ML Strategies Update

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Financial Services Legislative and Regulatory Update

Leading the Past Week

Congress usually tries to leave town for its month-long August recess either with a bang or a whisper, however on Friday it left town with a giant THUD, as both chambers failed to advance respective versions of the FY14 Transportation Housing and Urban Development ("THUD") bill. On August 1st Senate Republicans blocked a $54 billion proposal that would have funded highways, aviation, passenger rail, and other transportation projects because the bill exceeded previously agreed to spending limits. The Senate's actions came a day after House Republican leaders were forced to pull their $44 billion THUD bill from the floor due a lack of votes for the measure. These actions not only exposed rifts in the Republican party but also leaves many wondering if Congress will be able to keep the government operating upon its return. With only 11 legislative work days between the end of the District Work Period and the end of the Federal fiscal year on September 30th , plus the ever encroaching breach of the Federal debt limit, all sides will have to find a way to put forward a short term short-term continuing resolution ("CR") to keep the lights on while attempting to figure out how to address longer term issues like FY14 funding, the sequester and the debt ceiling.

While momentum is growing for some type of short-term CR, the impasse displayed during the THUD debate may be indicative of a broader inability of Congress to pass any long-term FY 2014 spending bills or reach compromise over ways to resolve the sequester. House, Minority Whip Steny Hoyer (D-MD) has said that, although post-sequester FY 2013 levels are about $70 billion less than what his party is seeking from FY2014 budget negotiations, he supports a short-term CR. Likewise, House Appropriations Committee Republicans have called for a CR in order to provide more time to negotiate details of FY 2014 spending with the Senate. The stopgap CR, which would be approximately $988 billion, has also been (sort of) endorsed by the House Budget Committee Chairman Paul Ryan (R-WI). Regardless, Ryan made it clear that any effort to enact any FY14 funding outside of a short term CR will see "the debt ceiling as the date which drives the process."

Even as lawmakers prepared to leave for August, President Obama said he would not be willing to negotiate increasing the statutory debt limit. In meetings with the House and Senate Democratic Caucus on Capitol Hill last week, the President sought to underscore that federal borrowing obligations cannot be used as a chip in negotiations over tax reform or the budget.

The upcoming fight over the debt limit and FY 2014 funding levels comes as the economy added 162,000 jobs in July—about 40,000 fewer than widely anticipated, but the unemployment rate dropped from 7.4 percent from 7.6 percent. The jobs report followed news that the economy grew only 1.7 percent in the second quarter. With last week's Federal Open Markets Committee (FOMC) meeting extending the Fed's current accommodative monetary policy and warning that tightening Federal budgets and tax increases may continue to impact growth, the numbers reflect the continued impact that a dysfunctional Congress is having on the economic recovery.

All of these factors, combined with the mass exodus of lawmakers and some staff from the Capitol for the month will push this tempest under the surface until it is ready to boil over when official Washington returns in September.

Legislative Branch

Senate

Senate Banking Committee Advances FHA Solvency Act

On July 31st, the Senate Banking Committee voted 21 to one to approve the FHA Solvency Act of 2013, which will allow the Federal Housing Administration (FHA) to charge higher premiums on insured loans, allow the agency to require more lenders to buy back loans when a borrower does not meet payments, and make prompt changes to the agency's reverse mortgage program through a lender letter as opposed to a formal rulemaking process. Senator Tom Coburn (R-OK) was the only Member to vote against the measure.

The Committee also approved by voice vote a package of amendments, including several proposed by Senator David Vitter (R-LA), to the bill which would give the Department of Housing and Urban Development (HUD) power to transfer mortgage servicing duties of an FHA insured loan from large banks to smaller firms better equipped to manage the loan. The amendment would also prohibit the FHA from limiting how much principal a borrower can access in a fixed-rate reverse mortgage, require more stringent stress tests, and direct the Treasury to notify the Committee before any bailout of the FHA's insurance fund. The same day, FHA Commissioner Carol Galante made a statement saying that the legislation will allow the agency to avoid undertaking significant restrictions to its reverse mortgage program and that the legislation makes the program "financially sound for the future."

Senate Banking Committee Holds Hearing to Discuss Financial Reform Implementation Progress

On July 30th, the Senate Banking Committee met to discuss Dodd-Frank and Jumpstart Our Business Startups (JOBS) Act rulemaking progress. Witnesses included Securities and Exchange (SEC) Chairman Mary Jo White and Commodity Futures Trading Commission (CFTC) Chairman Gary Gensler. Chairman White said that the SEC will complete a large number of Dodd-Frank rules in 2013, including the Volcker Rule and guidance on derivatives. White also said that that the SEC will soon publish a rule requiring disclosure of employee-to-CEO pay ratios and new rules governing crowdfunding will be released in the fall. Several Senators asked about recent issues surrounding possible investment bank tampering in physical commodities markets, with both White and Gensler responding that staff are examining these issues for possible rule revisions.

Senate Continues Probes into Bank Control of Commodities

On July 30th, Senate Agriculture Committee Chairman Debbie Stabenow (D-MI) wrote to the CFTC requesting the agency clarify its jurisdiction over London Metals Exchange (LME) Warehouses in the US. In a Senate Banking Financial Institutions Subcommittee hearing last week, witnesses told lawmakers that additional oversight is needed of bank control of commodities, including aluminum like that housed at LME. Stabenow noted that the Committee is preparing legislation to reauthorize the CFTC and requested the agency help "determine if there are any gaps in oversight and whether there is sufficient authority to deal with those gaps, and act." The same day, Senator Carl Levin (D-MI), Chairman of the Permanent Subcommittee on Investigations, announced the Subcommittee has been investigating banks' control of physical commodities and whether this control leads to price manipulation. In response to the rumblings on Capitol Hill that lawmakers may soon tackle banks' role in commodities trading, Goldman Sachs released a memo addressing concerns over the LME and noting support for recent proposals to reduce wait time at the warehouses.

Executive Branch

Federal Reserve

Federal Judge Overturns Fed Ruling Capping Interchange Fees

On July 31st, U.S. District Court for the District of Colombia Judge Richard Leon ruled a Federal Reserve (Fed) rule limiting the interchange fees banks could charge merchants for processing debit transactions "fundamentally deficient." Leon noted that the Dodd-Frank Act, in addition to statements made by Senator Richard Durbin (D-IL) who sponsored the amendment capping fees, make clear that Congress' intent was to decease the scope of debit card costs the Fed would be able to consider when setting the interchange standard. However, Leon found that the Fed "clearly disregarded Congressional intent by inappropriately inflating all debit card transaction fees by billions of dollars and failing to provide merchants with multiple unaffiliated networks for each debit card transaction." The Fed's 21-cent fee cap will remain in place until the agency is able to replace the vacated portions of the rule. The Court's ruling follows a March report by the Fed indicating it would not revisit the interchange fee level.

Senator Durbin praised the ruling, saying that overturning the rule capping swipe fees will yield lower rates and is a victory for small businesses and consumers. In addition, the Retail Industry Leaders Association (RILA) also lauded the decision, saying that the "flawed Federal Reserve rules have muted the law's intended benefits to merchants and consumers." Still, other industry groups expressed concern that invalidating the rule will be harmful. The American Bankers Association (ABA) and the Independent Community Bankers of America (ICBA) both expressed disappointment, the ICBA saying that it fears any new version of the cap on interchange will hurt small banks even further.

The Fed has said it is "reviewing the judge's opinion" but has otherwise not spoken out on the ruling. Notably, this is not the only legal setback to the Fed this week, as the Fed also failed in its effort to prevent Chairman Bernanke from being deposed by plaintiffs in a lawsuit related to the decision to bail out AIG in 2008.

FOMC Affirms Current Monetary Policy Strategy

On July 31st, the Federal Open Markets Committee (FOMC) voted eleven to one to continue its current bond buying levels. The Committee noted growth in the labor market and that economic activity expanded at a modest pace so far this year; however, also found that federal tax increases and spending cuts continue to impact growth. In addition, despite continued speculation after Chairman Bernanke's comments that the Fed would soon begin to taper quantitative easing, the

FOMC did not indicate when it will begin to wind down accommodative policies.

Federal Banking Regulators Issue Proposed Stress Test Guidance

On July 30th, federal regulators issued proposed guidance for medium-sized banks with assets in the $10 to $50 billion range that will be required, under the Dodd-Frank Act, to conduct annual stress tests. In a release announcing the proposed regulations, the Fed, the Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC) said the guidance is met to assist banks in appropriately scaling tests to their size, complexity, risk profile, business mix, and market footprint. Banks will be allowed to take different approaches to stress tests depending on these factors, with larger and more sophisticated banks expected to display a more advanced analysis of potential losses under stress. Comments on the guidance will be accepted until September 25th.

The "Invisible Primary" for Fed Chair Continues

Last week saw the continuation of the somewhat contentious debate over who the President should choose to serve as the next Chairman of the Fed. Two weeks ago, more than one-third of the Senate Democratic caucus signed a letter to President Obama urging him to nominate current Vice Chairman Janet Yellen, citing her "prescience" as a regulator and extensive monetary policy experience. Then this past week, thirty-seven House Democrats sent their own letter to the President on July 31st stating their belief that Yellen is the "best choice." While neither letter mentions other potential nominees, support for Yellen has largely been ginned up by opposition to former Treasury Secretary Larry Summers receiving the post. In a meeting last week with House Democrats, President Obama apparently forcefully defended Summers, mentioning his name along with Yellen's, and former Fed Vice Chairman Donald Kohn as possible candidates. In a meeting the same day with Senate Democrats, it was reported that Obama said he has interviewed several candidates for the chairmanship; however, no decision has been made and the White House has indicated that no nominations will be made until later in the fall.

SEC

SEC Approves New Securities Broker Rules

On July 31st, the SEC approved a final rule amending capital, customer protection, and recordkeeping rules for securities brokers, requiring addition disclosures and other safeguards. The Commission was divided in a three to two vote over the protection rules; however, unanimously approved additional amendments to existing rules to protect client money though changes to how capital is calculated and other documentation and notification requirements. Commissioners Troy Paredes and Daniel Gallagher, who voted against the new rule, released a joint statement explaining they fear the new rule does not "explicitly limit the scope of the Commission's audit documentation requests," which could impact the ability of the broker-dealer to interact with its auditor. Still, Commissioner Aguilar hailed the new rule as an important step to "cultivating early detection and to preventing the type of fraud [Bernie] Madoff perpetuated." The new rules will require broker-dealers to begin filing new quarterly reports by the end of 2013 and additional annual reports with the SEC beginning January 1, 2014.

Senate Confirms Nominations of Piwowar, Stein, and White

As part of "wrap-up" before leaving town, on August 1st, the Senate confirmed Michael Piwowar and Kara Stein to serve as Commissioners at the SEC. The Senate also confirmed current Chairman Mary Jo White to a full term which will expire June 5, 2019. All three nominations were approved by unanimous consent. Stein replaces Elisse Walter as a Democratic Commissioner and Piwowar replaces Troy Paredes as a Republican Commissioner. The Senate also approved Jason Furman to be chairman of the White House Council of Economic Advisors and Richard Metsger to be a member of the National Credit Union Administration (NCUA).

CFTC

Christopher Giancarlo to be Nominated to the CFTC

On August 1st, the White House announced that the President will nominate J. Christopher Giancarlo to serve as a Commissioner at the CFTC. Giancarlo, currently the Executive Vice President at GFI Group, a derivatives broker, will fill the opening left when Republican Commissioner Jill Sommers departed at the end of July.

Bloomberg Granted Swap Execution Facility Approval

On July 31st, the CFTC granted preliminary approval to Bloomberg LP for the company to run a swap execution facility (SEF) regulated derivatives trading platform. Bloomberg was the first firm to apply to the CFTC in June 2013 and was followed by Tradeweb, State Street, and other trading platforms.

CFPB

Bureau Warns that Private Student Loan Borrowers Still Facing Hurdles

On August 1st, the Consumer Financial Protection Bureau (CFPB) released a mid-year update analyzing complaints from private student loan borrowers. The report builds on an October 2012 report which detailed problems reported by borrowers and noted serious problems of active-duty servicemembers having difficulty accessing benefits under the Servicemembers Civil Relief Act (SCRA). The mid-year report reflects many of the same concerns, in addition to emerging problems, including: borrowers had a number of concerns about processing of payments, obtaining documentation about their loans, finding accurate information about their loan status and repayment options, and accessing basic account information.

House Republicans Question CFPB's 'Revolving Door"

On August 1st, House Republicans on the House Financial Services and House Oversight Committees wrote to Director Richard Cordray questioning whether four former Bureau employees "left the CFPB in order to profit from rules they helped create." Letter signatories include House Oversight Chairman Darrell Issa (R-CA), House Financial Services Chairman Jeb Hensarling (R-TX) and Representatives Jim Jordan (R-OH), Shelley Moore Capito (R-WV), and Patrick McHenry (R-NC). The lawmakers note that Raj Date, former Deputy Director, was heavily involved in the crafting of new mortgage lending rules before he left to start his own firm, Fenway Summer, and hired former CFPB colleagues Garry Reeder, Chris Haspel and Mitch Hochberg. Lawmakers wrote: "it appears that former CFPB employees are now offering financial products in a market sector created by the very rules they were in a position to influence while working in senior leadership positions."

Treasury

President Nominates Raskin to be Deputy Treasury Secretary, Dynan to Be Assistant Secretary

On July 31st, President Obama nominated current Federal Reserve Board Governor Sarah Bloom Raskin to be Deputy Treasury Secretary, taking over for departing Neal Wolin. Prior to serving with the Fed, Raskin was Commissioner of Financial Regulation for the State of Maryland, the Managing Director of Promontory Financial Group, General Counsel of Columbia Energy Services, and Banking Counsel to the Senate Banking Committee. Reacting to Raskin's nomination, Treasury Secretary Lew said that Raskin "has a deep understanding of banking and financial regulatory issues, as well as a firm grasp of how to run large, complex organizations" and shares his goal of increasing job creation, accelerating economic growth, and strengthening the middle class. In addition to Raskin, the President announced on August 1st that

Karen Dynan, current Vice President and Co-Director of Economic Studies at the Brookings Institution, will be nominated to serve as the Assistant Treasury Secretary for Economic Policy.

Upcoming Hearings

The Senate and House will be in Recess for the Month of August

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