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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

June 11, 2012

Leading the Past Week

On Sunday, Spain announced that it would be seeking a bailout and the Eurozone banks agreed to lend Spain 100 billion euros ($125 billion dollars) in order to stabilize its banks. The decision was applauded by Secretary Geithner who noted that the move was vitally important for the health of the Eurozone as a whole. This development will only serve to increase focus on the Federal Reserve to see if the deepening European troubles will cause the central bank to react with new monetary policy fixes to buffer the U.S. economy, a point raised during a Joint Economic Committee earlier this week where Chairman Ben Bernanke played coy about the Fed's future plans. Adding to the drama in Europe, in a surprise move, earlier in the week the People's Bank of China cut interest rates for the first time in four years. Countervailing these developments that may portend the possible future collapse of the global economy, regulators continued to implement financial reform, and though many were expecting fireworks at a Senate Banking Committee hearing to examine the implementation efforts, particularly in light of the JP Morgan trading loss, other than harsh questions for the OCC, it seemed as if most Senators were content to keep with the *status quo.*

Legislative Branch

Senate

Senate Baking Examines Dodd-Frank Implementation with an Eye to revelations by JP Morgan

On June 6th, the Senate Banking Committee held a hearing to consider the ongoing implementation of the Dodd-Frank Act. Although generally speaking the hearing was intended to focus on all aspects of the implementation, including reducing systemic risk and enhancing bank supervision efforts including implementing Basel III agreements, creating orderly resolution mechanisms, increasing capital requirements, stress tests, and the designation of systemically important financial institutions (SIFIs), since this was the first oversight hearing since the revelation of a large trading loss by JP Morgan, much of the attention focused on the

Volcker rule, and its impact / non-impact in the JP Morgan loss. Echoing the sentiment expressed by the SEC and CFTC at an earlier hearing, the regulators in attendance told lawmakers the events at JP Morgan would likely greatly influence Dodd-Frank implementation going forward, particularly in finalizing the Volcker Rule. Comptroller of the Currency Thomas Curry focused his testimony and response to questions by telling lawmakers that the loss was a result of inadequate risk management. This point was echoed, most notably by Chairman Tim Johnson, who said that the loss "does not appear to have caused systemic problems," which was a critical analysis as the possibility of legislation rests, in large part, on his shoulders. Ranking Member Richard Shelby (R-AL), who despite his Republican affiliation is generally seen as a critic of very large financial firms, also implied that not the Volcker rule, but rather "more adequate capital" could have improved the problem—which was echoed by Governor Tarullo who also expressed support for strengthening capital requirements.

While there was discussion of the "too big to fail" issue, there was no indication that lawmakers appear interested in breaking up large banks. Despite some fears from the banking industry that the hearing would be a venue for renewed calls to break up large banks; Republicans instead use the hearing as a forum to question the need for the Volcker Rule and voice other concerns with the Dodd-Frank reforms. The only Committee member to raise concerns over the size of these banks was Senator Sherrod Brown (D-OH), who has introduced legislation that would statutorily cap the size of US banks.

Housing Finance Reform Plan Appears Stalled in Committee
Despite the apparent bipartisan support for proposals that would make it easier for homeowners to refinance their mortgages, legislation put forth by Senators Robert Menendez (D-NJ) and Barbara Boxer (D-CA) is experiencing stumbling blocks in Committee. Despite indications that Chairman Johnson hopes the Banking Committee can quickly advance the Menendez-Boxer legislation and the apparent support of Senator Bob Corker (R-TN) to have a successful markup of the bill, a senior aide to Ranking Member Richard Shelby (R-AL) was skeptical. Shelby Spokesman Jonathan Graffeo asserted that Committee Democrats have been hesitant to schedule a markup without being "assured of its outcome." For Committee Democrats, a markup with an open amendment process would leave the refinance legislation exposed to proposals to overhaul Fannie and Freddie and other, contentious issues revolving around the larger issue of housing reform.

Sanders Calls on President to Replace CFTC Chairman Gensler for failure to act on Speculation
On June 4th, Senator Bernie Sanders (I-VT) wrote to President Obama requesting the replacement of CFTC Chairman Gary Gensler. The letter points to January 2011 missed deadline in the Dodd-Frank financial reforms that would implement rules to curb oil market speculation as the grounds for rejecting another term of Gensler. "In blatant disregard of the law," wrote Sanders, "Chairman Gensler has allowed oil and gasoline prices to be dictated by Wall Street speculators instead of supply-and-demand fundamentals."

House of Representatives

Bernanke Urges Lawmakers that Monetary Policy Alone is not Enough to heal Economy

At a June 7th Joint Economic Committee hearing, Fed Chairman Ben Bernanke reminded lawmakers that monetary policy is "not a panacea" and urged lawmakers to do more to support the economic recovery. Since the weak May jobs numbers and amidst continued tremors out of Europe, many, especially Democrats, have hoped that the Fed will once again take aggressive action to shore up the economy. However, Bernanke was cautious in foreshadowing additional stimulus, to the delight of Republicans who have been critical of previous monetary policy efforts and opposed to further Fed action. However, despite Bernanke's calls for action from Congress, ideological differences between parties and general gridlock make it unlikely that Congress will be able to enact any substantive legislation on this topic until after the election. Nevertheless, Bernanke said additional stimulus, while it may boost the economy, could have "diminishing returns" given the near record low interest rates.

The Joint Economic hearing reflected a growing concern about shocks coming out of Europe—even as reports began to circulate of preparations for a bailout of Spanish banks, which became confirmed on Sunday. Bernanke told lawmakers that the U.S. is better positioned than Europe to withstand crises emanating from Greece, Spain and Italy but that the Fed is prepared to act "in the event that financial stresses escalate. Bernanke did not provide further detail on what Fed action would look like, but continued on to warm lawmakers of the danger posed by the 'fiscal cliff' at the end of the year. Echoing similar warning from earlier appearances before Congress, Bernanke urged lawmakers to address the fiscal tightening, saying that the Fed may not be able to undo the damage should the country go off the cliff.

Finally, Bernanke did not shed any light on upcoming easing by the Fed, which will next convene on June 19th and 20th to discuss policy setting. The Fed is considering a number of policy options said Bernanke and nothing is off the table at this point.

House Appropriations Subcommittees Approve FY13 Funding for SEC and CFTC

This past week the House Appropriations Subcommittee on Financial Services approved legislation to fund the various agencies under its jurisdiction for the next fiscal year. The bill includes a total of $21.15 billion in funding for the Treasury and various regulatory agencies including the SEC, SBA and GSA. That amount is $376 million below last year's level and $2 billion below the President's request, which trims funding for the FCC and FTC but actually provides a small increase for the SEC. The House Financial Services and General Government subcommittee advanced the bill by voice vote on June 6th, despite staunch opposition from the panel's Democrats. Notably, the legislation once again also includes an amendment to bring the CFPB into the normal appropriation process rather than receiving funding from the Federal Reserve. Ranking Member of the House Financial Services Committee Barney Frank (D-MA) said the funding bills represent "a declaration of unilateral surrender to the forces of irresponsibility that wrecked our economy several years ago."

In addition, the House Appropriations Agriculture subcommittee voted to approve its funding measure, where the CFTC was given $180.4 million—a $25 million reduction from last year and $128 million below the President's request. The budget plan also directs the agency to spend at least $32 million of its total budget on technology and $1.4 million on the Inspector General. In

response, Chairman Gensler, said the operation of the Commission, including market surveillance, Dodd-Frank implementation and administrative duties— would be materially weakened if the budget is approved. During the meeting to approve the CFTC budget recommendation, Representative Rosa DeLauro (D-CT) introduced an amendment, which failed 5 to 8, to provide the CFTC with a budget of $308 million. It is expected that the full Appropriations Committee will review the bill as soon as the week of June 18th, with a floor vote potentially as soon as the first week of July.

House Financial Services Subcommittee Examines CARD Act Implementation and Enforcement
On June 6th the House Financial Services Subcommittee on Financial Institutions and Consumer Credit held a hearing on the final rule implementing the Credit Card Accountability Responsibility and Disclosure (CARD) Act of 2009. Witnesses at the hearing had several complaints about implementation of the rule, including its exclusion of household income when determining a credit card applicant's ability to repay debt in favor of personal income. While the Fed issues the rule, it was transferred to the CFPB as part of the Dodd-Frank reforms. Witnesses from the CFPB told lawmakers that the Bureau is actively evaluating the regulation and expects to come to a decision soon about interpretation of the rule. The Ranking Member of the Subcommittee, Carolyn Maloney (D-NY), one of the lead authors of the CARD Act, indicated that it was here sense that the rule as currently construed "misinterpreted Congressional intent in the area of a consumer's ability to repay their credit obligation." Given the pressure from Ms. Maloney and other Democrats, we anticipate that the CFPB will ultimately modify this proposal.

At Legislative Hearing, Bachus Indicates Openness to Making Changes to SRO Bill
On June 6th, House Financial Services Chairman Spencer Bachus (R-AL) said he is not opposed to addressing concerns in H.R. 4624, his bill to shift oversight of investment advisers to one or more self-regulatory organizations (SROs). The legislation, cosponsored by Representative Carolyn McCarthy (D-NY) has been the source of contention for many since its introduction in April. Groups—including the Investment Adviser Association, the Financial Planning Coalition and the Project on Government Oversight—agree that the under-funded SEC may not be able to provide meaningful oversight but disagree on the appropriate way in which to conduct oversight. FINRA was originally considered as the SRO that should be given the oversight power; however, comments at Thursday's hearing indicate this may not be set in stone. The FINRA option has drawn criticism from various groups despite support from the Financial Services Institute and the National Association of Insurance and Financial Advisors.

At the hearing, Bachus told his colleagues he is "more than willing to work with any member or interested stakeholders" to resolve concerns about the exemptions in the bill. While the legislation would require investment advisers to register with an SRO(s), it also exempts certain advisers from the requirement—including mutual fund advisers, firms that work with institutional investors, and private funds. The exemptions have drawn criticism from Democratic lawmakers and witnesses who thought the exemptions may result in a disproportionate burden on smaller firms. Meanwhile, Representative Maxine Waters (D-CA)

told the panel that she is currently working on legislation which would "allow the SEC to collect user fees to enable the examination of investment advisers."

Investors Tell Lawmakers They May be on Hook for Mortgage Servicing Errors
On June 7th, a House Financial Services Subcommittee panel heard from mortgage-backed securities investors as part of hearing to examine the need to protect investors from the government. While banks are allowed to make modifications to mortgages that they service on behalf of others, investors fear that loans will be unfairly targeted under the terms of a recent settlement between the five largest mortgage servicers (Bank of America, J.P. Morgan, Wells Fargo, Citicorp, and Ally Financial) and the government. In her written statement, Laurie Goodman, Senior Managing Director of Amherst Securities Group, told lawmakers the five banks may be unwilling or unable to modify enough loans to meet the terms of the agreement. Another witness, Adam Levitin of Georgetown Law, told lawmakers it is unclear whether investors will suffer financial harms from the principal reductions associated with the settlement as banks must still comply with investor pooling and servicing agreements (PSAs) regardless of the settlement. Levitin continued that PSAs require servicers to maximize the net present value of loans, thus, "if the servicers are complying with PSAs, then servicers will get credit under the settlement for loan modifications that they would have done anyhow."

Meanwhile industry testified that the net present value test used to identify loan modifications is troubling as banks subject to the settlement are not permitted to compare principal deductions with other loan modification tools—such as temporary hardship payment plans, government-backed refinancing, short sales, or deed-in-lieu of foreclosure transactions—which could preserve greater value for investors. Chairman of the Subcommittee on Capital Markets and Government Sponsored Enterprises, Scott Garrett (R-NJ), in recognition of the industry's concerns, has filed an amendment to the FY 2013 Department of Justice funding bill to ensure investors participate in any expansion of the mortgage servicing settlement.

Capito Requests Information on TAG Program from FDIC
On June 7th, House Financial Services Subcommittee on Financial Institutions Chairman Shelley Moore Capito (R-WV) wrote the FDIC Chairman Martin Gruenberg requesting information on the Transaction Account Guarantee (TAG) Program—which is set to sunset at the end of the year. In her letter, Chairwoman Capito requested FDIC comment on five questions: 1) the cost of the TAG program, to date, on the Deposit Insurance Fund (DIF) and what the costs would be if extended; 2) the consequences to the DIF if the program is (or is not) extended; 3) if the TAG program affects overall liquidity in the economy and the overall effect on the banking system of TAG; 4) consequences of expiration to the banking industry; and 5) if the FDIC will notify banks and customers of the expiration.

CRS Finds Financial Transactions Tax Would Raise Revenue, Not Succeed in Reducing Volatility
A June 1st CRS report found that initiatives to impose a financial transactions tax would be ineffective at reducing market volatility, despite possibly acting as a revenue raiser. Democratic House Members have been examining the possibility of a tax on the buyers and/or sellers of a security at the time of transaction for several years. H.R. 3313, sponsored by Representative

Peter DeFazio (D-OR), would impose a 0.03 percent excise tax on the purchase of a security, including stocks, bonds, futures and interests in a derivative. Representative Chaka Fattah (D-PA) has offered H.R. 1125 which would impose a 1 percent tax on all transaction in the economy, including those using checks, cash, credit cards and stock transfers. The CRS report suggested that a tax on securities could actually increase volatility and politely suggested that other regulatory mechanisms might be more appropriate. Using 2007 SEC trading volumes the report found that a 0.25 percent tax, assuming a 20 percent reduction in trading volume, could raise $132.3 billion and the same tax assuming a 50 percent reduction would raise $82.7 billion.

Executive Branch

Federal Reserve Board

Fed Published Proposed Rules to Create Regulatory Capital Framework

On June 7th, the Fed approved three notices of proposed rulemakings designed to help ensure banks maintain strong capital positions and create regulatory capital framework. The first notice of proposed rulemaking (NPR) would affect banks, savings associations, and bank holding companies with assets of more than $500 million and savings and loan holding companies. Under the rulemaking, lenders would be required to meet minimum capital requirements of common equity Tier 1 capital ratio of 4.5 percent, a total capital ratio of 8 percent of risk-weighted assets, and a Tier 1 leverage ratio of 4 percent. The proposed rule also makes changes to the definition of capital, making capital deductions stricter. The draft rule would capture all 7,307 U.S. banks, including small lenders. Notably, the Fed pushed forward with the rulemaking despite concerns from the Basel Committee on Banking Supervision—which recently suggested a rewrite of its trading book rules.

The second NPR applies to the same banking organizations captured by the first. The rulemaking is intended to "revise and harmonize the agencies' rules for calculating risk-weighted assets to enhance risk sensitivity and address weaknesses." Risk-weighted assets are used by banks and regulators to assign risk to asset classes with riskier assets requiring higher capital buffers. The third NPR applies to banking organizations that are subject to the banking agencies' advanced approaches rule or to their market risk rule. The rulemaking seeks to address risk sensitivity of the current rule for international firms and account for counterparty credit risk and interconnectedness among financial institutions. The comment period on the three proposals will remain open through September 7th, with the final rules to become effective January 1, 2013. In the open meeting to discuss the rules, Fed staff said they expect banks will be able to meet all of the new capital requirements through retained earnings.

CFPB

CFPB and Prudential Regulators Publish MOU on Coordinated Examinations Process

On June 4th, the CFPB along with the Fed, FDIC, OCC and NCUA published a Memorandum of Understanding (MOU) outlining an agreement for coordinating examinations of large banks and sharing supervisory information. The agreement applies only to banks with more than $10 billion in assets, as smaller institutions will continue to receive supervision from their primary regulator. The MOU reflects Section 1025 of the Dodd-Frank Act which requires the CFPB to coordinate supervision with prudential regulators. As part of Section 1025 regulators must

conduct simultaneous examinations of large banks (unless the institution requests separate examinations) and share draft supervisory reports for interagency comment. The MOU lays out protocols for scheduling simultaneous and coordinated supervision in addition to establishing points of contact at each regulator and notifying banks of upcoming examinations. The MOU also sets protocols for how the CFPB and other regulators will share draft examination reports—both the Bureau and prudential regulators are required to share reports and allow the receiving agencies 30 days for comment before finalization.

SEC

SEC Approves Measures to Curb Trading Volatility on US Markets

On May 31st, the SEC approved two proposals intended to dampen volatility in the stock market. First is the "limit up-limit down" plan to temporarily prevent trading in a particular listed stock in the event of rapid price swings. The second was a plan to tighten market-wide circuit breakers. The proposals were submitted to the SEC by the national securities exchanges and FINRA and will operate as a one year pilot beginning February 4, 2013. The limit up-limit down plan would replace the current single-stock circuit breaker pilot and requires exchanges, alternative trading systems, broker-dealers and other trading centers to implement policies and procedures to prevent the execution of trades outside of a set price band. The second proposal, to tighten market-wide circuit breakers, would update circuit breakers to: decrease the existing 10 percent, 20 percent and 30 percent market decline thresholds to 7 percent, 13 percent and 20 percent; using the S&P 500 as the circuit breaker threshold; recalculate the circuit breaker benchmarks on a daily basis; modify the time when halts may be set off; and modify the length of halts. The measures may have an impact on so-called high frequency or "algo" traders, some of whom are rumored to be under a far ranging congressional investigation to examine their impact on capital markets.

CFTC

CFTC Planning Vote on Extending Reach of Dodd-Frank Swaps Provisions Overseas

Bloomberg was reporting that at a June 21st meeting of the CFTC, the Commission may vote to propose guidelines for applying Dodd-Frank rules to overseas swaps trading. An interesting story since just last week Commissioner O'Malia told a conference in New York that he was unaware that any such guidelines had been drafted. According to the report, the interpretative guidance to impose margin requirements on non-U.S. swaps is still under consideration by top derivatives regulators and will remain open to changes until the vote. Notwithstanding O'Malia's ignorance, whether real or purported, these actions should come as no surprise to CFTC watchers, since on May 21st, Chairman Gensler said the JP Morgan loss underscored the need to extend Dodd-Frank's reach to overseas trades. The Commission should anticipate significant industry pushback, especially because as it stands, Dodd-Frank clearing and collateral rule do not apply to trades between overseas affiliated of U.S. firms and foreign-based companies not guaranteed by a U.S. company.

International

Canadian Bank Publish Voluntary Guidelines for Mobile Payments Systems

A group on Canadian banks and credit unions released a set of voluntary guidelines on the implementation of mobile payments systems in repose to a burgeoning demand for the technology. The guidelines come on the heels of a March 2012 report of the Canadian Task Force on Payments System Review which suggested the development of mobile payment guidelines. The Canadian Bankers Association, while it did not actually craft the guidelines, was involved in industry discussions and responsible for dissemination to the public.

The Mobile Reference Model lays out a framework for how Canadian financial institutions can offer mobile payment services and a blueprint for how information can be exchanges in these transactions. Though voluntary, the financial institutions who helped to develop the model have said they are committed to the principles and the accelerated adoption of mobile payments. Specifically, the Reference Model addresses both hardware and software and lays out recommendations in the areas of proprietary, collective and open forms of wallet applications.

Miscellaneous

NASDAQ Offers Apology, Compensation for Botched Facebook IPO

In response to technical glitches that botched Facebook's IPO NASDAQ has announced that it "owes the industry an apology" for the problems associated with the offering. NASDAQ has outlined a 'one-time' payout of approximately $40million as compensation; however, financial firms on Wall Street have met the payout with derision, saying it does not come close to coving the more than $100 million in losses sustained in Facebook's public offering. NASDAQ is also considering offering discounted trading fees and filed a compensation plan with the SEC on June 6th.

UPCOMING HEARINGS

The House will be in Recess this week.

On Tuesday, June 12th at 3:30pm, in 138 Dirksen, the Senate Appropriations Subcommittee on Financial Services and General Government will mark up draft legislation, "Fiscal 2013 Financial Services Appropriations."

On Wednesday, June 13th at 10am, in G-50 Dirksen, the Senate Banking, Housing and Urban Affairs Committee will hold a hearing titled "A Breakdown in Risk Management: What Went Wrong at J.P. Morgan Chase?"

On Thursday, June 14th at 10am, the House Small Business Subcommittee on Contracting and Workforce will hold a field hearing titled "Caught Up In Red Tape: The Impact of Federal Regulations on Small Businesses and Contractors."

On Thursday, June 14th at time TBA, in 106 Dirksen, the Senate Appropriations Committee will mark up draft legislation, "Fiscal 2013 Financial Services Appropriations."

On Tuesday, June 19th at 10am, in 2128 Rayburn, the House Financial Services Committee will examine the public policy implications of JPMorgan Chase's recent multi-billion dollar trading loss.

On Wednesday, June 20th at 9:30am, in 2128 Rayburn, the House Financial Services Capital Markets and Government Sponsored Enterprises Subcommittee will hold a hearing focused on U.S. equity market structure.

On Wednesday, June 20th at 1:30pm, in 2128 Rayburn, the House Financial Services Insurance, Housing, and Community Opportunity Subcommittee will examine recent efforts by the Consumer Financial Protection Bureau (CFPB) to change mortgage loan disclosures required at closing.

On Thursday, June 21st at 9:30am, in 2128 Rayburn, the House Financial Services Financial Institutions and Consumer Credit Subcommittee will meet for a hearing to discuss issues surrounding the provision of retail banking services to money service businesses.

On Wednesday, June 27th at 10am, in 2128 Rayburn, the House Financial Services Insurance and Housing Community Opportunity Subcommittee will hold a hearing on the appraisal industry and regulations impacting the single-family mortgage market.

On Thursday, June 28th at 2pm, in 2128 Rayburn, the House Financial Services Domestic Monetary Policy and Technology Subcommittee will hold a hearing on fractional reserve banking and its impact on monetary policy.