Committee.

On Tuesday, March 15th at 10am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Committee will hold a hearing titled "The Administration's Report to Congress: Reforming America's Housing Finance Market."

On Tuesday, March 15th at 1:30pm, in 2154 Rayburn, the House Oversight and Reform Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs will hold a hearing titled "State and Municipal Debt: The Coming Crisis (Part II)."

On Wednesday, March 16th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit will hold a hearing on "Oversight of the Consumer Financial Protection Bureau."

On Wednesday, March 16th at 2pm, in 216 Hart, the Senate Special Aging Committee will hold a hearing on securities lending and retirement plans.

On Wednesday, March 16th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises willing hold a hearing titled "Legislative Proposals to Promote Job Creation, Capital Formation and Market Certainty."

On Thursday, March 17th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Domestic Monetary Policy and Technology will hold a hearing titled "The Relationship of Monetary Policy and Rising Prices."

On a date TBA, in 2154 Rayburn, the House Oversight and Government Reform Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs will holding a hearing on "Small Business Lending Fund: TARP Dollars Redistributed to Incentivize Culture of Risk."