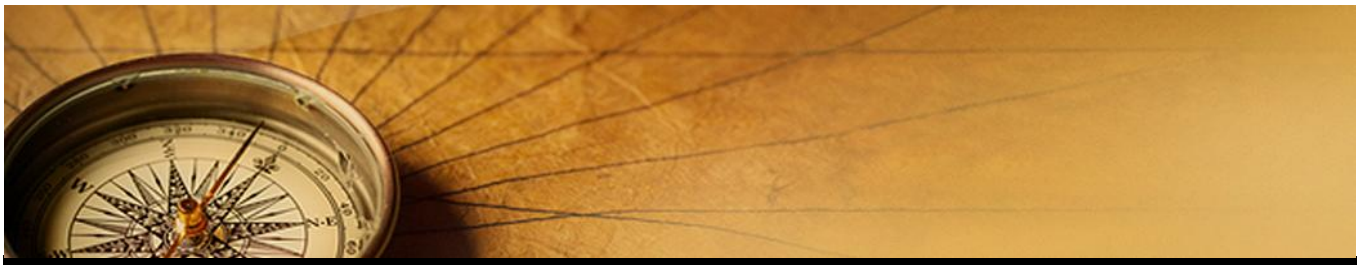

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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

July 16, 2012

Leading the Past Week

Last week provided an excellent frame by which to view the current political and regulatory landscape as we approach the two year anniversary of the signing of the Dodd-Frank Act and also find ourselves 113 days away from the election. In line with criticism that the Administration has been slow walking regulations, the CFTC and the SEC finally agreed to a definition of what constitutes a "swap"—notwithstanding the fact that both agencies have been putting out rules to regulate the market absent this critical component for the last 18 months. At the same time, Congress continued its oversight of Dodd-Frank with hearings to examine the implications of the reforms, as we saw this past week with a multitude of hearings in the House. Juxtaposing these hearings was the growing LIBOR scandal, which depending on one's perspective either shows that these reforms are not being implemented fast enough or that regardless of regulatory reform, market 'irregularities' will continue to occur. In other news, in a thinly veiled campaign event, the White House offered up a series of tax provisions aimed at shoring up small business investment and growth, which while DOA in the Congress, served to form the parameters of a larger political debate about the scope of the extension of the Bush tax cuts. Regardless of where the line is ultimately drawn, at $250,000 or some higher number, the key take away from the President's proposal is that it makes crystal clear that he intends to engage in substantive tax reform in 2013.

Legislative Branch

Senate

Senators Call for Investigation into LIBOR

On July 12th, twelve Senators sent a letter to Attorney General Eric Holder and members of the Financial Stability Oversight Council (FSOC) asking staff to "thoroughly investigate the banks and the process involved in setting LIBOR for any wrongdoing." The letter, signed by Senate Banking members Jack Reed (D-RI), Sherrod Brown (D-OH), Jeff Merkley (D-OR) among

others requested that the Justice Department look into allegations that both U.S. and foreign regulators were aware of the wrongdoing. Senators are also calling on U.S. regulators to address how much they knew about LIBOR rate setting. Especially in light of an email that emerged last week from then-New York Federal Reserve President Timothy Geithner to British regulators on how to 'enhance' the credibility of LIBOR.

Senate Rejects Small Business Bills

On July 12th, two small business tax cut plans failed in the Senate. In a 53 to 44 vote, Republicans rebuffed a Democratic bill that would have allowed small businesses to receive a ten percent income tax credit to their business in order to hire workers, give current workers raises or write off the purchase of new equipment. The Republican tax proposal—which was passed by the House in April—failed in a 24 to 73 vote. The plan would have provided a 20 percent tax cut for businesses with fewer than 500 workers and faced a veto threat from the White House.

Committee Examines Mobile Payments Framework

On July 10th, the Senate Banking Committee met in a sparsely attended hearing to examine ways in which to develop and implement a framework for safe and efficient mobile payments. The hearing follows a March 29th panel on the same topic. Witnesses included: Sarah Jane Hughes, University Scholar and Fellow in Commercial Law with the University of Indiana; Thomas Brown, Adjunct Professor, with the University of California, Berkeley School of Law; and Michael Katz, Professor of Economics with the University of California, Berkeley. Mr. Katz told Chairman Tim Johnson (D-SD) and Senator Jeff Merkley (D-OR)—the only lawmakers in attendance—that, in many cases, mobile services are not vast improvements over traditional card payments and privacy and security concerns with data collection may cause the need for regulation to ensure customer safety and certainty for business. Despite Mr. Katz's negative assessment, we expect both House and Senate banking Committees to continue hearings on this issue in the fall.

Especially because the industry continues to advance, as the Financial Times reported earlier in the week that the UK's largest mobile operators are preparing to launch Europe's first joint mobile phone payment platform in advance of an expected ruling approving the venture. The payment system is designed to be a single platform that can be used by retailers, banks and other groups to allow mobile wallets to be stored with cash and installed with various credit and debit functions. Rival groups have already made clear that the platform could give monopolistic powers of the mobile payments industry to its owners and Europe's competition oversight body has launched an investigation to determine if rivals would be shut out by the platform.

Senate Agriculture Planning Hearing on Dodd-Frank, MF Global

Last week, the Senate Agriculture Committee announced two hearings to take place in the coming weeks focusing on the implementation of the Dodd-Frank Act and the bankruptcy of MF Global. At a July 17th hearing CFTC Chairman Gary Gensler and SEC Director of Trading and Markets Robert Cook will testify on implementation of Dodd-Frank two years after its passage. At an August 1st hearing, witnesses from the CFTC and other investigators will testify

in addition to a panel of market participants on ways in which to strengthen protections for customer funds in light of the MF Global failure.

Republican Senators Pressure CFPB on Peregrine Financial Suit

In the wake of another massive firm failure, two Republican Senators are pressuring CFTC Chairman Gary Gensler on the investigation of Peregrine Financial Group's segregated customer fund violation. The Commission has sued Peregrine Financial alleging that the firm, during a recent SRO audit, falsely reported that it held more than $220 million in customer funds when, in reality, it held $5.1 million. The Peregrine suit marks the second time in just eight months that a registered futures commission merchant (FCM) has been scrutinized for improper use and misrepresentation of segregated customer funds. On July 12th, Senator Jerry Moran (R-KS) called on Gensler to resign while Senator Charles Grassley (R-IA) requested details of the CFTC's oversight of Peregrine. Moran, the Ranking Member of the Senate Appropriations Financial Services Subcommittee, which has jurisdiction over the CFTC, accused Gensler and the CFTC of placing too much emphasis on a "Dodd-Frank power grab" while failing to prioritize FCM oversight. Meanwhile, Grassley requested Gensler detail CFTC oversight of Peregrine from 2010 on. Grassley separately wrote to the leadership of the Senate Agriculture Committee requesting the Committee include questioning about Peregrine in an August 1st hearing to discuss MF Global.

Committee Urged to Do Something on Cybersecurity to Avoid Future Attacks

At July 11th Senate Homeland Security and Government Affairs Committee hearing on emerging threats, lawmakers were told that something must be done to address cyberthreats facing the U.S. Witnesses stressed to lawmakers that Congress must act now to avoid the risk of a catastrophic attack in the future. One remedy on the table in Congress is the Cybersecurity Act of 2012, which, despite support of leaders on the Senate Intelligence, Commerce and Homeland Security committees, has been stalled due to Republican concerns over authorizing the Department of Homeland Security to set security standards for the nation's "critical infrastructure" operators, including financial institutions. Still, Majority Leader Harry Reid (R-NV) has indicated a desire to advance the bill and begin floor debate by the end of July.

House of Representatives

ATM Fee Sign Repeal Passes House

On July 9th, H.R. 4367, a bill to amend the Electronic Fund Transfer Act passed the House in a vote of 371 to zero. The bill removes a requirement that banks and credit unions post on the exterior of ATM machines a warning that customers could be charged fees if they do not hold an account at that bank. According to banks, the requirement has led to a series of frivolous lawsuits. Similar legislation (S. 3204) has been introduced in the Senate, and given the broad support the measure had in the House and the powerful interest supporting it, we fully expect this legislation to become law soon.

House Financial Services Committee Examines Dodd-Frank Mortgage Rules, QM Standard

Witnesses at a July 11th House Financial Services Subcommittee hearing to discuss Dodd-Frank Home Mortgage reforms told lawmakers that the CFPB's qualified mortgage (QM) rule should

be broadly defined. While representatives from the Mortgage Bankers Association (MBA), the Securities Industry and Financial Markets Association (SIFMA), Center for Responsible Lending, and National Consumer Law Center agreed on the QM rule, there was debate over the degree to which legal protection should be afforded to those who originate and back the loans. The industry has been pushing for a strong safe harbor to protect against borrower lawsuits. While Debra Still, Chairman-elect of the MBA, told lawmakers that a safe harbor would benefit lenders and consumers, attorney from the Consumer Law Center, Alys Cohen, said concerns about the need for a safe harbor are overblown and the existing rebuttal presumption clause is sufficient.

Meanwhile, Representative Shelley Moore Capito (R-WV) and Brad Sherman (D-CA) announced at the hearing that they were preparing to send a letter to the CFPB on the QM rule, calling for strong legal protections for mortgage lenders who follow underwriting rules. A spokesperson for Sherman was later quoted in the press saying that that 90 lawmakers had signed onto the letter so far.

House Financial Services Examines Impact of Dodd-Frank on Consumers and Jobs
On July 10th, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprise held a hearing to consider the financial reforms' impact on capital markets, job creators and consumers. Witnesses from CRE Finance Council and CalPERS took opposing positions on how Dodd-Frank has affected commercial real estate markets. Paul Vanderslice, President of CRE Finance Council told Members that the premium capture cash reserve account provision will decrease loan originations and will lead to a bigger gap in commercial real estate debt. Meanwhile, Anne Simpson, Senior Portfolio Manager with CalPERS told lawmakers that curtailing speculative activity through the Volcker Rule and other provisions would strengthen U.S. pension funds. Other witnesses included Thomas Deas, from the National Association of Corporate Treasurers and the U.S. Chamber of Commerce; Tom Deutsch, from the American Securitization Forum; Dennis Kelleher, from Better Markets; and Thomas Lemke, from the Investment Company Institute.

House Judiciary Weighs Dodd-Frank's Impact on Competition
On July 10th, the House Judiciary Committee met to consider the effect of Dodd-Frank financial reform's effect on competition in the financial services industry. Subcommittee on Intellectual Property, Competition and the Internet Chairman Bob Goodlatte (R-VA) took the opportunity to decry the Dodd-Frank Act's burdens and underscore that it will hinder "competition in one of the most important sectors of our economy." One witness, Adam Levitin, a professor at Georgetown University Law Center, recognized the increased regulatory burdens but asserted that the reforms will improve competitiveness and level the playing field between large and small institutions.

Financial Services Member Pressing FIO on NAIC Reforms
In a July 12th letter, Representative Ed Royce (R-CA) requested that the Federal Insurance Office (FIO) investigate the National Association of Insurance Commissioners (NAIC) to study the "nature and scope of NAIC operations" as the group recommends how to modernize

regulations. Life and property insurers are overseen primarily by state officials who coordinate through the NAIC. Royce cautioned that NAIC could be overstepping its authority as it "appears to be engaging in regulatory activity." FIO Director McRaith has already begun collecting input for a report to Congress on how to update and improve the regulatory process. Royce requested the FIO report "kick off a comprehensive discussion on the future of insurance regulations." Royce is a member of the House Financial Services Committee and a supporter of the creation of the FIO.

Executive Branch

CFTC

CFTC Adopts Final Regulations to Define "Swap"

On July 10th, the CFTC adopted a final rule to define "swaps," "security-based swap," and "security-based swap agreement." The Commission voted 4 to 1 on the definitions, with Commissioner Bart Chilton voted against the measure. Commission Chilton explained his dissent on the basis that one of the exclusions to the definition could become "the new Enron loophole." Echoing Chilton's concerns, consumer groups, such as Public Citizen, are urging the Commission to ensure the swaps rule is not abused. Public Citizen cautioned that the CFTC has "opened a big loophole" by excluding forward contracts from the definition. Similarly, Americans for Financial Reform noted that the clearing exemption for small banks will cover more than 98 percent of banks, which hold more than 15 percent of U.S. banked assets.

Under the final swaps rule, certain insurance products, consumer and commercial transactions, loan participations, and forwards for nonfinancial commodities will not be considered swaps while swaps on interest rates, commodities, currency, equity and credit defaults will be included in the definition. Additionally, the CFTC clarified in its interpretation that foreign exchange forwards and other foreign exchange products not exempted by the Treasury will be treated as swaps in addition to foreign currency options, commodity options, non-deliverable forwards in foreign exchange, cross-currency swaps, forward rate agreements, options to enter into swaps, and forward swaps. Under the final rule, within two months of publication in the Federal register swap dealers and so-called major swap participants must register with the agency. The CFTC is estimating the rule will affect 125 companies, including JPMorgan, Goldman Sachs, Bank of America Corp, Citigroup Inc, and Morgan Stanley.

The rule also includes several exemptions for insurance and retail transactions. Forwards tied to nonfinancial commodities were also exempted. Commissioner Chilton underscored his concerns, saying the financial industry could create forwards with embed options so as to skirt regulations. The rule also includes an exemption for end-users from clearing so long as one counterparty to the swap transaction is a nonfinancial entity using the contract to hedge against commercial risk. As part of this exemption banks, savings associations, farm credit institutions, and credit unions that have less than $10 billion in total assets will not be considered "financial entities." Cooperatives, which would otherwise not qualify but that are entering into the swap for the benefit of members, will also qualify for the clearing exemption. The Commission also voted 5 to zero to exempt some companies from the requirement that they guarantee swaps at a central clearinghouse.

The rule was adopted jointly with the SEC who met in a closed session on July 6th to approve the rules. Finalizing the CFTC definitions will trigger numerous other requirements—some of which have already been proposed—including the registration of swap dealers and major swap participants, swap data repository registration standards, business conduct standards and position limits. On the contrary, the SEC has made clear that the finalization of the definitions will not trigger new requirements as the majority of the SEC's substantive swaps requirements remain in the proposal stage.

CFTC Reopens Comment Period on Margins for Uncleared Swaps Rule
In a July 6th statement the CFTC reopened the comment period for a rule that would establish initial margin requirements for uncleared swaps. Citing new international research, the CFTC reopened the rule for comments through September 14th in order to give interested parties the opportunity to comment based on proposals in the Basel Committee on Banking Supervision and International Organization of Securities Commissions consultative paper on margins for uncleared swaps. The rule was originally proposed in April 2011 and would require each side in transactions between swap dealers and major swap participants to pay and collect initial and "variation" margin for every trade. Variation margin acts as collateral used to cover continues exposure to a swap dealer or major swap participant due to changes in market value of the swap. Notably, the proposed rule does not impose cash margins on end-users.

SEC
SEC Adopts Final Regulations to Define "Swap"
On July 6th, the SEC voted to adopt rules to define the terms "swap" and "security-based swap." The SEC vote occurred during a closed meeting and the Commission released a fact sheet outlining the modifications that occurred to the proposed rule. The text of the final rule will be published in the Federal Register, and then will become effective 60 days following that date.

SEC Adopts Consolidated Audit Trail Rule
On July 11th, the SEC voted 3 to 2 to adopt a rule aimed at increasing surveillance of the equities market and establishing a central database of every trade order, execution and cancellation. Democratic Commissioners Luis Aguilar and Elisse Walter dissented, citing concerns that the rule provides exchanges with too much flexibility. Aguilar also voiced concerns that the rule "fails to set appropriately specific requirements to ensure the creation of a comprehensive market surveillance system." The rule is a response to the May 6, 2010 'flash crash' which temporarily wiped out $862 billion in U.S. equity value.

The rule will give U.S. exchanges 270 days to jointly submit a plan to the SEC to establish a consolidated audit trail. FINRA, its broker member, and exchanges will be responsible for providing detailed information to the SEC database, known as the CAT system. The final rule significantly eases requirements over the proposed rule by scaling back provisions requiring trade data to be submitted in real time in response to concerns from exchanges and brokers and instead requires the data to be submitted by 8am the following morning. The final rule also offered additional allowances to exchanges, such as allowing them to determine how data will be

reported to the SEC repository, as well as giving broker-dealers up to three years to begin reporting. Furthermore, FINRA will not be required to tag each order with a unique identifier, as had originally been proposed, but instead will only need to tag and store orders on the CAT system.

The rule also features an unprecedented change of the SEC's economic analysis process for rulemaking. Rather than provide a cost-benefit analysis in the adopting release, the SEC will perform an analysis of the CAT system after SROs have submitted plans and cost estimates.

Statute of Limitations for Filing Charges Against Financial Crisis Bad Actors Drawing Near
As the five year statute of limitations for filing civil suits against fraud and other charges comes to a close, the SEC is readying charges against firms and people involved in wrongdoing during the financial crisis. Among other cases, it is being reported that the SEC will be filing charges against those involved in a $1.6 million mortgage bond deal called Delphinus CDO 2007-1, a CDO which went bad within months. The case contends that investors in the CDO were not made aware that the hedge fund was betting on some of the subprime loans and other bundled assets decreasing in value.

SEC Updates Schedule of Dodd-Frank Implementation
On July 2nd, the SEC updated its schedule for implementation of the Dodd-Frank Act from an approximate timeline of agency actions to a list of pending Commission actions. The current schedule does not estimate dates of completion for each proposed rulemaking or public disclosure and simply lists actions by subject and Dodd-Frank section number.

CFPB
Bureau Proposes New Mortgage Disclosure Rules
On July 9th, the CFPB proposed rules to update the mortgage disclosure forms required by the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA) as well as amend Regulation X and Regulation Z to establish new "loan estimate" and "closing disclosure" forms. Under the rule, within three days of applying for a loan, consumers would be provided with a loan estimate outlining the terms, including how much interest they would pay, how that might shift over the life of the loan and the highest loan amount that consumers could face. Lenders and settlement service providers would also be required to keep electronic copies of the forms they provide to consumers—something the CFPB says will resolve compliance questions.

Speaking on the proposed rules, Director Richard Cordray said that previous iterations of mortgage disclosure do not adequately represent the information that is important to most borrowers and the new forms will highlight consumer abuses and restore trust in the mortgage industry. Dodd-Frank required the CFPB to issue the proposed rule by July 21st; however, there is no deadline for a final rulemaking and the Bureau is likely to delay finalizing the forms until other mortgage reforms—such as 'ability to pay' rules—are finalized. The CFPB also proposed a rule to expand the definition of a "high-cost mortgage" and strengthen protections for consumers who take out such loans. The rule implements Dodd-Frank provisions strengthening the Home Ownership and Equity Protection Act so as to prohibit balloon payments and

prepayment penalties. Comments on the "high-cost mortgage" rulemaking are due by September 7th. Comments on the majority of the new mortgage form rule are open through November 6th; however, comments are due for specific portions after 60 days, or on September 7th.

White House

Administration Proposes Series of Small Business Initiatives

On July 11th, the White House announced five proposals that would help small business expand and create jobs. The plan includes a proposal to increase expensing in 2013 and regulatory reforms. Also under the proposal, small businesses could write off up to $250,000 in capital investments in 2013. The package will be included in the President's legislative proposal to extend the 2001 and 2003 Bush tax cuts for households earning less than $250,000 a year. Also on July 11th, Majority Leader Reid (D-NV) thwarted an attempt by Republicans to force an immediate vote on extending all of the Bush tax cuts. The Administration is also crafting regulatory reforms to the New Markets Tax Credit—designed to make it easier for community development firms to attract private funds for investment in startups and small business. The White House is also proposing to open up the Small Business Administration's (SBA) Small Loan Advantage program, raising the maximum loan amount from $250,000 to $350,000. Finally, the initiative would streamline online applications for SBA's disaster loan program.

Federal Reserve

FOMC Minutes Increase Expectation of QE3

Minutes of the June 19th and 20th Federal Open Market Committee (FOMC) meeting released on July 11th show that members were split over whether the economy merited a third round of quantitative easing to promote economic growth and recovery. Market participants have taken the minutes as a sign that, should the economy continue to slow, the Fed will begin additional stimulus actions. Even before the minutes were made public, there were was an expectation that the Fed would undertake additional monetary easing. The Wall Street Journal's monthly survey showed that approximately half of economists surveyed expect a third round of quantitative easing.

FDIC

FDIC Releases Sections of Living Will Plans

On July 3rd, the FDIC released the public portions of its initial living will resolution plans for Bank of America, Barclays, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, JPMorgan Chase, Morgan Stanley and UBS. These nine large banks were the first group to submit plans to regulators detailing how the government could break up and sell assets in the event of a bank failure. Firms in this group include U.S. bank holding companies with $250 billion or more in total nonbank assets and foreign-based bank holding companies with $250 billion or more in total U.S. nonbank assets. Over 100 banks are required to submit living wills by the end of 2013 after which they will be required to update them annually or in the event of a substantial change in the firm.

UPCOMING HEARINGS

On Tuesday, July 17th at 9:30am, in 106 Dirksen, the Senate Homeland Security and Government Affairs Permanent Investigations Subcommittee will hold a hearing titled "U.S. Vulnerabilities to Money Laundering, Drugs and Terrorist Financing: HSBC Case History."

On Tuesday, July 17th at 10am, in G50 Dirksen, the Senate Banking, Housing, and Urban Affairs Committee will hold a hearing to receive testimony from Chairman of the Federal Reserve Ben Bernanke on the Semiannual Monetary Policy Report to the Congress.

On Tuesday, July 17th at 10am, in 328-A Russell, the Senate Agriculture, Nutrition and Forestry Committee will hold an oversight hearing on the Dodd-Frank Act (PL 111-203), focusing on its impact over the past two years.

On Wednesday, July 18th at 10am, in 2128 Rayburn, the House Financial Services Committee will hold a hearing to receive the semi-annual monetary policy report from the chairman of the Federal Reserve.

On Thursday, July 19th at 9:30am, in 2154 Rayburn, the House Oversight and Government Reform Committee will hold a hearing titled "Continuing Oversight of Regulatory Impediments to Job Creation: Job Creators Still Buried by Red Tape."

On Thursday, July 19th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit will hold a hearing on the impact the Dodd-Frank Act (PL 111-203) is having on consumers and the CFPB.

On Thursday, July 19th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Oversight and Investigations will hold a hearing on the impact the Dodd-Frank Act (PL 111-203) is having on jobs and the economy.

On Friday, July 20th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing on the impact the Dodd-Frank Act (PL 111-203) is having on municipal advisers and pending legislation.