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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

September 17, 2012

Leading the Past Week

Last week Congress returned from its six week August recess, and the House promptly passed a a continuing resolution ("CR") to fund the Government through March of 2013, by an overwhelming vote of 329-91. With Senate action expected on the CR this week and no clear path to passage on any other legislation, the House announced that it would adjourn by the end of this week until after the elections. The Senate is expected to announce a similar decision and so what was already anticipated to be a short 8 day legislative period in September will be truncated even further. In other news, as was widely anticipated following the dismal August jobs report, the Fed pinned its hopes on a "third times the charm" belief for our nation's monetary policy with the announcement of a third round of quantitative easing. As was also anticipated, the news was praised by Democrats—who are hoping an economic boost will give them a needed bump for November elections—and outrage from Republicans, many of who were calling for Ben Bernanke's head, while reiterating concerns about destabilization of the recovery and the threat of inflation. While the Fed is supposed to be above politics, it is clear that the economy and its continued weakness is a political issue that both parties are trying to use. However, with less than 55 days to go to the election, and with the Presidential race still certainly up for grabs, many in Washington are beginning to view the race through the analysis of famed political prognosticator Charlie Cook who said earlier this week, "if President Obama is reelected, it will be despite the economy and because of his campaign; if Mitt Romney wins, it will be because of the economy and despite his campaign."

Legislative Branch

Senate

Cordray Gives Semiannual Report to Senate Banking Committee

Appearing before the Senate Banking Committee on September 13th, Director of the CFPB Richard Cordray explained to lawmakers the Bureau's accomplishments in drafting rules fixing mortgage servicing, increasing supervision of unregulated non-bank financial firms, writing rules to increase transparency in prepaid debit cards and handling complaints in its consumer database. Cordray also affirmed that the Bureau will undertake regulation of prepaid cards in the near future. However, Committee Republicans pursued concerns over the legitimacy of the Bureau and Ranking Member Richard Shelby (R-AL) expressed concerns that the CFPB will reinterpret established laws and inflict undue costs and burdens on small lenders. Still, some lawmakers lauded the performance of the Bureau, applauding efforts to weed out abusive practices and praising the "Know Before You Owe" campaign.

Responsible Homeowner Refinancing Act Reintroduced
On September 10th, Senators Robert Menendez (D-NJ) and Barbara Boxer (D-CA) reintroduced the Responsible Homeowner Refinancing Act, calling for Republicans to join them in passing the legislation designed to help responsible homeowners refinance to lower mortgage rates. Specifically, the legislation would: remove barriers to competition by requiring the same streamlined underwriting for new servicers as they do for current servicers; ensure equal access to streamlined refinancing for all GSE borrowers; eliminate up-front fees on refinances and appraisal costs for borrowers; and streamline the refinancing application process. The new bill also drops several provisions in order to win over industry support, including language imposing financial penalties on second lien holders that prevent refinancing and on mortgage insurers that refused to transfer insurance to refinanced loans and a provision which would have extended the date for HARP eligibility for one year.

With the support of the White House and newfound support from industry, Democratic leadership could bring the bill to the Floor for a vote in the next two weeks. Still, hurdles can be expected from Senate Republicans and passage in the House is unlikely. Republican opposition is rooted in the belief that the legislation may not be necessary as 2011 FHFA program enhancements have performed better than expected. One additional change that is being considered does have the potential to garner Republic support: language directing the CFPB to adopt "safe harbor" legal protections for lenders that comply with pending qualified mortgage (QM) rules. This language would constitute a significant change to the Dodd-Frank Act—something Republicans have been pushing for since the passage of the Wall Street reform legislation.

Tax Extenders Bill Likely on Hold until After Election
On September 11th, Senate leadership suggested that, amid Republic threats to block the bill, the Senate Finance Committee's $205 billion tax extenders plan may have to wait until after the election. Senate Majority Leader Harry Reid (D-NV) had previously intended to bring up the measure, the Family and Business Tax Cut Certainty Act of 2012 (S. 3521), before Congress left town in advance of the election. S. 3521 passed the Senate Finance Committee on August 2nd in a 19 to 5 vote, with Senators Jon Kyl (R-AZ), Tom Coburn (R-OK) and Richard Burr (R-NC) voting against and offering a minority bill with more substantial cuts. Republican Senators have expressed concern "that the relentless dedication to subsidizing so called 'green-energy' will prevent the most efficient development of energy sources and cause a loss of jobs in the broader economy."

Online Poker Bill Hits Roadblock in Senate

The fate of legal online poker appeared to take a turn for the worse this week when a war of words broke out between Senate Majority Leader Harry Reid (D-NV) and his Nevada colleague Dean Heller (R-NV). Reid and Heller have been working for months with Senator Jon Kyl (R-AZ) toward the goal of a bill banning all internet gambling expect poker. The Internet Gambling Prohibition, Poker Consumer Protection, and Strengthening UIGEA Act of 2012 adds additional enforcement tools for preventing illegal gambling while providing a limited exemption for online poker in participating states. However, late last week private tensions came to a public boil, perhaps in large part because Harry Reid is actively working to defeat his Nevada colleague this November. Procedural concerns also surfaced about whether the House or Senate would take the lead as Heller and Kyl communicated to Reid that they would like to see the House measure taken up by the Senate. Given this very public spat, it seems unlikely that all sides will be able to come back to the table in the near future.

House of Representatives

House Approves Measure Setting Minimum Mortgage Insurance Premiums

On September 11th, the House passed H.R. 4264, a bill that would establish minimum annual premiums for mortgage insurance from the FHA. The legislation, which passed in a 402 to 7 vote, sets a minimum annual premium of 0.55 percent of the remaining insured principal mortgage balance and would allow a maximum annual premium of 2 percent. The CBO has estimated that the measure would cost $11 million to implement over FY 2013 to FY 2017. A successful amendment includes offsets by redirecting $2.5 million annually through FY 2016 from administration contract expenses.

JOBS Act Implementation Scrutinized in Joint Subcommittee Hearing

On September 13th, both the House Financial Services Capital Markets Subcommittee and the House Oversight and Government Reform TARP and Financial Services Subcommittee met to consider how quickly the SEC should implement the Jumpstart Our Business Startups (JOBS) Act. Prompting the hearing was a decision by Chairman Mary Schapiro to issue a proposed rule to lift the ban on general solicitation rather than an interim final rule, which would take effect upon publication. One witness at the hearing, Jeffrey Van Winkle, Treasurer of the National Small Business Association (NSBA), told lawmakers there is "every indication" the SEC is moving slowly, expressing fear it will miss its crowdfunding deadline "by a very wide margin." Still, Schapiro has recently said that there is no reason to predict a delay of the rule to implement crowdfunding provisions.

At this third hearing on the JOBS Act since the legislation's enactment in April, Republicans and Democrats clashed over what the SEC's priorities should be. Chairman of the TARP Subcommittee, Patrick McHenry (R-NC) led Republicans in calls to prioritize JOBS Act implementation over finalization of the Dodd-Frank Act, saying the JOBS Act rulemaking "should be seen as a walk in the park." Similarly, Representative Scott Garrett (R-NJ) blasted the SEC for proceeding with an "unacceptable" general solicitation. Democrats defended the SEC's actions, fighting the notion that the JOBS Act should take priority over Dodd-Frank implementation. Ranking Member of the Capital Markets Subcommittee Maxine Waters (D-CA) called out her Republican colleagues for pushing to delay several SEC Dodd-Frank rulemakings and Representative Mike Quigley (D-IL) said the SEC is appropriately balancing its "dual mission to facilitate capital formation and protection investors."

Financial Services Committee Approves Bill Regulating Municipal Advisors – Floor vote this week

On September 12th, the House Financial Services Committee approved by voice vote modified legislation to narrow the role of financial advisers who are subject to federal regulation as a result of their work with municipalities. H.R. 2827, sponsored by Representative Robert Dold (R-IL), would amend the Dodd-Frank Act to limit the application of the term "municipal adviser" to those who are engaged with or compensated by a municipality. The bill passed as amended by two provisions, one to strike a provision defining municipal advisers as only those who have written agreements with municipalities, and another to eliminate a requirement that individuals associated with municipal adviser firms register with the SEC.

The bill was prompted by criticism from both the banking industry and municipalities that the SEC rule implementing this provision of the Dodd-Frank Act defined municipal advisers too broadly. The bill originally would have simply eliminated the requirement that municipal advisers be subject to a fiduciary standard; however, the language was softened as a result of opposition form a group of Democrats on the Committee. The scaled back bill had wide support on the Committee, with Ranking Member Barney Frank (D-MA) agreeing that the SEC had gone too far in crafting the proposed rule. The measure will be on the floor this week under the suspension calendar, a mechanism for moving non-controversial legislation.

Financial Services Subcommittee Hears Testimony on Consumer Credit Data

On September 13th, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit met for a hearing titled, "Examining the Uses of Consumer Credit Data." The first panel featured Robert Schoshinski, Assistant Director of the Division of Privacy and Identity Protection at the FTC. Schoshinski told the Subcommittee that data compiled and maintained by consumer reporting agencies (CRAs), is used to make critical decisions about the availability and cost of various products and services, including credit, insurance, employment, and housing. However, errors in credit reports "can cause consumers to be denied credit or other benefits or pay a higher price for them, and may lead credit issuers to make inaccurate decisions that result in declining credit to a potentially valuable customer or issuing credit to a riskier customer than intended." The second panel featured members of the credit data industry and experts in the field.

Bill Introduced to Limit Use of Eminent Domain for Federal Support of Mortgages

On September 13th, Representative John Campbell (R-CA) introduced the Defending American Taxpayers from Abusive Government Takings Act (H.R. 6397), a bill to prohibit Fannie Mae and Freddie Mac from purchasing, the FHA from insuring, and the Department of Veterans Affairs from guaranteeing, making, or insuring, a mortgage that is secured by a residence or residential structure located in a county in which the State has used the power of eminent domain to take a residential mortgage. The bill responds to recent calls for local government to explore the use of eminent domain to seize, restructure and resell mortgages that are underwater or delinquent.

Executive Branch

Federal Reserve

Fed Pulls Trigger on QE3, Action Raises Political Rhetoric on Both Sides as well as the Market

In a highly anticipated move, the Federal Reserve announced on September 13th a new round of quantitative easing. Since Chairman Ben Bernanke's August Jackson Hole speech, in which he voiced "gave concern" over the health of the labor market, it was expected that the September meeting of the FOMC would bring a new round of bond-buying, known as QE3. QE3 will consist of Fed purchases of mortgage backed securities on the order of $40 billion a month. In addition to MBS purchases, the Fed said its target short-term interest rate benchmark will remain at the low, near-zero rate though 2015.

Both political parties have been pressuring the Fed around QE3. The announcement comes as welcome news to Democrats, who have been urging the central bank to act since the summer in the hopes an improving economy will give President Obama and other Democratic candidates the edge in November. Meanwhile, Republicans—who have always been critical of the Fed's recent monetary policy—have urged the Fed not to pursue additional stimulus, arguing it could destabilize the economy and trigger inflation. Republicans reacted loudly to the QE3 announcement with Senator Bob Corker (R-TN) accusing Bernanke of "serious damage to the Fed as an institution," and Representative Scott Garrett (R-NJ) calling for "fundamental reform" of the central bank. Garrett also called for removing the Fed's supervisory function and placing the responsibility with a consolidated financial regulator. Unsurprisingly, Democrats rushed to the defense of Bernanke and the Fed, with Senator Charles Schumer (D-NY) saying the Fed was fulfilling its mission to combat unemployment and Representative Barney Frank (D-MA) accusing Republicans of "putting partisan politics ahead of economic interests."

FDIC

FDIC Releases Report on Unbanked and Underbanked Populations

According to the FDIC's National Survey of Unbanked and Underbanked Households released on September 12th, U.S. households without bank accounts grew by 821,000 from 2009 to 2011—making the total unbanked population 8.2 percent of Americans. This amounts to 17 million Americans who operate without checking or savings accounts at insured institutions—many of whom rely on non-banks such as payday lenders and check-cashing services. In addition the report found that 20.1 percent of households were underbanked in 2011, up from 18.2 percent in 2009. The report, which was released in conjunction with a conference to explore ways to increase service in these populations, noted that some banks simply do not want customers with deposits and investments of less than $100,000. Interestingly, there is no clear link between income and banking status as close to half the population most expected to be underbanked—those earning $15,000 or less in annual income—are fully banked.

SEC

Former FDIC Chair Calls for FSOC Action on Money Market Mutual Funds

On September 13th, citing the SEC's deadlock on the issue Systemic Risk Council Chair Sheila Bair called on the FSOC to impose new risk management standards on money market mutual funds. Bair's statement followed an August 22nd announcement by SEC Chairman Mary Schapiro that she would not be able to secure the necessary three votes to implement plans to overhaul the $2.6 trillion market. "Given the current impasse at the SEC," said Bair, the FSOC should act to address "risk before another potentially destabilizing run" on the money market mutual fund sector.

CFTC

CFTC to Give Two Month Grace Period for Swap Dealer Registration

On September 10th, CFTC staff clarified that swap dealer registration regulations will go into effect on October 12th but that firms will have at least a two-month grace period in order to come into compliance. Firms must register by no later than two months from the date they exceed the de minimis threshold placing them under the definition of swap dealer. The two month deadline begins at the end of the month in which the threshold was reached. For example, the CFTC said "if an entity reaches $8 billion in swap dealing the day after October 12, then the entity would have to register within two months after the end of October, or by December 31." The $8 billion de minimis threshold is being phased-in over a period of 39 months to 5 years.

FSOC

GAO Advises FSOC to Beef Up Transparency Efforts

A recent report by the GAO has found that the FSOC and OFR should take steps to improve their transparency. The GAO recommended that the regulatory body charged with monitoring financial stability should strengthen transparency and accountably through collecting financial risk indicators, increasing detailed record keeping of closed deliberations and creating forward-looking plans to help "prioritize the threats." Treasury Undersecretary for Domestic Finance Mary Miller answered the GAO with a letter saying the FSOC supports the recommendations and is already working "quickly to fulfill its statutory mission" and promote greater collaboration."

<u>Miscellaneous</u>

Moody's Stays Decision on Downgrade of US Rating Pending Congressional Action to Address Budget Crisis

On September 11th, Moody's Investors Service announced it will wait for the 113th Congress to make a decision on lowering the Federal government's Aaa credit rating. In a report, "Update of the Outlook for the U.S. Government Debt Rating," the ratings agency maintained the Aaa rating but with a negative outlook, pointing to 2013 budget negotiations as the deciding factor. The report said: "If those negotiations lead to specific policies that produce a stabilization and then downward trend in the ratio of federal debt to GDP over the medium term, the rating will likely be affirmed and the outlook returned to stable." Moody's warning did not seem to excite House Speaker John Boehner (R-OH) who said he was "not confident at all" that Congress could reach a deal next year. In response, Senate Majority Leader Harry Reid (D-NV) expressed disappointment in Boehner's remarks and said he was "confident" they will "reach some kind of arrangement."

Meanwhile, the House passed yet another bill (H.R. 6365) on September 13th in a vote of 223 to 196 to replace the first year of the sequester. Like similar attempts, the bill is not expected to pass the Senate. In addition, there have been halfhearted bipartisan attempts to come to a deal on sequestration and the other expiring measures, collectively known as the "fiscal cliff," there is little Congress can during the abbreviated September session.

International

European Commission Considering Measures to Promote Banking, Fiscal and Political Unity

The European Commission unveiled on September 12th broad bank regulatory reform legislation with the goal of giving the European Central Bank supervisory powers over more than 6,000 financial institutions in the Eurozone. Every EU member state has the option of participating. The legislation is a result of a conditions imposed by Germany in exchange for allowing European Union rescue funds and the use of the European Stability Mechanism to directly recapitalize banks. The proposed changes have drawn complaints from EU member states that are not in the Eurozone, where many banks are owned by financial institutions based in countries that participate in the monetary union. It remains to be seen how the UK—which houses the largest banking industry in the EU and which has opposed ECB supervision of London-based banks— will react to the legislation.

In addition to banking supervision legislation, EU member states are considering final terms of capital requirements legislation and a new banking resolution proposal. It is also possible legislation for a pan-EU bank account guarantee scheme which has been under negotiations for two years will see action. The European Commission is planning for all the aforementioned legislative proposals be voted on by the end of this year so as to form a "banking union" which will provide for further EU integration, fiscal unity and political cohesiveness. Economics Commissioner Ollie Rehn testified before parliament on September 3rd that "the banking union, fiscal union and political union will form the foundation for the new 2.0 European Economic and Monetary Union."

US-UK Sign Bilateral Agreement to Improve Tax Compliance

The Treasury announced September 14th that it has signed a bilateral agreement with the UK implementing information reporting and withholding tax provisions under the Foreign Account tax Compliance Act (FACTA). Enacted in 2010, FACTA was intended to address non-compliance by U.S. taxpayers using foreign accounts. The agreement is based on a July model and developed in consultation with France, Germany, Italy, Spain and the UK.

UPCOMING HEARINGS

On Thursday, September 20th at 10am, in 210 Capitol Visitor Center, the House Ways and Means Committee and the Senate Finance Committee will hold a joint hearing on proposals relating to the taxation of capital gains as a part of a broader overhaul of the tax system.

On Thursday, September 20th at 10am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Subcommittee on Securities, Insurance, and Investment will hold a hearing on computerized trading of securities.

On Thursday, September 20th at 10am, in 2128 Rayburn, the House Financial Services Committee will hold a hearing on the semi-annual report to Congress of the Consumer Financial Protection Bureau.

On Thursday, September 20th at 1pm, in 2360 Rayburn, the House Small Business Committee will hold a hearing titled "Sequestration: The Threat to Small Businesses, Jobs, and the Industrial Base."

On Thursday, September 20th at 2pm, in 2200 Rayburn, the House Financial Services Subcommittee on Domestic Monetary Policy and Technology will hold a hearing on the monetary effects of interest rates and the consequences of interest rate setting as a monetary policy tool employed by the Federal Reserve.