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Jason Rosenstock,
JRosenstock@MLStrategies.com
Abby Matousek,
AMatousek@mlstrategies.com

ML Strategies, LLC
701 Pennsylvania Avenue, N.W.
Washington, D.C. 20004 USA
202 434 7300
202 434 7400 fax
www.mlstrategies.com

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Financial Services Legislative and Regulatory Update

Leading the Past Week

Before leaving for the Christmas recess the House of Representatives passed the Bipartisan Budget Act of 2013 by an overwhelming bipartisan vote of 332 to 94. With the Senate expected to follow suit early next week, it will mean that for the first time since 1997, [Congress will have voted to approve a budget bill](#). This achievement, [which required some pain from both sides](#), is offered up by some as akin to the [baby steps](#) necessary to help repair a broken relationship, and potentially helping to [bridge a path towards tax reform](#). However, these perspectives may be [too optimistic](#), especially with a calendar next year that quickly tees up votes on an omnibus appropriations bill to keep the government open, and to increase the debt ceiling, both of which have the distinct ability to suck the life out of whatever reconciliation was achieved through the budget process.

Outside of Congress, the other major story from this past week occurred when five banking regulators jointly issued the final version of the so-called Volcker Rule. The rule, which technically codifies section 619 of the Dodd Frank and is intended to prevent banks from using customer funds to make proprietary bets for the banks benefit, is named after former Fed Chairman Paul Volcker. Whether this revised rule, with its complicated definitions and exemptions, will ultimately be viewed as an early Christmas present or a lump of coal for the banks, will take some time and considerable legal bills to determine. However if you're interested in learning more about the final Volcker rule, ML Strategies and Mintz Levin put together a full alert that can be found if you click [here](#).

With the House home for the holidays, the Senate has the spotlight to itself this week. After a [truce](#) was reached on a week-long fight related to nominations and the new Senate procedures, the Senate is set to wrap up a few remaining nominations, including that of Janet Yellen to head the Federal Reserve, before they vote on approval of the budget. After a very grueling 2013, everyone in our nation's capital is ready for a few weeks of [holiday downtime](#), and to hoping that next year is [more productive](#).

Legislative Branch

Senate

Watt Confirmed as FHFA Director

On December 10th, the Senate confirmed Representative Mel Watt (D-NC) to be director of the Federal Housing Finance Agency (FHFA) in a 57-41 vote, with only two Republicans, Rob Portman and Richard Burr voting affirmatively. In his role at the FHFA, Watt will have control over Fannie Mae and Freddie Mac and will be instrumental in shaping the future of mortgage finance system. However, it is unclear whether Watt will implement liberal dream policies such as principal reduction or expanding other initiatives to homeowners who are underwater on their homes, or whether his ability to do so only will serve to strengthen the Democratic position as negotiations in the larger housing finance reform debate continue.

Johnson Bottles Up Iran Sanctions Legislation

Following appeals by the Obama Administration, this week Chairman Tim Johnson (D-SD) announced that he would hold off on committee action to move legislation related to increasing sanctions on Iran. Johnson added that he and Ranking Member Mike Crapo (R-ID) have prepared a bill in the event that Iran does not comply with the P5+1 agreement or if negotiations fail. While additional sanctions have been put on pause, David Cohen, Under Secretary for Terrorism and Financial Intelligence with the Treasury, told lawmakers at the hearing that the Treasury is still “actively dissuading international oil companies and others who think that now may be a time to test the waters in Iran.”

Senate Banking Examines Credit Risk in Housing Finance Reform

On December 10th, the Senate Banking Committee held another hearing on housing finance reform, this time to examine the fundamentals of transferring credit risk. In his opening statement, Chairman Johnson (D-SD) noted that in previous hearings on the future of housing, witnesses have said that any new system should “include an explicit government guarantee with private capital taking the first loss position;” however, he continued to note that the system must have enough private capital to prevent reductions in liquidity. Therefore, the goal of the hearing was to examine the capacity for private capital to take on additional credit risk in front of a government guarantee. The witnesses included: Kevin Palmer, Vice President, Freddie Mac; Laurel Davis, Vice President, Fannie Mae; Ted Durant, Vice President of Analytic Services, Mortgage Guaranty Insurance Corporation; and Sandeep Bordia, Head of Residential & Commercial Credit Strategy, Barclays Capital.

Johnson Outlines End of Year Housing Priorities

Speaking at a Bipartisan Policy Center event on December 11th, Chairman of the Senate Banking Committee Tim Johnson (D-SD) provided an overview of the current state of housing reform legislation in the Senate. While Johnson had hoped to work with his Ranking Member Mike Crapo (R-ID) on moving a housing reform bill out of Committee by the end of the year, a number of factors, such as the government shutdown, have delayed the process. Still, Johnson said he would prefer to get the housing bill done “right” not “hastily” and he still is “bullish” about the prospects for housing reform.

Senate Banking Subcommittee Examines the Rebuilding American Manufacturing

On December 11th, the Senate Banking Subcommittee on Economic Policy heard from witnesses on the rebuilding the American manufacturing sector. Appearing before the committee were: Suzanne Berger, Raphael Dorman-Helen Starbuck Professor of Political Science and Co-Chair, Production in the Innovation Economy Project, Massachusetts Institute of Technology; Leo Hindery, Chairman,

Smart Globalization Initiative, New America Foundation; Derek Scissors, Resident Scholar, American Enterprise Institute; and Julie Skirvin, General Counsel, Oregon Iron Works, Inc.

Senate Finance Committee Approves New IRS Commissioner

On December 13th, the Senate Finance Committee approved by voice vote the nominations of John Andrew Koskinen to be Commissioner of the Internal Revenue Service, Sarah Bloom Raskin to be Deputy Treasury Secretary and Rhonda Schnare Schmidlein to be a member of the U.S. International Trade Commission. Although the approval for all of the nominees was unanimous, Senator Chuck Grassley (R-IA) did note his opinion that the Committee should have delayed consideration of Koskinen's nomination until the panel's investigation of IRS' targeting of conservative groups had been completed. Interim IRS Commissioner Danny Werfel has said he will leave by the end of 2013 and Chairman Max Baucus (D-MT) said he would like to see Koskinen confirmed by the full Senate before Werfel's departure, though that may be difficult given the Senate calendar and the lack of comity regarding nominations in the aftermath of the exercise of the so-called "nuclear option."

House of Representatives

House Passes Budget

The budget deal, announced by Representative Paul Ryan (R-WI) and Senator Patty Murray (D-WA) earlier in the week, increases overall spending levels from \$967 billion to \$1.012 trillion and replaces approximately \$63 billion of the sequester cuts. The sequester relief is fully offset by savings contained in the budget, including increased premiums for pensions backed by the Pension Benefit Guaranty Corp. (PBGC) and not extending unemployment benefits, which expire at the end of the year. With Senate passage anticipated, it will be a busy Christmas and New Years for the staff on the Appropriations Committees as they work to pull together an omnibus appropriations bill to keep the government operating for the remainder of the 2014 Fiscal Year. Barring a short term continuing resolution (CR), this omnibus bill needs to pass before January 15th or else the government will be forced to shut down again.

Lew Appears Before House Financial Services for Annual Testimony on International Finance

On December 12th, Treasury Secretary Jack Lew appeared before the House Financial Services Committee to provide annual [testimony](#) on the state of the international finance system. In his testimony, Lew touched on the important role of the International Monetary Fund (IMF), the impact Dodd-Frank reforms have made in building global standards, and the role of multilateral development banks (MDBs). As part of this overview, Lew urged lawmakers to consider the IMF and MDBs as "indispensable partners" and urged Republicans not to pursue deeper cuts to the U.S.'s commitment to these organizations. Lew reminded lawmakers that the President's most recent budget already contains plans to reduce the U.S. commitment to the IMF's crisis lending fund, decreasing the US quota in the IMF, and that any further cuts would reduce the U.S. influence in the IMF. Lew also touched on the progress U.S. financial reforms have made globally, saying they have raised the international standard for regulation. Still, Lew warned against diluting U.S. reforms by including them in trade agreements with Europe. Lew told lawmakers that that the Financial Stability Board (FSB) and Group of 20 (G-20) are the more appropriate bodies to negotiate international financial regulations.

Fed Kicks Off Series of Hearing on the Future of the Federal Reserve

On December 12th, the House Financial Services Committee held the first of what was billed as multiple hearings to investigate the Fed's dual mandate, and its other roles in the economy, including lender of last resort and regulator. Witnesses at this first [hearing](#) included: Douglas Holtz-Eakin,

President, American Action Forum; Alice Rivlin, Senior Fellow, Economic Studies, Brookings Institution; Marvin Goodfriend, Professor of Economics, Tepper School of Business, Carnegie-Mellon University; and Hester Peirce, Senior Research Fellow, Mercatus Center, George Mason University.

House Energy and Commerce Subcommittee Examines the State of Online Gaming

On December 10th, the House Energy and Commerce Subcommittee on Commerce, Manufacturing, and Trade held a hearing to review the status of online gambling in light of recent developments in Nevada, New Jersey, and Delaware where intrastate internet gaming has been legalized. The Subcommittee also considered the Internet Poker Freedom Act of 2013 ([H.R. 2666](#)), a bill authored by Representative Joe Barton (R-TX) that would establish a federal license for internet poker and create a system for the regulation of online gaming. Witnesses included: Joe Pappas, Executive Director, Poker Players Alliance; Andrew Abboud, Vice President of Government Relations and Community Development, Las Vegas Sands Corporation; Geoff Freeman, President and Chief Executive Officer, American Gaming Association; Les Bernal, National Director, Stop Predatory Gambling; Kurt Eggert, Professor of Law, Chapman University; and Rachel Volberg, Ph.D., Associate Professor, University of Massachusetts Amherst. Although Congress has struggled to overturn the Unlawful Internet Gambling Enforcement Act (UIGEA), perhaps Barton will have more luck with his bill, as he noted that [God is in favor](#) of his legislation.

Executive Branch

Federal Reserve

Volcker Rule Finalized – Now Comes the Tricky Part

On December 10th, all five regulators with jurisdiction over institutions subject to Section 619 of the Dodd Frank Act voted to approve the a final version of the [Volcker rule](#). Similar to what was included in the rule as originally proposed, the final Volcker rule generally prohibits banking entities from engaging in short-term proprietary trading of securities, derivatives, commodity futures, and options for their own benefit. It also bars banks from having certain relationships with hedge funds or private equity funds. However, there are numerous exemptions to these prohibitions, such as allowances for market making, underwriting, hedging, trading in government obligations, and organizing and offering a hedge or private equity fund. Among the changes made in the final rule were broader exemptions for a banks' market-making activities, and a more limited definition of what constitutes prohibited foreign funds or commodity pools covered by the Rule's fund investment and sponsorship restrictions.

It will take some time before it can determined whether these exemptions will swallow the intent of Volcker rule, but it is immediately clear that this regulation will increase compliance cost. For example, the final rule will require banks to analyze, test, and demonstrate its risk mitigation programs, as well as perform "value-at-risk" calculation reporting. Furthermore, the rule requires CEO attestation of compliance.

Whether the finalization of Volcker, and it may be premature to view this way as a court challenge is likely, is the last effort by populists to break-up the so-called "too big to fail" institutions remains unclear. Since, speaking later in the week, FDIC Vice Chairman Thomas Hoenig said that the Volcker rule's ban on proprietary trading has the potential to be a "useful" step in spurring efforts to split up commercial banks from their broker-dealers. Hoenig, citing "increasing evidence" that the biggest institutions would benefit from downsizing, has echoed calls by some lawmakers, including Senator Elizabeth Warren (D-MA), to reinstate the firewall between commercial and investment banking known as Glass-Steagall.

For additional coverage of the final Volcker Rule, please read the ML Strategies / Mintz Levin alert, available [here](#).

Regulators Finalize Appraisal Rule

The Fed, along with the FDIC, OCC, Federal Housing Finance Agency (FHFA), National Credit Union Administration (NCUA), and the Consumer Financial Protection Bureau (CFPB) finalized a [rule](#) on appraisal requirements for higher priced mortgages. Under the rule, before making riskier loans, creditors must hire appraisers to physically visit the property and assess the value of the real estate. Regulators outline exemptions for some mortgage loans of less than \$25,000 and for certain refinance loans. The final rule also exempts loans on mobile and manufactured homes for 18 months to give time for lenders to come into compliance.

Regulators Warn Banks on Social Media Compliance

On December 11th, the Fed, in conjunction with other regulators, released [guidance](#) for financial institutions using Facebook, Twitter, and other social media outlets to garner business. The guidance comes in response to a request from banks seeking how consumer protection laws apply to social media. Regulators generally outlined that financial institutions must be able to control risks from their social media by protecting their reputation and ensuring they are within the bounds of federal law. The guidance comes after JPMorgan Chase encountered some serious static when it attempted, and then quickly aborted, a Twitter town hall event.

Fischer Rumored to be Pick for Fed Vice Chairman

As Janet Yellen will likely soon move into her role as Chairman of the Federal Reserve, reports surfaced last week that Stanley Fischer, a former International Monetary Fund official and governor of the Bank of Israel, is the front runner to replace Yellen as Fed Vice Chair.

Fed Studies Costs and Benefits of the Dollar Coin

Last week the Fed released a [staff working paper](#) outlining the costs and benefits of replacing the one dollar note with a dollar coin. The study found the cost of minting a dollar coin and replacing the dollar bill would not be offset by the longer life of the coin and that making the change would be inefficient. In addition, there would be a cost to businesses that would have to adapt to handling transactions with coins instead of bills. The Government Accountability Office (GAO) has long held that moving to coins would save money over time; in March 2011 they estimated that replacing bills with coins would save approximately \$5.5 billion over 30 years. However, the Fed points out that this estimate does not account for the costs of shifting to the new coins.

Treasury

FSOC Meets on Cybersecurity Threats

On December 9th, the Financial Stability Oversight Council (FSOC) held a public meeting primarily to discuss cybersecurity threats to the financial services industry. Briefing the Council, Treasury Assistant Secretary Cyrus Amir-Moki told members that the Treasury has been collaborating with federal agencies to brief regulators and the private sector in order to address cyber threats that are growing in frequency and sophistication. Amir-Moki said that a public-private partnership to confront cyber threats to the financial sector is “not only desirable, but necessary” in addition to a “whole government” effort and interagency coordination. Treasury Secretary Lew noted that some needed

collaboration goes beyond the authorities outlined in the President's cybersecurity Executive Order and called for legislation to address this issue.

FIO Releases Insurance Modernization Report

On December 12th, the Federal Insurance Office (FIO) released a [report](#) on strategies to modernize and improve the way insurance is regulated in the U.S. The report, required under Title V of the Dodd-Frank Act, recommends near-term reforms that states should make in the areas of capital adequacy, safety and soundness, reform of insurer resolution practices, and marketplace regulation. While the report argues that states are better equipped to tackle insurance regulation as products are often location-specific, it also argued for a larger Federal oversight role. Specifically, the report suggested a "hybrid model" for insurance regulation, where state and Federal regulators act in concert and the Federal government act as a coordinating body to more closely monitor financial stability.

FDIC

FDIC Releases Single Point of Entry Resolution Strategy

On December 10th, the FDIC released a [plan](#) for comment on the use of single point of entry (SPOE) for the resolution of systemically important financial institutions (SIFIs) in order to prevent the collapse of large banks. Under the FDIC's strategy, a failing institution's holding company would close and its subsidiaries would be spun out and managed as set-aside institutions by a new board of directors and executives. All shareholders would be removed and unsecured creditors would be able to appeal for claims. Announcing the plan, Chairman Martin Gruenberg said that this strategy could be more appropriate than liquidating large firms through the bankruptcy system and that the "FDIC must resolve systemically important financial institutions in a manner that holds their shareholders, creditors and culpable management accountable for their failure while maintaining the stability of the U.S. financial system." The Fed is expected to soon release a proposed rule that would require banks to hold minimum levels of long-term unsecured debt that would be used to keep the spun out subsidiaries operating in the event of a failure.

FDIC Board Approves 2014 Operating Budget

Last week, the FDIC approved a \$2.39 billion Corporate Operating Budget for 2014, a 10.9 percent decrease from the 2013 budget. Announcing the budget, Chairman Gruenberg said that "this is third consecutive reduction in the FDIC's annual operating budget, and the 2014 budget is the lowest annual budget since 2008" but it also "reflects the continuing recovery" and the balanced approach to managing costs. In conjunction with the budget, the FDIC also authorized a 2014 staffing level of 7,199, down 854 positions from 2013.

CFPB

Bureau Releases Research on the Use of Arbitration Clauses

On December 12th, the CFPB released the findings of [research](#) it conducted into the use of arbitration clauses in consumer financial products and services. The research shows that arbitration causes are common in credit card and checking account agreements and that about 90 percent of clauses allow banks to prevent class action suits. In addition, the CFPB found that: larger institutions are more likely to have an arbitration clause; arbitration clauses tend to be more complex than the rest of a contract; consumers do not choose arbitration over class action when the option is available; consumers do not file arbitrations for small-dollar disputes; and few consumers file small claims court actions. The same day, the Bureau also held a field hearing in Texas on arbitration. Panelists at the hearing discussed the CFPB's findings, made recommendations for how the study should proceed, and debated what

regulations the CFPB should eventually issue. Supporters of arbitration clauses generally stated that the process of arbitration is more cost efficient, quicker, and results in better results for consumers. However, opponents said arbitration clauses deprive customers of their constitutional rights and are often hid in complicated, confusing language.

Bureau Publishes Mortgage Rule Readiness Guidelines

Last week, the CFPB released the [2013 CFPB Dodd-Frank Mortgage Rules Readiness Guide](#), intended to help financial institutions come into and maintain compliance with the new mortgage rules under the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA). The guide consists of a summary of the new rules, a readiness questionnaire, frequently asked questions, and helpful compliance tools.

CFTC

CFTC Releases Re-Proposed Position Limits Proposed Rule

On December 11th, the CFTC issued a [notice of proposed rulemaking](#) to begin to implement regulations to cap speculation on certain commodities, including crude oil, natural gas, and gas. The rulemaking comes after a November 5th vote to re-propose the position limits following the defeat of the original rule in federal court 2012. The re-proposed regulations continue to detail how the agency would cap the number of futures contracts a company may hold in the derivatives market in limit one entity from controlling too large a share.

Industry Groups Oppose Definition of High Frequency Trading

This past week saw the closing of a public comment period on a CFTC concept release on high frequency trading. Industry, in the form of the Futures Industry Association (FIA) filed [comments](#) indicating that a definition of high-frequency trading is not necessary. In its comment, the FIA told the CFTC that it fears a definition would create “arbitrary boundaries that may lead to an overly broad or overly narrow definition for regulatory purposes.” Instead, the organization proposed the CFTC categorize automated traders by whether they are directly connected to an exchange or not. Alternatively, the Federal Reserve Bank of Chicago [wrote](#) to the CFTC that a common definition among the CFTC, SEC, and other regulators is crucial in order to prevent regulatory arbitrage.

Wetjen to Lead Global Markets Advisory Committee

On December 12th, the CFTC [announced](#) that it appointed Commissioner Mark Wetjen to serve as the sponsor of its Global Markets Advisory Committee (GMAC). The CFTC created GMAC in 1998 “to provide a forum to discuss the competitive and regulatory issues facing U.S. markets and U.S. firms engaged in providing financial services around the world.” Speaking on his appointment, Wetjen said he looks forward to engaging GMAC members to “foster dialogue and international cooperation on global issues facing customers, market participants, the CFTC, and foreign and domestic regulators.”

SEC

Merrill Lynch to Pay SEC Fine Over CDOs

On December 12th, the SEC [announced](#) that Merrill Lynch has agreed to pay the agency \$131.8 million to resolve charges that the company misled customers who invested in collateralized debt obligations (CDOs) which it structured and marketed. Specifically, the SEC’s settlement order finds that “Merrill Lynch failed to inform investors that hedge fund firm Magnetar Capital LLC had a third-party role and exercised significant influence over the selection of collateral for the CDOs.”

HUD

HUD Finalizes Final QM Rule

On December 11th, the Department of Housing and Urban Development (HUD) released a [final rule](#) establishing a definition of “qualified mortgage” for the single family residential loans that the agency guarantees. The HUD definition builds upon the CFPB guidelines, giving lenders a safe harbor from borrowers who face foreclosure and want to challenge the lender’s determination of their ability to afford the loan. It is worth noting that HUD’s rule is slightly different from the CFPB’s definition in order to account for the higher insurance premiums that the Federal Housing Administration charges. Despite these differences, barring any unforeseen interference, both the HUD and the CFPB’s rule will become effective on January 14, 2014.

GAO

GAO Releases Dodd-Frank Regulatory Analysis Report

On December 11th, the GAO released a [regulatory analyses](#) for all rules issued under the Dodd-Frank Act. The report found that all federal agencies conducted the appropriate regulatory analyses for all of the rules identified by the GAO as issued pursuant to the Dodd-Frank Act. While the report found that where appropriate regulatory analyses had been conducted, it also noted that the Office of Management and Budget (OMB) may not be consistently determining which rules are considered major rules under the Congressional Review Act (CRA). For example, the GAO notes that it “found rules issued by different agencies that had similar economic impacts but were not similarly classified as major.”

International

European Union Countries Looking to Narrow Transaction Tax Proposal

Meeting on December 12th, the eleven European Union countries that had agreed to impose a financial transactions tax considered narrowing the scope of the tax. Among other things, they are now considering excluding from the transaction tax framework repurchase agreements and other instruments that could affect pensions and government debt. In addition, the meeting also considered clarifying the definition of primary market transactions. These transactions are already outside the scope of the transactions tax, but the definition may be expanded to include the issue of money market instruments and shares in collective investment undertakings.

Miscellaneous

Visa/Mastercard Interchange Settlement Approved by Federal Judge

On December 13th, U.S. District Court Judge John Gleeson approved a \$7.25 billion settlement ending a drawn out legal battle over the interchange fees that Visa and Mastercard may charge retailers in credit card transactions. Gleeson said that the settlement reflects awards for significant damages and meaningful injunctive relief. He also urged merchants to use the settlement as an opportunity to challenge “hidden bank fees.” Despite Gleeson’s advice, it appears that the Retailers are poised to appeal the decision, calling it “woefully inadequate.”

Upcoming Hearings

The House of Representatives is in Recess

On Tuesday, December 17th at 10am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Committee will hold a hearing on the nomination of Arun M. Kumar to be director general of the United States and Foreign Commercial Service, and Assistant Secretary of Commerce.

On Tuesday, December 17th at 2:30pm, in 226 Dirksen, the Senate Judiciary Committee will hold a hearing titled "The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?"

On Wednesday, December 18th at 10am, in 215 Dirksen, the Social Security, Pensions and Family Policy Subcommittee of Senate Finance Committee will hold a hearing titled "The Role of Social Security, Defined Benefits, and Private Retirement Accounts in the Face of the Retirement Crisis."