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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

February 13, 2012

Leading the Past Week

In a week that saw a major announcement intended to heal the housing crisis it was worth noting that it came nearly five years to the day of the beginning of the very credit crisis that resulted in the need for a settlement. The news of the nation-wide (but for Oklahoma) settlement on the mortgage servicing momentarily distracted K Street and parts of Wall Street, as shops affiliated with both avenues vigorously fought back against provisions in the STOCK Act that would have impacted their revenue streams. At the same time the White House appeared to lose some of its political momentum as the rest of country's attention was deviated from the positive economic news of last week to the culture war issues of birth control and abortion. Late on Friday the President was forced to retreat on the issue, even though some analysts pontificated that this is a fight that helps him in the long run.

Legislative Branch

Senate

Senate Panel Examines State of US Economy with Fed Chairman:

On February 7th, Federal Reserve Chairman Ben Bernanke appeared before the Senate Budget Committee to discuss the state of the US economy and the outlook for US monetary and fiscal policy. Bernanke comments echoed those he gave before the House Budget Committee last week, telling lawmakers that the economy is gradually recovering despite still being vulnerable to shocks. Speaking on the debt, Bernanke said "problems in our fiscal path arise after the next 10 years, going out 15, 20, 30 years as our population ages, as health care costs rise." To that end, he urged lawmakers to work to further reduce the long-term US debt burden and recommended a broader based, fairer tax code among other policies to address the budget gap. Bernanke warned that inaction towards the debt would have negative consequences in terms of investor confidence but suggested that the debt had not already begun to impact economic performance,

emphasizing that “we’re on a path that’s going to not be sustainable...where the amount of debt will cause higher interest rates, which will cause higher deficits.”

Senate Panel Considers Impact of Online Gaming on Indian Tribes:

Last week the Senate Indian Affairs Committee held a hearing to examine how the recent Justice Department decision that opens the door for states to start online gambling systems so long as they do not include sports betting would impact tribal gaming interest. While the tribes seemed split on the issue, there are some who believe that the enactment of a Federal online gambling bill would cripple tribal casinos across the country. It was clear that those who espoused this view, in part, feel threatened by the efforts of “Nevada and New Jersey gaming interests” as their ongoing efforts to legalize Internet poker was described as a “brazen power grab.” The Poker Players Alliance is trying to find a middle ground, and at the hearing they testified that legalized Internet poker, by itself, would not pose much of a threat to tribal gaming because poker currently only accounts for one percent of revenues at brick-and-mortar casinos. Other forms of online gambling like blackjack, roulette and slot machines would eat into revenues more deeply. The lack of consensus on how a federal law allowing Internet poker / other forms of gambling, combined with the set-back for internet gaming interests in DC (see below) made it look more likely that proponents of overturning the federal ban on Internet Poker would need to draw an inside straight to get a bill enacted this year.

Brown Leads Bipartisan Push for Crowdfunding:

On February 3rd, Senator Scott Brown (R-MA) asked the White House for assistance in advancing his bill, S. 1791, the Democratizing Access to Capital Act of 2011, in part due to the White House’s endorsement of crowdfunding as a means of aiding small businesses. Brown’s bill would create a registration carve out for crowdfunding. Crowdfunding has received considerable attention in recent months. The White House’s endorsement for the concept, and the fact that there is similar legislation out there, such as the Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure (CROWDFUND) Act of 2011, introduced by Senators Merkley and Bennet and Representative Patrick McHenry’s H.R. 2930, the Entrepreneur Access to Capital Act, passed the House by a vote of 407–17 shows that there is growing momentum on this issue. It will be curious to see how politics will impact policy, as Senator Brown is one, if not the, top target for Democrats in the upcoming fall elections.

House of Representatives

House Passes STOCK Act:

On February 9th, the House passed the Stop Trading on Congressional Knowledge (STOCK) Act (H.R. 1148) in a 417 to 2 vote. The Senate passed its version of the legislation (S. 2039) to ban insider trading in a 96 to 3 vote on February 2nd. The House bill makes several changes to the Senate legislation, including striking a provision introduced by Senate Judiciary Chairman Patrick Leahy (D-VT) to reinstate criminal penalties in public corruption cases and excluding Senator Grassley’s provision with new registration requirements for political intelligence operatives. The House bill also strengthens insider-trading restrictions in the Executive Branch and would prohibit lawmakers, staff and Executive Branch officials from taking part in initial public offerings (IPOs). The differences will require the two chambers to conference their

differences, whether formally or informally. It is anticipated that the Grassley language, as in the Senate-passed version will not survive, as a spokesperson for House Majority Leader Eric Cantor (R-VA) told reporters that the political intelligence provisions “was extremely broad, and its impact would have raised more questions than it answered.”

While some in Congress may want this story to go away quickly, the conference negotiations will be handled in the shadow of an Office of Congressional Ethics (“OCE”) investigation into House Financial Services Chairman Spencer Bachus. OCE conducts independent investigations into allegations of misconduct against members, officers and staff, and it is reported that the investigation into Bachus was triggered by the CBS “60 Minutes” program that triggered the populist impetus to move the STOCK act in the first place.

House Committee Considers Bills Aimed at CFPB Accountability:

On February 8th, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit held a hearing to consider three bills aimed at altering the CFPB’s structure and operations. The three bills under consideration included: H.R. 1355, the Bureau of Consumer Financial Protection Accountability and Transparency Act; H.R. 2081, a bill to remove the CFPB Director from the Board of Directors of the Federal Deposit Insurance Corporation and replace him with the Chairman of the Federal Reserve Board; and H.R. 3871, the Proprietary Information Protection Act of 2012. These bills would, respectively, place the CFPB in the Treasury so that it is under the normal appropriations process, replace the CFPB Director with the Fed Chairman on the FDIC Board and protect documents turned under to the CFPB with attorney-client privilege. Of these bills, H.R. 3871, or something similar, has the best chance for enactment this Congress.

While Republicans and Democrats remained divided over reforms that would place the Bureau under normal appropriations and take the director off the FDIC Board, members pledged to work in a bipartisan manner to ensure attorney-client privilege is extended to documents and information shared with the Bureau by banks, calling the lack of such protection and oversight of the Dodd-Frank Act. The CFPB has said that such information would be protected under the authority for protecting consumer laws which was transferred to the Bureau; however, Director Cordray has said he supports a legislative fix to ensure statutory protection. Without explicit statutory language, the CFPB would have the option to waive attorney-client privilege, enabling third parties to obtain the information. However, even with the pledge that the two parties would work together to make the change, there was disagreement over how to address the problem. For example, Ranking Member of the Subcommittee Carolyn Maloney (D-NY) said she prefers Senator Richard Shelby’s version of the legislation (S. 2055) which would amend the Federal Deposit Insurance Act protecting information given to regulators over Representative Bill Huizenga’s (R-MI) H.R. 3871 which would amend Dodd-Frank.

Another theme of the hearing was a discussion of the CFPB’s rulemaking process, including its statutory mandate to uphold the Administrative Procedures Act and to conduct small business review panels prior to proposing regulations. Representative Patrick McHenry (R-NC) questioned witnesses on the rulemaking process, which brought up a discussion of the small

business review panels. Mr. Andrew Pincus, testifying on behalf of the Chamber of Commerce, faulted the CFPB for having failed to so far convene small business panels and warned lawmakers that they should be concerned that the CFPB's use informal rulemaking process could become the norm, as the Bureau attempts to bypass a formal regulatory process.

House Subcommittee Examines Extraterritoriality of Title VII of Dodd-Frank:

On February 8th, the House Financial Services Capital Markets Subcommittee met to discuss the extraterritorial reach of Dodd-Frank Act regulations and legislation to exempt certain swaps transactions involving non-US parties from regulation. H.R. 3283, the Swap Jurisdiction Certainty Act seeks to address to what extent the Dodd-Frank Act can apply to cross-border swaps transactions. At the center of the legislation is the question of extraterritoriality and the potential of the swaps rules to infringe on the sovereignty of foreign countries. In addition to the potential sovereign consequences, Representative Scott Garret (R-NJ), one of the bill's sponsors, outlined additional concerns, including among other things the increased cost for non-US firms and how the regs could place US firms at a competitive disadvantage.

The impending regulations on swaps is not the only area where Dodd-Frank's extraterritoriality is being questioned as the US is increasingly becoming the target for criticism from Canadian, British and EU regulators over the potential impact on their economies by the implementation of Dodd-Frank. Specifically, foreign countries have warned that the Volcker Rule ban on proprietary trading of foreign sovereign debt, exempting the US, would have on borrowing costs and access to capital. Testifying at the hearing, JPMorgan Associate General Counsel Don Thompson told the Subcommittee, that if the Volcker Rule affects US banks foreign subsidiaries without reaching overseas competitors, the US could face a "significant disadvantage."

Financial Services Subcommittee Approves Housing Bills:

On February 7th, the House Financial Services Insurance, Housing and Community Opportunity Subcommittee approved a trio of bills that would overhaul affordable housing programs. These included legislation to expand the Department of Housing and Urban Development's (HUD) definition of 'homeless' to children and youth (H.R. 32), a draft bill to improve efficiency and operations of Section 8 housing vouchers and a draft measure to increase the Federal Housing Administration's (FHA) premiums in order to bolster its finances. All three measures were approved by voice vote. Notably, the FHA Emergency Fiscal Solvency Act would shore up the Mutual Mortgage Insurance Fund by: establishing minimum annual premiums; expelling unscrupulous lenders from the program; requiring repayment of losses incurred due to fraudulent lending to the FHA; and improving FHA's transparency and disclosure requirements.

Executive Branch

White House

White House Applauds Agreement with Mortgage Servicers on Settlement:

Late on February 8th, state and federal authorities reached an agreement with banks over foreclosure abuses in the culmination of months of negotiations. The deal will provide over two million American homeowners with \$26 billion in compensation from large US banks, including

Bank of America, JPMorgan Chase, Wells Fargo, Citigroup and Ally Financial, involved in the foreclosure crisis. While the agreement marks a major victory for homeowners and the government, only a small number of the millions facing foreclosure will be benefited. The settlement requires banks to provide \$17 billion in loan modifications to delinquent borrowers, \$3 billion for those borrowers underwater to refinance, \$1.5 billion in restitution payments to those who lost their homes and \$4.5 billion for state-run housing assistance programs. Independent monitors will work to ensure mortgage servicers comply with the settlement terms.

Obama's Regulations so far have an Estimated \$25 billion dollar Price tag:

Regulations approved by President Barack Obama over the first 32 months of his term cost businesses an estimated \$25 billion, more than double the total of each of his two predecessors, according to White House data. Although Obama has signed off on fewer total regulations, he has put into place some very costly ones, with the most expensive rules last year included energy conservation standards for refrigerators, requirements that cargo on passenger aircraft be screened and limits on ozone pollution from coal power plants that crosses state lines.

The administration has defended the regulation by saying that the benefits outweigh the costs by \$116 billion and that judging regulations by cost alone doesn't take into account the economic benefits of healthier children, safer roads or fewer industrial accidents. With OMB set to send a full report on this issue up to Congress in the coming weeks, it is very likely that there will be hearings on the topic as well.

Federal Reserve

Fed Delays Vote on Capital One Acquisition of ING Direct:

A vote that was slated to occur February 8th was rescheduled to February 13th, delaying Fed action on Capital One's proposed acquisition of ING Direct. The Fed delayed the decision without comment; however, the delay has received considerable attention as it is part of a new merger analysis function at the Fed required by the Dodd-Frank Act which directs the Fed to consider, among other things, whether acquisitions could lead to more highly concentrated bank risk. Although the Fed has already considered one acquisition under this new standard, and even though it found no such concentration issues in that instance, because the Capital One-ING merger is larger and more complex the decision being watched more closely.

SEC

In Advance of SEC Proposed Rules on Money Market Funds Lawmakers Slam SEC:

In the coming weeks, the SEC is set to complete a two part proposal aimed at stabilizing the money market fund industry and lawmakers are already pushing back against the reforms. On February 8th, Senator Patrick Toomey (R-PA) told a gathering of industry officials at the Chamber of Commerce that the SEC's money market proposal has the potential to stifle the industry and that he plans to ensure "there is as much public scrutiny as possible. The SEC is considering capital buffers in addition to moving funds to a floating NAV. The proposal also is expected to combine capital requirements with redemption restrictions requiring investors to wait 30 days prior to getting all their money back after redemption. Toomey pledged that he will continue to work with the SEC to ensure they consider the costs and benefits and that he would

not “rule out legislation” pushing back against the SEC and protecting the functions of the money market. The SEC is expected to issue its proposal in the first quarter of 2012.

CFTC

CFTC Rescinds Registration Exemption for Mutual Funds:

On Thursday, by a vote of 4-1, with Republican Commissioner Sommers being the lone holdout, the CFTC adopted rules requiring registration by mutual funds when they have investments in commodities. The rule, pushed by the National Futures Association and Senator Levin (D-MI) rescinds exemptions, first enacted in 2003, from CFTC registration for mutual funds that use futures and swaps tied to commodities. According to the Chairman, investment companies have “increased significantly” their use of commodity futures, swaps and options markets since 2003, and as a result, there was a need for CFTC oversight. The Investment Company Institute, a Washington-based trade association that represents mutual funds, opposed the change and said the firms are already subject to regulation by the Securities and Exchange Commission, and as a partial consolation, the CFTC also unanimously approved a proposal seeking comment on efforts to coordinate the two agencies’ record-keeping and registration procedures.

Groups Continue to Press for Delay in Position Limits Rule:

Few should have been surprised when the International Swaps and Derivatives Association (ISDA) and the Securities Industry and Financial Markets Association (SIFMA) filed a request with US District Judge Robert Wilkins to put CFTC position limit rules on hold while their legal challenge is pending. The group made a similar request in an earlier suit they filed at the circuit court level that had been knocked out on a procedural level. While the petitioners argued that compliance with position limits rules will “include restructuring of corporate relationships and divestment” which will come with costs that “will be impossible to recoup if the rule is invalidated,” unless an injunction is granted the rule will go into effect while the case is pending.

IRS

US Government Unveils FACTA Guidance:

On February 8th, the US released a 400 page guidance document on the upcoming implementation of the Foreign Account Tax Compliance Act (FACTA). The implementing rules of FACTA propose changes to previous guidance, including relaxing due diligence requirements required by banks to identify US accounts and expanding the definition of “deemed compliant” entities when banks disclose US-owned accounts. FACTA, enacted under the Hiring Incentives to Restore Employment (HIRE) Act, requires foreign financial forms to enter into agreements with the US government to report US-owned accounts to the IRS. In conjunction with the guidance, the government also released information on an agreement between the US, France, Germany, Spain, Italy and the UK to create an intergovernmental information exchange of across border accounts. A Treasury Official said talks are underway for further agreements of this nature and the agreement will “hopefully serve as a model with other countries.”

The guidance reflects changes which take into account positive considerations of industry concerns, including providing institutions additional time to comply with FACTA and providing

for a longer phase-in time for more detailed aspects of required reporting. For example, basic taxpayer information—such as name, address and account number—will be required in 2014 and 2015 and expanded and full reported will be phased in during 2016 and 2017. Another important change reflected in the guidance is the ability for financial institutions to rely on existing know-your-customer and anti-money-laundering systems to identify high-risk accounts rather than reinventing the wheel. Comments on the FACTA guidance are due by April 30th and a hearing on the guidance is set for May 15th.

Miscellaneous

DC City Council Repeals Legislations Okaying Online Gambling:

On February 7th, the DC Council voted 10 to 2 to repeal legislation that would have allowed DC to become the first to implement a legal internet gambling system. DC's attempt to become the first city to offer online gambling has been closely followed by the internet gambling community. Supporters of federal internet gambling legislation have repeatedly told Congress that it must act before states seize on the opportunity to set up online gambling systems—cutting out the federal government and large casinos out of the profit stream. DC council member Michael Brown said he would reintroduce the legislation, with protections saying “no casino industry may bid on this project.”

UPCOMING HEARING

On Tuesday, February 14th at 10am, in 608 Dirksen, the Senate Budget Committee will hold a hearing to overview the fiscal 2013 budget.

On Tuesday, February 14th at 10am, in 215 Dirksen, the Senate Finance Committee will hold a hearing to overview the fiscal 2013 budget.

On Wednesday, February 15th at 9:30am, in 2123 Rayburn, the House Energy and Commerce Subcommittee on Commerce, Manufacturing and Trade will hold a hearing titled “Where Are the Jobs? Trends and Analysis.”

On Wednesday, February 15th at 10am, in 608 Dirksen, the Senate Budget Committee will hold a hearing on the fiscal 2013 budget at the Department of Transportation.

On Wednesday, February 15th at 10am, in 215 Dirksen, the Senate Finance Committee will hold a hearing on the fiscal 2013 budget at the Department of Health and Human Services.

On Wednesday, February 15th at 10am, in 1100 Longworth, the House Ways and Means Committee will hold a hearing to overview the fiscal 2013 budget.

On Wednesday, February 15th at 10am, in 2141 Rayburn, the House Judiciary Committee will hold a hearing titled “Executive Overreach: The President's Unprecedented 'Recess' Appointments.”

On Wednesday, February 15th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Oversight and Investigations will hold a hearing on the fiscal 2013 budget request for the Consumer Financial Protection Bureau.

On Wednesday, February 15th at 10am, in 210 Cannon, the House Budget Committee will hold a hearing to overview the proposed fiscal 2013 budget.

On Wednesday, February 15th at 1pm, in 2360 Rayburn, the House Small Business Subcommittee on Healthcare and Technology will hold a hearing titled “Broadband: A Catalyst for Small Business Growth.”

On Wednesday, February 15th at 2:30pm, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Subcommittee on Financial Institutions and Consumer Protection will hold a hearing titled “Pay for Performance: Incentive Compensation at Large Financial Institutions.”

On Thursday, February 16th at 10am, in 608 Dirksen, in 608 Dirksen, the Senate Budget Committee will hold a hearing on revenue proposals in the fiscal 2013 budget.

On Thursday, February 16th at 10am, in 2128 Rayburn, the House Financial Services Committee will mark up pending legislation: H.R. 3606, H.R. 2308, H.R. 1838 and H.R. 3871.

On Thursday, February 16th at 2pm, in 210 Cannon, the House Budget Committee will hold a hearing on revenue and economic policy proposals in the proposed fiscal year 2013 budget.

On Tuesday, February 28th at 10am, in 2128 Rayburn, the House Financial Services Committee will mark up pending legislation regarding homeless children and FHA overhaul.

On Wednesday, February 29th at 10am, in 2128 Rayburn, the House Financial Services Committee will hold a hearing to receive the semi-annual monetary policy report from the Federal Reserve