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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

January 23, 2012

Leading the Past Week

With the Senate on still on recess or in *pro forma* session last week, the House had sole spotlight in our nation's capital. Taking advantage of this, the House Financial Services Committee held a marathon hearing on the so-called "Volcker Rule" where a bipartisan chorus attacked the proposal and cited its numerous flaws. In addition, the House formally rejected President Obama's request to raise the debt ceiling by a vote of 239-176. This *kabuki-esque* exercise will be followed shortly in the Senate as part of the play that was written into the debt deal in August. Both votes are exercises in futility in the sense that the President will veto the Congressional action and neither the House nor the Senate is anticipated to muster the support needed to for an override.

Of course, the biggest news during the past week was the full engagement of newly, and controversially appointed, CFPB Director Cordray, who convened his first CFPB public hearing and participated in his first Federal Deposit Insurance Corporation (FDIC) board meeting, either action potentially providing a plaintiff with standing to bring suit to challenge the appoint.

Legislative Branch

House of Representatives

Lawmakers Grill Regulators on the Implementation of the Volcker Rule – Is a Reproposal in the near future?

At a January 18th meeting of the Financial Services Committee, lawmakers on both sides of the aisle criticized the proposed Volcker Rule and grilled regulators about how they planned on implementing Section 619 of the Dodd-Frank Act. With the heads of all of the relevant federal banking and securities agencies present, these regulators attempted to allay lawmakers' concerns about the length and complexity of the rule. However, since the proposed rule runs nearly 300 pages long and asks for comment on over 1,000 questions surrounding definitions, authorized and exempted activities, compliance and costs and benefits, many lawmakers remained skeptical of regulators' ability to issue a workable rule that reflects both public comments and which can make the appropriate distinctions between banned proprietary trading and legitimate banking activities before the July 2012 effective date. Unsurprisingly, Representative Barney Frank (D-MA) defended the Volcker Rule and the regulators' efforts to implement the rule in a thoughtful manner. Frank acknowledged the complexity of the proposed rule, though he put the blame on industry for trying to protect certain carve outs and industries as the genesis of the problem.

A major theme that emerged during the hearing was how regulators plan to distinguish between banned proprietary trades and legitimate market making, underwriting and risk-mitigating hedging activities. Statutorily, the Volcker Rule lays out a complicated "intent test" to differentiate between the trading activities. Federal Reserve Board Governor Daniel Tarullo told lawmakers the regulators have identified various approaches to the intent test which hold promise but present challenges for their "considerable complexity or deviation from the statutory standards." Lawmakers also raised concerns about the lack of international harmonization around a Volcker-like rule and the possibility of creating regulatory arbitrage and a US competitive disadvantage. Acting Comptroller of the Currency, John Walsh, echoed lawmakers' fears saying, "foreign jurisdictions have not adopted restrictions resembling those in the Volcker Rule" and the US may face a "competitive disadvantage" as foreign banks remain unaffected by the rule. Given all of the complexities surrounding the rule as currently proposed, it would not be surprising if the regulators decided to go back to the drawing board and repropose the rule, a thought raised by at least one of the members of the Committee.

Bachus Will Not Seek Waiver for the HFSC Chairmanship in the Next Congress:
Representative Spencer Bachus (R-AL) has announced he will not ask the Republican Steering Committee for a waiver to continue to serve as the Chairman of the Financial Services Committee beyond his term. Bachus has said that he has always supported the six-year term limit rule for committee chairmen but that he expects to maintain a "position of high responsibility in the leadership." There are a number of possible successors who could serve as the next chair of the committee including Representatives Ed Royce (R-CA), Jeb Hensarling (R-TX), Scott Garrett (R-NJ), Shelley Moor Capito (R-WV) and Randy Neugebauer (R-TX). Bachus has said he would like to play a role in choosing his replacement and believes there are 'at least five people who are fully capable." Regardless of who becomes chair, with the retirement of Barney Frank the leadership of the Committee, and the potential interplay between Chairman and Ranking member, which despite a few occasional flare-ups should be described as generally positive, will be drastically different in 2013.

Financial Services Committee Staff Changes:
Following Chairman Baucus' announcement, the Committee also made public some staff changes. Larry Lavender, long time Baucus aide, and the current Chief of Staff for Financial Services Committee will be joining the law firm Jones Walker. However, before joining the private sector, Lavender will head down to Alabama to head Bachus' primary re-election campaign. Lavender will be replaced by Jim Clinger, the current Chief Counsel for the Committee.

Senate
Senate Agriculture Plans Futures Market Hearing:
In a vaguely worded and exceptionally non-specific request, Senate Agriculture Committee Chairman Debbie Stabenow (D-MI) issued an open invitation to representatives from the financial services industry, market participants, advocacy groups and other stakeholders to participate in a hearing on the rules and regulations designed to protect customers in the futures market. The invitation was not clear as to when this hearing would take place, but it is obvious that Stabenow is focusing on the issue in response to the failure of MF Global and that the hearing will play a role in the Committee's investigation of that company's bankruptcy.

Executive Branch

White House

President's Job Council Releases Recommendations on Employment:

On January 17th, the President's Council on Jobs and Competitiveness released its annual report with recommendations on boosting US employment. The Council found that the White House has already taken action on 33 of the 35 proposals made by the previous years' report that did not require legislation and has fully implemented 16 job creating ideas. In addition to reviewing past actions addressing unemployment, the Council's report recommends additional long-term strategies such as investing in education and innovation and building up manufacturing of clean energy.

The White House has already announced that the President will take action on the Council's recommendation to expand the SelectUSA program housed in the Commerce Department. SelectUSA is a unique program aimed at promoting investment in the US through: building a network of foreign direct investment promotion; supporting over 300 investment cases annually; and hosting SelectUSA conferences to boost investment. While it wouldn't be surprising to some of the recommendations worked into the State of the Union this week, given the public dissent of the report issued by Richard Trumka and UFCW leader Joe Hansen it will be interesting to see how the White House moves forward with the Councils report.

CFPB

Cordray Presides Over Public Hearing on Payday Loans:

On January 19th, the CFPB held its first public hearing since Richard Cordray's controversial appointment to be Director of the Bureau. Not surprising, the hearing focused on the activities of payday lenders, as the Bureau had clearly indicated that the industry would be one of its first targets once it was fully up and running. While Cordray did not mention any specific new regulations or directions the in which the Bureau will go to restrict payday lending, he did say that the goal of CFPB oversight would be to "develop a more vibrant, competitive market for small consumer loans" and focus on "aggressive debt collection."

While saying that they don't have any set path in mind, the CFPB announced during the hearing that when the interest on payday loans is calculated as an annual rate (as is required by the Truth in Lending Act [TILA]) it comes to as high as 521 percent. To address this, Cordray said the Bureau must understand what information is available to consumers who seek out such loans. To that end, the CFPB will use its examination authority to better its understanding of the industry prior to regulation. In remarks at the hearing, Cordray said the Bureau's examination authority allows them to "inspect their books, ask tough questions, and work with them to fix any problems [they] uncover."

SEC

SEC Issues Revised Timeline for Implementing New Fiduciary Standards for Broker-Dealers as well as some of its other Dodd-Frank Rulemaking:

While this update was on hiatus, the SEC updated its Dodd-Frank Act implementation schedule. Notably, the January 5th update revised the timeline for the uniform fiduciary standard for broker-dealers and investment advisors moving the deadline from December 2012 to a date "still to be determined." The SEC also included revised timelines for a number of other rules such as municipal adviser registration, resource extraction disclosures and corporate clawbacks.

The SEC also pushed some swaps rulemakings to the future, including a joint SEC-CFTC Congressional report on stable value contracts and the adoption of rules governing trade reporting, data elements and real-time public reporting for security-based swaps. While some swaps rulemakings have been pushed back, other are expected to be finalized by June 2012, including: key definitions of swaps products and intermediaries; security-based swap clearing rules; registration and regulation of security-based swap data; mandatory clearing of security-based swaps rules; and end-user exemptions for security based swaps.

Lawmakers Call on SEC to Strengthen, Finalize ABS Rule:
On January 12th, Senators Carl Levin (D-MI) Jeff Merkley (D-OR) urged the SEC to finalize a proposed rule to ban those who package and distribute asset backed securities from participation in transactions that would conflict with the interests of investors. In a letter to the Commission, the lawmakers called for the rules to be finalized "as soon as possible" and recommended the agency strengthen the proposal by expanding the rule to cover more abusive activities. Specifically, lawmakers asked that the SEC clarify the definition of "covered person" and "covered product" to fully ensure abusive actors are targeted by the new rule. The proposed rule was originally issued in September 2011; however, the comment period has already been extended twice, in conjunction with the Volcker Rule, to address the relationship between the two proposals.

CFTC

DOL Comments on CFTC Business Conduct Rule:
On January 17th, the Department of Labor (DOL) sent a letter to the CFTC regarding the Commission's external business conduct standards for swap dealers and major swap participants. DOL reviewed the rules for the possibility they would have a "direct impact on Employee Retirement Income Security Act (ERISA) covered plans and plan fiduciaries." Following DOL's review, the agency determined that the CFTC's final rules do not "conflict with the Department's existing regulations, nor compel swap dealers or major swap participants to engage in fiduciary conduct." Thus, by DOL's estimation, there will be no unintended consequences for swap dealers from the rulemaking.

CFTC Delays January Dodd-Frank Meetings:
For the second time this year, the CFTC has announced it will postpone a Dodd-Frank Rulemaking meeting. Planned meetings slated for January 17th and January 25th will both be postponed and rescheduled. The CFTC has yet to shed light on why the meetings have been delayed and commissioners have already begun to comment that the implementation schedule to finalize 11 Dodd-Frank ruled by the end of March is an overly optimistic pace.

FDIC

FDIC Approves Stress Test Rule for Large Banks:
On January 17th, the FDIC proposed a rule to require "large insured depository institutions to conduct annual capital-adequacy stress tests." The proposed rule would implement section 165(i)(2) of the Dodd-Frank Act and require banks with over $10 billion in assets to craft responses to three economic scenarios posed by the FDIC. According to the FDIC, as of September 30th, 23 institutions would fall under the purview of the rule. The rulemaking is similar to Fed proposal to test holding companies with over $50 billion in assets and an upcoming OCC rule for federally-charted banks and thrifts with more than $10 billion in assets. Notably, the FDIC rule does not address how it will disclose stress test data—such as loss revenues, capital ratios, net income and other proprietary information— provided by banks.

The FDIC board meeting to propose the rule was the first meeting attended by Richard Cordray, the newly appointed CFPB Director. Prior to the meeting, Cordray told the press his position on the Board, created by the Dodd-Frank Act, "brings a consumer perspective, which is an arguably different angle from the other banking agencies." Cordray voted to approve the FDIC stress test rule saying it will "protect consumers" and "the system as a whole," which conceivably could provide standing to any of the banks impacted by the rule to sue due to the potentially ex constitutional nature of Cordray's appointment.

<u>International</u>

IMF Asks for Funds to Shore Up Bailout Fund:

Last week, the International Monetary Fund (IMF) asked its member companies to contribute an additional $500 billion so as to provide for increased global demand for bailout loans in the coming two years. It has been reported that the US has already nixed the possibility of increasing its contribution to the fund given staunch opposition in Congress to increasing the US commitment. Countries such as Brazil and India and other emerging markets are more supportive of the request despite indicating that Europe should largely finance their own troubles. The IMF did not release details on what regions will most likely require bailouts; however, it is expected that the Euro zone countries will be the most in need—with Spain and Italy at the front of the line.

International Groups Propose Guidelines to Govern OTC Derivatives:

On January 17th, the Committee on Payment and Settlement Systems (CPSS) and International Organization of Securities Commissions (IOSCO) released a set of global recommendations for collecting, storing and disseminating data on over-the-counter (OTC) derivatives trading. The report is an updated version of a draft released by the bodies in August. The report, mandated by the Financial Stability Board (FSB), recommends that data on transaction economics, counterparties, underlies and other operational and event data be reported trade repositories so as to asses risk and financial stability. The groups also recommended the "expeditious development" and use of a standard international Legal Entity Identifier (LEI) which would aggregate OTC derivatives data across trade repositories. The use of an LEI would "facilitate and improve the ability of authorities to properly attribute OTC derivatives activity to a party or group," said CPSS and IOSCO.

The groups noted that "some questions remain" on how to address OTC derivatives and the Group of 20 has directed the FSB to further consider the issue. Even as these international bodies work to develop OTC standards, the SEC and CFTC continue to issue rules for derivative trading taking place in the United States or by US based entities.

<u>Miscellaneous</u>

Investors Call on Companies to Disclose Political and Electoral Spending:

On January 19th, a group on institutional investors called on 40 companies to disclose their political lobbying expenditures. The investors included New York State Common Retirement Fund, Walden Asset Management, the American Federation of State, Country and Municipal Employees' Pension Plan, among others. The investors argued to companies—such as Bank of America Corporation, Coca-Cola, Pfizer and Northrop Grumman Corporation—that shareholders deserve to know how corporations spend resources affecting political and electoral decisions. The move comes about two years after the Supreme Court's *Citizens United*, fundamentally altered the way in which corporations could make political contributions. In related developments, there is a petition circulating among law school academics asking the SEC to require public companies to disclose political spending, and as we've previously reported, several Democratic lawmakers, including Gary Ackerman (D-NY) and Michael Capuano (D-MA), have also asked the agency to require such disclosures.

UPCOMING HEARINGS

On Tuesday, January 24th at 10am, in 210 Cannon, the House Budget Committee will markup budget process overhaul legislation.

On Tuesday, January 24th at 10:30am, in B-318 Rayburn, the House Ways and Means Subcommittee on Social Security will hold a hearing on the future of the Social Security Disability Insurance (SSDI) program.

On Tuesday, January 24th at 1:30pm, in 2154 Rayburn, the House Oversight and Government Reform Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs will hold a hearing titled "How Will the CFPB Function Under Richard Cordray?"

On Wednesday, January 25th at 10am, in 2247 Rayburn, the House Oversight and Government Reform Subcommittee on Government Organization, Efficiency and Financial Management will hold a hearing titled "Solutions Needed: Improper Payments Total $115 Billion in Federal Misspending."

On Wednesday, January 25th at 10am, in 2203 Rayburn, the House Oversight and Government Reform Subcommittee on Federal Workforce, U.S. Postal Service and Labor Policy will hold a hearing titled "Retirement Readiness: Strengthening the Federal Pension System."

On Thursday, January 26th at 10am, in 608 Dirksen, the Senate Budget Committee will hold a hearing on the outlook for the U.S. and global economy.