ML Strategies Update

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Financial Services Legislative and Regulatory Update

Leading the Past Week

What had been a relatively quiet week, where until Friday it seemed like the biggest news was that Treasury Secretary Jack Lew was working on his penmanship, was upended by revelations at the end of the week that the IRS had been targeting some conservative groups for extra scrutiny. This news and the attendant congressional backlash are sure to dominate the next week.

Outside of this growing scandal, the past week could have been framed by two bills that were respectively passed by the House and the Senate that may face difficulty becoming law. First, on Monday, the Senate passed legislation to change how taxes are collected on internet based retail, while on Thursday the House passed a bill to prioritize payments of principal and interest on debt should the U.S. reach its borrowing limit. Interestingly, the question of when the debt ceiling will be reached, and when it will become an issue appeared to come into better focus, as better than expected returns to the Treasury from Fannie and Freddie mean that although the ceiling will be breached on May 18th the country will be able to pay its bills through Labor Day. This news sets up the possibility for a very interesting end of July, as Congress is expected to take its annual August recess.

In other news, the SEC is reportedly circulating a much-anticipated draft of long-awaited reforms to the money market fund industry that appears to primarily target prime funds, and Chairman Bernanke said that additional capital requirements can help address bank vulnerability to shocks.

Legislative Branch

Senate

Senator Warren Introduces Student Loan Interest Rate Legislation

On May 8th, Senator Elizabeth Warren (D-MA) introduced her first piece of stand-alone legislation, a bill to allow students eligible for federally subsidized Safford loans to borrow at the same rate that banks are able to borrow at from the Federal Reserve discount window. Warren said that large banks can borrow from the Fed at rates of approximately 0.75 percent while on

July 1st the rate students pay on Stafford loans will increase to almost 7 percent.

Bloomberg Report Finds that Large Banks Receive Subsidy from Too Big to Fail Perception
In yet another attack against the nation's biggest banks, the June issue of Bloomberg Markets Magazine will include a comprehensive report about how large banks are operating at a competitive advantage based on a perception that they are "too big to fail." Among other things the report finds that large banks earned approximately $82 billion in subsidies between 2009 and 2011 because investors believe they are too big to fail.

House of Representatives
On May 7th, the House Financial Services Committee approved nine bills to amend the Dodd-Frank Act and the Jumpstart Our Business Startups (JOBS) Act. The Committee also passed legislation by voice vote to require the SEC to fully implement the JOBS Act by October 31, 2013 (H.R. 701) and to require savings and loan holding companies to register with the SEC (H.R. 801). The other bills considered by the Committee include:

- H.R. 742, to repeal the indemnification requirements for regulatory authorities to obtain access to data from swap entities (52-0).
- H.R. 1314, to direct the FSOC to study the differences between U.S. and other jurisdictions in implementing the derivatives credit valuation adjustment capital requirement (59-0).
- H.R. 634, to exempt non-financial companies using derivatives to hedge risk from Dodd-Frank margin requirements (59-0).
- H.R. 677, to exclude from the definition of "swap" any agreement, contract or transaction between affiliated entities under common control of the same parent company (50-10).
- H.R. 992, to repeal all regulatory provisions except a subsection prohibiting a taxpayer bailout of swaps entities (53-6).
- H.R. 1256, to direct the SEC and CFTC to issue joint rules on swaps and security-based international swaps (48-11).
- H.R. 1062, to require the SEC to conduct cost-benefit analyses of all future rulemakings (31-28).

At the markup, Chairman Jeb Hensarling (R-TX) touted the bipartisan nature of a number of the bills and hoped the Committee would continue to work to improve the Dodd-Frank Act. Still, Ranking Member Waters (D-CA) voted against several of the bills, including H.R. 677, H.R. 1256, H.R. 992, and H.R. 1062, all of which had the support of other rank and file Democrats, which some in the press cited as a potential divide in the minority on these issues. The chance for large bi-partisan support for those measures going forward could be muted as Waters said she was "exceedingly nervous" about revisiting the Dodd-Frank Act before regulations have finished rulemakings.

Appropriations Subcommittee Examines SEC Budget Proposal
In her first appearance before a Congressional committee since becoming Chairman of the SEC, Mary Jo White testified on the SEC's before the House Appropriations Financial Services Subcommittee on May 7th and in defense of the President's Budget request of $1.674 billion for FY 2014 at the SEC, a 27 percent bump from current funding levels under the CR. White told lawmakers that sequestration has not yet led to furloughs at the agency; however, the budget cuts are affecting the SEC's oversight of derivatives market as it does not have the funding to build the regulatory infrastructure required by the Dodd-Frank Act.

White added that sequestration has impacted their technology budget impeding their enforcement and examinations. In addition to discussing the effect of the budget cuts, White said she is reviewing the agency's practice of allowing defendants who settle with the agency to do so with neither admitting nor denying allegations. In other comments, White said she is hopeful that some JOBS Act rulemaking will be finalized this year and that, in light of SEC enforcement actions brought against the state of Illinois for misleading municipal bond investors, the SEC will continue to ensure municipal issuers make adequate disclosures.

House Passes Debt Prioritization Legislation

On May 9th, the House voted 221 to 207 to pass the Full Faith and Credit Act (H.R. 807), which would direct the Treasury to prioritize payment of principal and interest on the debt, in addition to Social Security payments, over all other government spending obligations, should the debt ceiling be reached. While the bill is intended to ensure that the U.S. would not default on its obligations should the debt limit be reached, Democrats have criticized the bill as a "pay-China-first" measure. The OMB has also warned that the legislation would "threaten the full faith and credit of the United States, cost American jobs, hurt businesses of all sizes and do damage to the economy." The day after the House vote, Treasury Secretary Lew said that though the statutory debt limit will be reached in just a few days when it expires on May 18 extraordinary measures taken by the Treasury will delay it until after Labor Day.

<u>Executive Branch</u>

Federal Reserve

Fed Working on Insurance Oversight Issues

On May 10th, speaking at a conference of state insurance regulators, Fed Director of Banking Supervision and Regulation Michael Gibson said the Fed is working to determine how it can make sense of "two somewhat dissonant provisions in Dodd-Frank." On one hand, the financial reforms give the Fed authority over savings and loan companies owned by insurers (which have traditionally been state regulated), but also states that capital requirements be tailored for certain companies. Gibson said the Fed is still "in the learning phase" on the insurance issue and is trying to work out potential conflicts. The Fed has decided it will treat insurers with savings and loans separately from insurers that may be deemed systemically significant by the FSOC.

Bernanke Says Higher Capital Requirements Can Curb Vulnerability to Shocks at Large Banks

On May 10th, Chairman Ben Bernanke said that the Fed is working with federal regulators to monitor and address vulnerabilities and risk-taking of the largest banks. Speaking at the Federal Reserve Bank of Chicago, Bernanke told the audience that they are attempting to address vulnerabilities to shocks through broader measures such as requiring banks to hold more capital and liquidity.

CFPB

Final Risk Retention Rule Heading for Delay?

Last week, *Politico* reported that the Dodd-Frank Act risk retention rule, which would force mortgage lenders to hold 5 percent of the credit risk against loans sold to investors, will likely not be finalized until fall or that it will be re-proposed entirely. Although the rule was proposed in March 2011, regulators have had to wait to finalize the rule until the CFPB finalizes the Qualified Mortgage (QM) rule and the definition of Qualified Residential Mortgage (QRM). In part, the QM and QRM are being delayed due to pressure to align the QRM definition more closely with the definition of QM. At a recent Mortgage Bankers Association conference, HUD Secretary Shaun Donovan said regulators are working to align the QM and QRM standards "as much as possible" and they are "very focused on getting QRM right."

CFPB Report Examines Impact of Significant Student Debt

On May 8th, the CFPB released a report outlining ways in which student loan debt is an impediment to a "full financial life for consumers." The report also discusses option for policymakers and market stakeholders to help borrowers manage loans in the private market. In February 2013, the CFPB published a request for information requesting input on affordable repayment options for borrowers with existing student loans. The Bureau received more than 28,000 comments which informed this report. The report details a "domino effect" that can result from student debt through housing as first-time homebuyers struggle to qualify for mortgages, small business development as student debt may impact the ability to access small business credit, retirement savings as debt burden may force students to rely on parents who are nearing retirement, and rural communities which struggle to retain young professionals. Some marketplace solutions proposed by the report include: "refi relief" for borrowers who pay on time; a road to recovery for distressed borrowers; and a clean credit slate for defaulted borrowers.

Justice Department Takes on First Case Referred by CFPB

On May 7th, the CFPB announced that, in coordination with the Department of Justice, it has filed a complaint in a federal district court in New York against two debt-relief service providers that allegedly charged consumers illegal advance fees for debt-settlement services. The Bureau is seeking to halt the operations and to obtain both penalties and relief for victims. The two firms, Mission Settlement Agency and Premier Consultant Group, allegedly charged customers illegal upfront fees to settle their debt and failed to provide adequate debt relief services. The case is the first time the Bureau has made a criminal referral.

SEC

SEC Circulating New Draft Money Market Mutual Fund Reforms

Last week, Reuters reported that staff at the SEC are circulating a revised draft with reforms to the $2.6 trillion money market fund industry. While all of the details about the 500 page proposal have yet to surface, it has been reported that the proposal would require prime funds to move from a fixed-net asset value (NAV) to a floating NAV. The proposal purportedly focuses on prime funds as they were more prone to runs during the financial crisis. The draft was circulated following comments made by Chairman White at an Investment Company Institute conference, saying that the proposal would be balanced and released in the "near future." Commissioner Aguilar, one of three Democrats on the Commission and who had been the swing vote, told the Wall Street Journal he is likely to support the draft.

CFTC

US Regulators Eyeing Bitcoin for Additional Oversight

In recent weeks, US regulators have publically discussed the possibility of regulating Bitcoin, which is cyber-currency. Speaking to the Financial Times, CFTC Commissioner Bart Chilton said that issues with Bitcoin are certainly something the agency should explore and that they need "to ensure that we protect markets and consumers, even in what at first blush appear to be 'out there' transactions." While CFTC jurisdiction usually would not extend to cash markets, under Dodd-Frank Act derivatives provisions, the Commission has broad power to regulate retail foreign exchange dealers. In addition, in March, the Treasury ruled that all firms that exchange or transfer virtual currency would be considered "money services businesses" and subject to reporting requirements to prevent money laundering. Founder of Bitcoin, Roger Ver, said "even if US regulations make it hard for Bitcoin businesses to operate in the US, that doesn't mean it will make it difficult for people to use Bitcoin as a currency in the US. Bitcoin is a world currency."

CFTC to Hold SEF Vote
On May 16th the CFTC will meet for a public vote on final rules governing swap execution facilities (SEFs), the derivatives trading platform established by the Dodd-Frank Act. The Commission will also vote on final rules for large block trades.

Upcoming Hearings

On Tuesday, May 14th at 3:15pm, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Subcommittee on Securities, Insurance and Investment will hold a hearing on private capital, mortgage markets and housing finance.

On Wednesday, May 15th at 10am in 1100 Longworth, the House Ways and Means Subcommittee on Select Revenue Measures will hold a hearing on the discussion draft of "Small Business and Pass-through Entity Tax Reform."

On Wednesday, May 15th at 10am in 2128 Rayburn, the House Financial Services Subcommittee on Oversight and Investigations will hold a hearing titled "Who Is Too Big to Fail: Does Title II of the Dodd-Frank Act Enshrine Taxpayer-Funded Bailouts?"

On Wednesday, May 15th at 2pm in 2128 Rayburn, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing on the structure and costs government sponsored enterprises (GSEs).

On Wednesday, May 15th at 2:30pm in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Subcommittee on Securities, Insurance and Investment will hold a hearing on the impact of cross-border bank resolution on taxes and the economy.

On Thursday, May 16th at 10am in 2128 Rayburn, the House Financial Services Committee will hold an oversight hearing on the Securities and Exchange Commission (SEC).

On Thursday, May 16th at 2pm in 2128 Rayburn, the House Financial Services Subcommittee on Housing and Insurance will hold a hearing on multi-family housing finance.

On Thursday, May 16th at 2pm in 1105 Longworth, the House Ways and Means Subcommittee on Trade will hold a hearing on U.S.-EU trade and investment partnership negotiations.

On Wednesday, May 22nd at 10am, in 216 Hart, the Joint Economic Committee will hold a hearing with testimony from Federal Reserve Chairman Ben Bernanke on the economic outlook.

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