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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

November 19, 2012

Leading the Past Week

Now that the election is behind us (for analysis of how the results could impact the financial services sector see, http://mlstrategies.com/articles/legislative-update-11-7-2012.pdf) the focus in Washington has shifted to the fiscal cliff, with the President and Congressional leaders meeting at the end of the week after both sides publicly floated their opening negotiating positions. Other than whether we will drive off the cliff at the end of the year, or how the solution will be structured, it seems that many people are trying to figure out where Senator-elect Elizabeth Warren will end up. While Ms. Warren hasn't publicly indicated if she will be trying to get on the banking committee, she has shown that she knows how to play the game in town, as other senior members of the Committee, notably Jack Reed, went to bat publicly for her, and it now appears that she will be on the committee in 2013 if she asks for it.

Besides dealing with rumors about future members, the Senate Banking was busy this past week examining the controversial Basel III capital standards. While the House Financial Services Committee will examine that issue after the Thanksgiving break, it released a controversial analysis of the MF Global collapse, which among other things served as kindling for renewed calls to merge the functions of the SEC and CFTC. In the administration, Martin Gruenberg will no longer be called acting Chair, as he, and Thomas Hoening were official confirmed as Chair and Vice Chair respectively, while the current deputy director of the CFPB, Raj Date, announced he will leave the Bureau at the end of January, which should coincide with the CFPB's finishing some of its mortgage rules, including QM and the RESPA/TILA reforms.

Fiscal Cliff

With only 43 days left to negotiate to avert the so-called fiscal cliff, both sides continue to sound positive that a deal can be found. On November 16th, Congressional leaders and the White House met to discuss the impending taxing and spending issues that make up the cliff.

Following the meeting, Majority Leader Harry Reid (D-NV) said there was agreement on how they will construct a deal that would resolve issues without pushing hard decisions off to the 113th Congress. Minority Leader Mitch McConnell (R-KY) and House Speaker John Boehner (R-OH) also left the White House meeting appearing ready to compromise and saying Republicans are "prepared to put revenue on the table." Echoing this optimism, Treasury Secretary Timothy Geithner said he believes that "within several weeks" lawmakers will be able to draft a compromise to avert tax hikes and resolve sequestration. Lawmakers will continue to meet over Thanksgiving and plan to meet with the President again the first week of December.

Even as lawmakers enter the Thanksgiving holiday with renewed willingness to compromise, think tanks are stakeholders are weighing in with their plans to avert the cliff. Five think thanks—the American Action Forum, the Bipartisan Policy Center, the Center for American Progress, the Economic Policy Institute, and the Heritage Foundation—released plans for dealing with the fiscal cliff and the deficit. While the plans differ in how they would raise revenues and what they cut, there seems to be a growing consensus for utilizing a cap on deductions as an alternative toward raising all rates. This idea is shared by the moderate Democratic group, Third Way, which has also weighed in with the idea of a package of tax changes which could raise $1.3 trillion over 10 years without raising rates.

Legislative Branch

Senate

Senate Banking Examines Basel III Capital Proposal

On November 14th, the Senate Banking Committee heard from the Fed, OCC and FDIC on how those agencies intend to implement the Basel III capital requirements. The hearing follows an earlier announcement by these regulators that they would not finalize the capital rules by the January 1st deadline for the rule. Further, the witnesses did not shed any light on a revised timeline during the hearing. Lawmakers took the opportunity to express concerns to regulators about the impact of the regulations on community banks, the treatment of insurance firms, the complexity of the rule and whether these reforms will ultimately strengthen the banking sector. Chairman Johnson expressed particular concern about the impact of the Basel III reforms on the insurance industry, requesting Federal regulators work with state insurance regulators and industry to hone the rules.

Regulators sought to assuage concerns about the effect of the rules on community banks, saying they are weighing the more than 1,500 comments received, and "will seek to further tailor the requirements as appropriate for community banks." Despite assurances, the industry is still calling for community banks to be treated differently. In a letter sent after the hearing, Better Markets, Inc. noted its support for capital requirements but stressed community banks and "Wall Street's too-big-to-fail" banks must be treated differently.

Speaking the following day at the Cato Institute's annual monetary conference, prior to being confirmed as FDIC Vice-Chair, Thomas Hoenig reiterated his opposition to the Basel III proposal, calling for regulators to rethink their approach to promoting capital buffers. Saying

Basel is "too complicated and too easily gamed," Hoenig recommended a tangible capital ratio which income managers use to asses strong or weak capital.

Citing LIBOR Concerns -- Republican Senators Place Hold on OFR Nomination
Senators Chuck Grassley (R-IA) and Mark Kirk (R-IL) has said they will place a hold on the nomination of Richard Berner to be the head of the Office of Financial Research (OFR), pointing to a failure of the Treasury to provide information on LIBOR manipulation as cause. The Senators say Treasury has "refused to respond" to a letter sent October 2nd asking why the agency used LIBOR even after it was discovered the rate was manipulated. Berner, former chief economist for Morgan Stanley, was nominated in December 2011 to head the new office charged with data collection for the FSOC.

Johnson Plans Hearing on FHA Financials
On November 16th, Senate Banking Chairman Tim Johnson (D-SD) said the Committee will hold a hearing this year on the finances of the Federal Housing Administration. Announcing the hearing, Johnson said, as the agency plays a crucial role in the housing market, the Department of Housing and Urban Development (HUD) and the Administration need to "do everything in their power to protect taxpayers and restore its capital reserve to the 2 percent level required by law." Johnson's statement came the same day as an HUD's annual report on the FHA's finances which detailed steps the agency plans to take to avoid a taxpayer bailout of the insurance fund. These measures include: raising its annual insurance premium on new mortgages by 10 basis points in 2013, mitigating losses, providing new relief for troubled borrowers, streamlining short-sale programs, and reversing a policy that cancels premiums for new borrowers as they pay off their loans. FHA Commissioner Carol Galante has also said the agency will ask Congress for new powers to recoup losses.

Warren Heading to Senate Banking? Johnson Lends Support to Warren for Banking Committee
In a statement November 13th, Chairman Johnson said he would support Senator-elect Elizabeth Warren (D-MA) should she wish a spot on the Banking Committee. Johnson pointed to a "good working relationship" with Warren and her "expertise and knowledge" as assets to the Committee. While Warren has yet to announce what committee assignments she will seek in the 113th Congress, liberal groups have been vocal in their support for putting her on the Committee, having generated over 80,000 signatures. In addition, Senator Jack Reed (D-RI), second in seniority behind Chairman Johnson has repeatedly voiced his public support for adding Warren to the Committee. The latest conventional wisdom is that Warren and Senator Chris Coons (D-DE) will be added and that other members may also join the committee depending on who leaves for other committee assignments.

House of Representatives
MF Global Autopsy Proposes Combining SEC, CFTC
On November 14th, the House Financial Services Subcommittee on Oversight and Investigations released a report which places heavy blame for the collapse of MF Global with the firm's CEO Jon Corzine and proposes a number of controversial policy changes, such as merging the CFTC and SEC into one agency. The report also recommends that Congress

consider legislation placing civil liabilities on those that sign futures brokers' financial statements or authorize transfers from customer accounts and requests lawmakers consider ways to spur competition in the industry.

In addition to panning Corzine, regulators were heavily criticized in the report, which outlined miscommunications between the SEC and CFTC connected with MF Global's failure. While the SEC has disputed the assertion that it failed to share information, as a remedy, the report proposes combining the SEC's and CFTC's operations into a "single financial regulatory agency that would have oversight of capital markets." However, the proposal is unlikely to gain traction as jurisdiction for the agencies in question spans several different committees in the House and Senate. Still, the proposal has support from key stakeholders; Barney Frank pushed for a merger during the debate over Dodd-Frank, Chairman of the Financial Services Committee Spencer Bachus voiced support, and SEC Chairman Schapiro has posited that the agencies could be combined, saying: "There is an enormous amount of logic to combining the two agencies and I think as well as we work together, having to divide the over the counter derivatives market is an example of why combining the two agencies would make sense." However, any attempt to facilitate this merger would set off a massive turf battle on the hill and not surprisingly, Representative Frank Lucas (R-OK), the Chairman of the House Agriculture Committee and Senator Pat Roberts (R-KS) the Ranking Member of the Senate Agriculture Committee, both weighed in against the idea last week.

Hensarling Officially Seeking Chairmanship of Financial Services Committee
On November 12th, Representative Jeb Hensarling (R-TX) officially announced he will seek the Chairmanship of the House Financial Services Committee. Hensarling, current Vice Chair, has long been expected to seek the leadership role on the Committee, despite having to give up his spot as House Republican Conference chair to do so. With current Ranking Member Barney Frank retiring, and his seat likely to be filled by Representative Maxine Waters (D-CA), Hensarling and Waters were reported to have met for lunch to discuss the Committee. Waters ascension to the top Democrat on the committee will set off a waterfall of changes, starting with a vacancy as ranking Democrat on the Capital Markets and Government-Sponsored Enterprises Subcommittee, though many believe that Carolyn Maloney will take it. If so, that would create an opening at the top of the Financial Institutions subcommittee that we hear will be filled by Luis Gutierrez, which means that the Insurance, Housing and Community Opportunity will have two new faces at the top, since current Chairwoman Judy Biggert lost her reelection bid. In addition, the Domestic Monetary Policy and Technology Subcommittee (currently headed by retiring Representative Ron Paul (R-TX)) will have a new chairman.

<u>Executive Branch</u>

Treasury

FSOC Approves Money Market Mutual Fund Proposals
On November 13th, the Financial Stability Oversight Council voted to publish three proposals for public comment that would require the SEC to take action on money market reforms. Two of these three were previously floated at the SEC but Chairwoman Schapiro didn't have the consensus of her commissioners to move forward. This includes transitioning from a fixed $1

share price to a "floating" NAV, or alternatively to require funds to have a 1 percent capital buffer and limit redemptions. The third proposal is a more burdensome, as it would require larger capital buffers as well as impose additional restrictions on funds such as more stringent investment requirements. After the 60 day public comment period, the FSOC will review comments and make recommendations to the SEC. At which point the SEC will be required to adopt the FSOC's recommendations or explain it failed to do so.

Treasury Names OFR Advisory Panel
On November 14th, the Treasury announced the members who will serve on the Financial Research Advisory Council, which will provide guidance to the Office of Financial Research. The 30-member board includes representatives from the business world, non-profits, and academics. Some members of the council include Andrew Lo of MIT, Donald Kohn, former Vice Chairman of the Federal Reserve, Anna Ewing, Executive Vice President and CIO of the NASDAQ OMX Group, and Clinton Lively, Global Head of Market Risk for the Royal Bank of Canada. The goal of the OFR and the council is to improve quality, transparency, and accessibility of financial data and information; conducting and sponsoring research related to financial stability; and promoting best practices in risk management.

National Flood Insurance Program to seek Additional funds from Congress for to deal with Hurricane Sandy
At a Federal Advisory Committee on Insurance meeting at the Treasury Department November 14th, Edward Connor, FEMA's deputy associate administrator for Federal insurance said the Administration may ask Congress for an increase in the National Flood Insurance Programs' borrowing authority due to a $6 to $12 billion estimated payout for claims associated with Hurricane Sandy. Currently, the NFIP has $840 million on hand through November but will soon have to start drawing on the remaining $2.9 billion of its $20.7 billion borrowing authority. The program was reauthorized by Congress in June but is still recovering from debts incurred after Hurricane Katrina.

CFPB

CFPB Extends Effective Date for Mortgage Disclosure Changes
On November 16th, the CFPB announced it will delay the deadline for lenders to make changes to mortgage disclosures to borrowers and align the effective date with rules combining the Truth in Lending Act (TILA) and Real Estate Settlement Procedures Act (RESPA) forms. In a statement on the delay, Director Cordray said "considering these disclosures on the same timeline will ensure that consumers receive clear, concise, and consistent information." The mortgage disclosure rule, which will require lenders to detail how much debt will be owed after foreclosure, partial payment and other circumstances, would have gone into effect on January 21st.

Deputy Director to Leave CFPB
Raj Date, the Deputy Director of the CFPB, will be leaving the Bureau at the end of January. Date, who operated the Bureau from August 2011 through January 2012 and played a major role in the formation of the agency, has not announced plans for after his departure. A number of rules are due to be finalized by the CFPB before Date's departure, such as the qualified

mortgage rule. While Date hasn't disclosed his future plans, many expect him to reunite with his former colleague Senator-elect Warren. Date's departure also frees up for a new Deputy Director to be named who will likely have to take over when current Director Richard Cordray's term expires at the end of the year.

CFPB Announces Initiative to Promote Consumer Friendly Innovation
On November 14th, the CFPB unveiled Project Catalyst as part of an effort to collaborate with technology entrepreneurs to foster consumer-friendly innovation in the financial marketplace. Speaking in Silicon Valley, Director Richard Cordray said "good, consumer-friendly innovation holds great potential for achieving our mission of making the consumer finance market work again for consumers." Three companies have already agreed to collaborate with the CFPB on this project and BillGuard, Plastyc and Simple will be sharing anonymous data about consumer behavior.

SEC
In First Year, Whistleblower Program Receives More Than 3,000 Tips
On November 15th, the SEC announced that it has received 3,001 tips from the whistleblower program established by the Dodd-Frank reforms in the first year. Common complaints to the SEC were failures related to corporate disclosure and financials leading to potential fraud and manipulation. The SEC made its first award under the new program to a whistleblower that helped the SEC stop an ongoing multi-million dollar fraud. Whistleblowers are paid between 10 percent and 30 percent of the sanction the agency collection from enforcement. Speaking on the success of the program, Chairman Schapiro said "the whistleblower program already has proven to be a valuable tool in helping us ferret out financial fraud."

CFTC
CFTC Will Appeal Court Decision Overturning Position Limits
On November 15th, the CFTC formally voted 3 to 2 to move forward with an appeal of a federal district court's decision vacating the position limits rule. The appeal, which was supported by Chairman Gensler and Commissioners Chilton and Wetjen, would seek to overturn a September decision which found ambiguities over whether Congress truly mandated the rule.

Commissioner Chilton Says Volcker Good Enough to Prevent Calls for a Return to Glass-Steagall
Speaking before FX12, a Bloomberg sponsored foreign-exchange conference, Commission Bart Chilton said the Volcker Rule should prevent a return to Glass-Steagall. Chilton said he believes the proprietary trading rule will resolve the "troublesome duplexity between having two different visions" at one institution and a return to Glass-Steagall would not be needed. Still, Chilton pointed to a potential loophole in the rule which allows banks to continue activities to hedge against potential losses. In addition to his thoughts on the Volcker Rule, Chilton spoke on rules governing inter-rate and credit-default swaps which would move trades to central clearinghouses, saying these rules will address "systemic risk" and the potential for future bailouts.

OCC

Curry Calls for Higher Standards for Big Banks

In remarks on November 15th at a New York Clearing House conference, Comptroller of the Currency Thomas Curry called for "heightened expectations" for audit, risk management and corporate governance at large banks. Curry has made risk management a theme of recent speeches, on October 29th cautioning that the OCC will not accept less than satisfactory procedures and warning against reducing provisions in order to boost earnings. "The OCC is very much focused on improving its supervision programs," said Curry, continuing that they have are implementing, "heightened expectations for corporate governance and oversight." While Curry acknowledged this is a "tall set of orders" for banks, he also stressed that banks must understand the risks they accept.

DOL

Fiduciary Re-Proposal Will Not be Ready Until 2013

On November 15th, Phyllis Borzi, Assistant Secretary of Labor for EBSA, corrected the record that, contrary to reports, the re-proposal of a rule to redefine "fiduciary" is not at the OMB for review and will not be ready for OMB approval until 2013. At a meeting of the Worldwide Employee Benefits Network, Borzi said DOL "is not finished" and they are still working on the proposal which includes three components: regulatory language, economic analysis, and prohibited transaction provisions, including prohibited transaction proposals, amendments and exemptions.

International

Eurozone Falls Back into Recession Despite Growth in France and Germany

Last week, the 17-member Eurozone fell back into recession. Eurostat, the EU's statistics service said the region's economy shrunk by 0.1 percent from June to September, largely due to the Netherlands and other peripheral countries. Despite the overall contraction, the EU avoided recession with growth of 0.1 percent in the third quarter, driven by a boost from the Olympics. France and Germany's economies also both expanded, France growing by 0.2 percent and Germany by 0.3 percent.

UPCOMING HEARINGS

The House and Senate will be in Recess for the Thanksgiving Holiday

On Thursday, November 29th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit and Subcommittee on Insurance, Housing and Community Opportunity will hold a joint hearing on examine the impact of the proposed rules to implement Basel III capital standards.

On Thursday, November 29th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee the Domestic Monetary Policy and Technology Subcommittee will hold a hearing on potential cost savings from changing the metallic content of certain circulating coins and from replacing the $1 bill with a $1 coin.