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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

February 6, 2012

Leading the Past Week

It was only fitting that in a week where we honor America's worst weatherman, err… rodent that the week ended with a jobs creation announcement that shattered predictions. The Bureau of Labor Statistics reported that 243,000 jobs were created in January. The increase helped drop the unemployment rate to 8.3 percent, the lowest level in close to three years. This growth comes despite the lack of the temporary holiday hiring that accompanied the report from December, with the biggest gains in the professional and business services which added 70,000 jobs. The result exceeded most predictions by over 100,000 jobs, and it capped off a week that saw the Administration get its political swagger back. Throughout the week we continued to see the White House blend politics and policy. From the President announcing a new housing plan to aid underwater homeowners just as the Republican primary season comes to one of the epicenters of the housing crisis, to Treasury Secretary Geithner defending Dodd-Frank and using rhetorical jujitsu to accuse the law's opponents of being responsible for undermining our nation's financial institutions, it seems clear that the White House is fusing its political and policy messages. By contrast, perhaps the biggest news out of Congressional Republicans this past week was their intention to file an *amicus brief* in support of some future court challenge to the recess appointment.

Legislative Branch

Senate

Cordray Testifies Before Senate Banking – Republicans decide not to Boycott:

On January 31st, Richard Cordray appeared before the Senate Banking Committee in a hearing to review the CFPB's first semi-annual report to Congress. The Banking

Committee hearing marks the Cordray's second appearance before Congress since becoming Director of the CFPB with lawmakers raising many of the same concerns as members of the House Oversight Committee had in the previous week. Notably, in response to questioning from both Chairman Tim Johnson (D-SD) and Ranking Member Richard Shelby (R-AL), Cordray promised to convene advisory panels of to measure the costs of Bureau rulemakings on small businesses. Despite Cordray's attempted *mea culpa* on this issue, Shelby still blasted Cordray for, thus far, failing to convene these review panels, for indicating he will not convene panels for crucial rulemakings such as mortgage underwriting standards and for issuing 'interim final rules' to get around statutory requirements. Other Senators also expressed concerns about how the CFPB was regulating prepaid card practices, payday lenders, financial literacy and the recent remittance rule.

Although there had been rumors of a Republican boycott, on the whole, the controversial nature of Cordray's recess appointment was not a focus of the proceeding. Following the hearing, Committee Republicans said they would not block the nominations of any other financial regulatory nominees because of Cordray's recess appointment. However, a few days after the hearing thirty-nine Senate Republicans announced their intention to file an amicus brief challenging the appointment of Richard Cordray to be Director of the CFPB, in addition to President Obama's appointments to the National Labor Relations Board (NLRB). The members, led by Senator John Cornyn (R-TX) declared their intention in a brief letter calling the move "unprecedented and unconstitutional."

Senate Passes Insider Trading Bill:
On February 2nd, the Senate passed S. 2038, the Stop Trading on Congressional Knowledge (STOCK) Act. The bill, which was introduced by Senator Joseph Lieberman (I-CT) late last month, received support from 96 senators, with only Senators Jeff Bingaman (D-NM), Richard Burr (R-NC), and Tom Coburn (R-OK) voting against the measure. The legislation was initially designed to prohibit lawmakers and staff from trading stocks and other securities based on nonpublic information, but an amendment introduced by Senator Richard Shelby (R-AL) extended the ban to executive branch officials. That amendment was more narrowly approved by a vote of 58 to 41. In addition, the bill requires covered individuals to disclose their stock purchases and sales.

In addition to the Shelby amendment, 19 other amendments were considered. Other approved amendments include: requirements for lawmakers to disclose more financial data on their home mortgages; preventing Freddie Mac and Fannie Mae from issuing bonuses while under government conservatorship; requiring those who provide political intelligence to hedge funds and other companies to register their activities in a manner similar to lobbyists. An amendment that would have permanently banned earmarks was rejected, as well as one which would have expressed Senate support for a constitutional amendment creating term limits. President Obama praised the Senate approval of the measure—he had advocated for its passage in the State of the Union—and Majority Leader Eric Cantor (R-VA) indicated that the House will consider the measure as early as this week.

House of Representatives

Bachus Accuses Senate of Stalling Job Creation and Capital Access Agenda:
On January 31st, Chairman Spencer Bachus (R-AL) called on the President to pressure the Senate to take up a series of bills to create jobs and increase small business access to capital. While there is probably a consensus between Democrats and Republicans for these measures, it is unlikely that we will see any movement until after the November elections.

The specific bills that Chairman Baucus advocated moving include, H.R. 1070 the Small Company Capital Formation Act, which was introduced by Representative David Schweikert (R-AZ) and passed the House by a vote of 421-1. This bill would raise the SEC filing exemption, which has remained static for two decades, from $5 million to $50 million. H.R. 2930 the Entrepreneur Access to Capital Act was introduced by Representative Patrick McHenry (R-NC) and passed the House by a vote of 407-17. It would remove SEC restrictions on crowdfunding. A third bill, H.R. 3606 the Reopening American Capital Markets to Emerging Growth Companies Act of 2011 was introduced by Representatives Stephen Fincher (R-TN) and John Carney (D-DE) with 34 bipartisan cosponsors, but has yet to be considered by the full House. It would permit a 5-year transitional stage for smaller firms before they would need to comply with SEC reporting requirements. We anticipate that these bills will eventually move through the Senate.

Legislation introduced to eliminate 1099-K requirement for payment processors:
On February 1st, Representative Aaron Schock (R-IL) introduced H.R. 3877 the 1099-K Overreach Prevention Act. If enacted, the bill would prevent the IRS from requiring payment providers, such as credit card companies, from reporting the monthly totals of transactions that they processed for individual merchants to the IRS. The requirement for this new reporting stems from the passage of the Housing and Economic Recovery Act of 2008, which had a provision that requires a more precise record of electronic transactions. As written, the rule requires businesses with annual revenue of at least $20,000 and 200 transactions per year to complete the forms. Senator John Thune (R-SD) is expected to introduce an identical version of the bill in the Senate.

Executive Branch

White House

Obama Proposes Housing Plan:

On February 1st, President Obama announced a new housing plan to allow homeowners to refinance their mortgages to loans with lower interest rates backed by the Federal Housing Administration (FHA). Borrowers could qualify for refinancing if they owe more than the value of their home or if they are unable to secure a new mortgage from a private lender. The plan also calls for national mortgage servicing standards, a "homeowner bill of rights," and simplification of mortgage disclosure forms already underway at the CFPB. However, with a $5 billion to $10 billion estimated cost of the program it is unlikely to find support in Congress. The Administration is planning additional proposals that would not require Congressional approval—such as auctions for bulk sales of foreclosed homes—but the plan the President laid out last week is likely a campaign ploy more than a viable housing strategy. Interesting, this plan avoids more highly charged proposals, such as government sponsored enterprises (GSE) reform.

Differences Remain between White House and Congressional Republicans Regarding Tax Treatment for Overseas Profits:

Comments made by Administration officials support changes to the taxation of profits made by U.S. companies operating overseas, a priority outlined in the President's State of the Union given last week. By enabling the IRS to collect a "basic minimum" tax rate on profits earned abroad, the President believes it will discourage companies from moving jobs overseas. Gene Sperling, Director of the National Economic Council, argued that companies "should not believe that they can go to a tax haven as a way of having a tax advantage over a company that chose to stay in the United States." The details of the plan are expected to be included in the President's 2013 Budget proposal, but with Republicans favoring a territorial tax system the posturing appears to be more campaign-orientated than policy minded. A territorial system, such as the one outlined by Ways and Means Committee Chairman Camp (R-MI) would largely exempt profits earned overseas from taxation, with the intent to incentivize the reinvestment of those profits back into the United States. An estimate by JPMorgan Chase indicates that companies have stored $1.4 trillion overseas to avoid U.S. tax rates.

Federal Reserve

Bernanke Calls for Further US Austerity Measures:

On February 2nd, appearing before the House Budget Committee to testify on the state of the US economy, Fed Chairman Ben Bernanke told lawmakers that the economy is showing signs of improvement despite being vulnerable to shocks. Bernanke also called on Congress to work to further reduce the long-term US debt burden, warning that we will be unable to grow ourselves out of fiscal problems, and suggesting tax and spending policies designed to address the budget gap. While the Fed Chairman said he expects the deficit to decrease in the coming years as the economy improves, lawmakers should consider policies to incent working and saving, promoting skills training, investing in research and development and funding infrastructure.

Treasury

Geithner Criticizes Opponents of Dodd-Frank for trying to make their Rhetoric a Self-fulfilling Prophecy:

On February 2nd, Treasury Secretary Geithner criticized opponents of the Dodd-Frank Act, accusing detractors of undermining efforts to shore up the financial system and putting the US on a path to another crisis. Geithner said attempts to rollback portions or all of the financial reforms not only would make the US more vulnerable to a crisis but that "those who are working to slow the pace of reform will only increase uncertainty, and they will damage our efforts to try to get the rest of the world to adopt a level playing field." Geithner continued to say that there is "no credible evidence" to suggest that the Dodd-Frank Act has harmed the recovery in the way opponents assert it has, such as by tightening credit.

Geithner also spoke on a plan to proceed with broad legislation to replace GSEs and overhaul the housing finance system. Geithner said details on such a plan would come as soon as this spring and that it would: "wind down the GSEs and bring private capital back into the market, reducing the government's direct role in the housing market and better targeting our support towards first-time homebuyers and low- and moderate-income Americans."

Treasury and Labor Announce new Proposals Intended to Strengthen Retirement Security:

On Thursday, in a joint release, both the Department of Treasury and the Department of Labor announced executive actions designed to enhance retirement security by creating "flexible lifetime income" options for individuals. Treasury's guidance package initiative is crafted to promote the adoption of lifetime income payments, including encouraging plans to provide retirees with partial annuity options, to allow plan participants to use a portion of their savings to purchase a deferred "longevity" annuity, and to provide greater clarity regarding plan rollover and spousal protection rules. The expanded options are intended to minimize the risk of retirees outliving or underutilizing their savings, as many retirees find it difficult to develop a plan to manage their savings over the uncertain timeframe. For more on the Department of Labor's announcement, see below.

DOL

EBSA Finalizes 401(k) Fee Disclosure Rules:

On February 2nd, the Department of Labor' Employee Benefits Security Administration (EBSA) released its long awaited final rule on fee disclosures for 401(k) plans. The final rule also extends the effective date of the new rule for service providers and new and existing contracts covered by the Employee Benefits Security Administration (ERISA) by three months to July 1st. The fee disclosure rule requires providers to provide information to enable pension plan fiduciaries to make determinations on the appropriateness of the compensation being paid to providers and any conflicts of interests that may affect the provider. The rule will enable fiduciaries to "get better information on associated fees and expenses," said Assistant Secretary of EBSA Phyllis Borzi, adding that this will allow them to "make informed decisions that will lead to cost savings and a larger nest egg for retirement."

CFTC

O'Malia Calls for Renewed Focus on Futures Trading -- Indicates that CFTC will begin taking a closer look at High Frequency Trading; Gensler Continues to Expresses Optimism at Finalizing Dodd-Frank Rules by end of 2012:

On January 31st, CFTC Commissioner Scott O'Malia said the agency should be more aggressively upholding its mandate to regulate futures markets. O'Malia proposed that in order to bolster the CFTC's futures supervision, Congress should create an entity that could commence insolvency proceedings against futures intermediaries. O'Malia's comments reflect an increased attention to the issue in the wake of MF Global's bankruptcy declaration. "The commission needs to stop addressing potentially fundamental issues through an ad hoc process," said O'Malia, adding that since Dodd-Frank became law the CFTC has "fixated" its attention on the swaps market to the detriment of its other supervisory and regulatory responsibilities.

That same day O'Malia also announced that the Commission would begin seeking public nominations for a CFTC subcommittee to focus on identifying high frequency trading issues within the US futures, swaps and options markets. This subcommittee would be charged with providing the CFTC with knowledge of high-speed trading and put in place protections against another flash crash. The subcommittee will be housed in the CFTC's Technology and Advisory Committee, which O'Malia chairs.

Also, last week, Chairman Gensler also spoke out on the CFTC's agenda for the year. Speaking at the John Bogle Legacy Forum in New York, Gensler said he has "great confidence" that the Commission would be able to finalize all rules under the Dodd-Frank Act by the end of 2012. The agency still must complete approximately 25 rules, having already completed 25 Dodd-Frank provisions.

IRS

FACTA Rules Still Pending:

Proposed rules implementing the Foreign Account Tax Compliance Act (FACTA) are still pending, despite indications that the Internal Revenue Service (IRS) would issue them by the end of January. The statute requires foreign banks to disclose any US-owned accounts to the IRS or face up to a 30 percent withholding tax. Emily McMahon, the Acting Assistant Treasury Secretary for Tax Policy, stated that the rules were in the final stages of clearance at the Treasury and the IRS, last week. McMahon added that the proposed rule addresses concerns of foreign banks, which had expressed concerns about the cost of compliance and that officials have worked to minimize the administrative costs to foreign banks.

International

Foreign Governments Continue to Press for Exemption to Volcker Rule:

Foreign governments are pressuring five federal regulatory agencies to exempt sovereign debt from the provisions of the Volcker Rule. While the ban on proprietary trading exempts US government debt from the rule, foreign government bonds are covered by the Dodd-Frank Act. Officials from Canada, Japan and the UK have sent comment letters to the Treasury Department and other regulators responsible for the rule stressing that the ban on trading sovereign debt could raise borrowing costs and cut off capital access. International concerns over the Volcker Rule grew during last week's World Economic Forum in Davos, Switzerland. Specifically, Bank of Canada Governor Mark Carney—who will replace Mario Draghi as Chairman of the Financial Stability Board (FSB)—expressed that he had "some obvious concerns" with the rule such as liquidity issues.

Statutorily, the Dodd-Frank Act allows trading activity to be expected from the Volcker Rule if it would "promote and protect the safety and soundness of the banking entity and of the financial stability of the United States." US regulators have been receptive to the concerns of foreign peers and have indicated they may be open to changes. For example, acting Comptroller of the Currency, speaking on the sovereign debt concerns at a January 18th Financial Services subcommittee hearing, said US banks would be placed at a "complete disadvantage" due to the Volcker Rule, signaling that additional attention was needed.

Derivatives Regulations Stall in Europe:

January 31st was supposed to be the day when the European Union announced regulations for the $700 trillion derivatives markets, however an objection by the European Parliament delayed the effort minutes before a press conference scheduled to announce approval of the measures. While agreement had been reached last week in the

Economic and Finance Ministers Council with regard to authorizing and oversight of counter clearing parties (CCPs) for derivatives contracts, this was the same issue that caused this latest delay. The rules would require most derivatives to be traded through exchanges and routed through CCPs that would assume responsibility in case of a default.

Disagreement centered on the mechanism to grant authority to the European Securities and Market Authority (ESMA) to be the final arbiter for clearinghouses. Denmark, which holds the EU's rotating presidency, has been facilitating "trialogue" negotiations between Parliament, the Council of Ministers, and the European Commission, which all must approve the final regulations. The Commission first proposed the regulations in 2010, but they encountered opposition from the United Kingdom which feared the loss of business to its financial hub in London. There is still a conflict between the UK and the European Central Bank, which would prefer euro denominated derivatives to be cleared in a Eurozone country. This latest delay comes as Parliament and national governments agreed that two-thirds of national regulators could block the authorization of clearinghouses, while Parliament viewed unnecessary a measure favored by those governments to require a two-thirds vote to grant ESMA its arbitration authority. Denmark will need to take the revised plan back to the national governments as negotiations continue.

UPCOMING HEARINGS

On Tuesday, February 7th at 10am, in 608 Dirksen, the Senate Budget Committee will hold a hearing on the outlook for U.S. monetary and fiscal policy.

On Tuesday, February 7th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Insurance, Housing and Community Opportunity will markup a draft bill to overhaul programs of the Federal Housing Administration, focusing on affordable housing.

On Tuesday, February 7th at 2:30pm, in 216 Hart, the Joint Economic Committee will hold a hearing titled Bolstering the Economy: Helping American Families by Reauthorizing the Payroll Tax Cut and Unemployment Insurance (UI) Benefits.

On Wednesday, February 8th at 9am, in 1100 Longworth, the House Ways and Means Committee will hold a series of hearings on the interaction of tax policy and financial accounting rules (such as Generally Accepted Accounting Principles, or GAAP), and how this interaction affects how publicly-traded companies respond to tax policy.

On Wednesday, February 8th at 10am, in 2141 Rayburn, the House Judiciary Subcommittee on Crime, Terrorism and Homeland Security will hold a hearing titled

"Combating Transnational Organized Crime: International Money Laundering as a Threat to our Financial Systems."

On Wednesday, February 8th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit will hold a hearing on legislation concerning accountability and transparency at the Consumer Financial Protection Bureau (CFPB).

On Wednesday, February 8th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing on legislative proposals that would limit the extraterritorial impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act (PL 111-203).

On Thursday, February 9th at 10am, in 2360 Rayburn, the House Small Business Contracting and Workforce Panel will hold a hearing titled "Construction Contracting: Barriers to Small Business Participation."

On Thursday, February 9th at 10am, in 538 Dirksen, the Senate Banking Committee will hold a hearing titled "State of the Housing Market: Removing Barriers to Economic Recovery."