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## **FINANCIAL SERVICES REGULATORY REFORM UPDATE**

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As expected, little time was wasted in the 112<sup>th</sup> Congress before a bill was introduced to repeal the Dodd-Frank Wall Street Reform and Consumer Protection Act. This past week Rep. Michele Bachmann (R-MN) along with her colleagues Rep. Todd Akin (R-MO), Rep. Darrell Issa (R-CA), Rep. Tom McClintock (R-CA) and Rep. Bill Posey (R-FL) introduced, H.R. 87, which is a one sentence bill to repeal Dodd-Frank. Although the bill certainly grabbed a lot of attention upon its introduction, it is unlikely that the legislation will pass the House, and it is all but certain that the Senate will not take it up. Of course, were either of these to miraculously occur, President Obama is guaranteed to veto the legislation and we cannot see how the measure would have passed with veto proof majorities, so we are confident in our prediction that Representative Bachmann's legislation will not become law.

As reported in past ML Strategies updates, we anticipate that the more effective strategy for Republicans will be to withhold funding from the agencies that need to increase their budgets in order to carry out their mandated rulemaking under the Dodd-Frank Act. Also, it is worth noting that Rep. Issa, one of the co-sponsors to Rep. Bachmann's repeal, is the Chairman of the House Oversight and Government Reform Committee, and he has already outlined his intention to use the power of his committee to investigate certain aspects of the law. This effort, in conjunction with similar hearings lead by the House Financial Services Committee, will regularly bring many of the top members of the Administration charged with implementing Dodd-Frank before Congressional committees. The obvious goal of which is to slow down the implementation, and also to hopefully spotlight programs that the Republicans believe are politically unpopular in order to generate pressure for targeted rollbacks. This approach is much more likely to be successful than a single bill to repeal Dodd-Frank.

The Senate remains in recess until the week of January 24<sup>th</sup>, but we expect that the pace will pick up in the coming week in the House, which is still in session. The House put off a handful of items on its agenda this past week, including the consideration of the repeal of the health care law, in deference to the shooting incident in Tucson, AZ that gravely injured Rep. Gabrielle Giffords (D-AZ) and killed others. Although, lawmakers came together for a brief period in a show of solidarity for their colleague, regardless of their party affiliation, we expect that this bipartisanship will be short-lived. However, we note that Sen. Mark Udall (D-CO) has been pushing for new seating arrangements at the President's State of the Union address, scheduled for Tuesday, January 25<sup>th</sup>. Custom dictates that members sit separately, along party lines, but no rules exist to enforce this. The idea has been endorsed by House Majority Whip Kevin McCarthy (R-CA) but it remains unclear whether this proposal will move forward, though if it does, it could be indicative of a renewed interest in push bipartisanship in Congress.

### CHAMBER SEEKS TAX REFORM, DELAYED IMPLEMENTATION OF REG REFORM

On January 11, The Chamber of Commerce outlined what policy positions it will pursue in 2011, including tax reform and reductions in the corporate tax rate. President and CEO of the Chamber, Tom Donohue, said the business community has been encouraged by a new tone from the White House; however, concerns over regulations, taxes and other policies remain.

Donohue said in order to make the US more competitive to global investors, the Chamber will work to reform the tax code and lower the corporate tax rate. A Chamber official said other countries have been engaged in tax cut competition for a decade, leaving the US with the second highest rate in the world. The White House has signaled that the President would be willing to consider an overhaul of the tax code so long as the effort includes the elimination of loopholes.

The Chamber said it will also be working to slow the implementation of President Obama's regulatory agenda. Chamber President, Tom Donohue, cited health care legislation, financial regulations and other regulatory efforts as a 'tsunami' that threatens U.S. jobs, competitiveness and enterprise. Donohue did not encourage a repeal of the regulatory overhaul but lamented the 159 new agencies created by the health care law and the 259 new regulations mandated by the Dodd-Frank Act. Donohue specifically cited the establishment of the Consumer Financial Protection Bureau (CFPB) as a provision that should be slowed.

### IMPACT OF VOLCKER CONTINEUS TO BE FELT WELL IN ADVANCE OF THE IMPLEMENTATION OF THE RULE

In anticipation of the implementation of Dodd-Frank's "Volcker Rule," which prohibits U.S. banks and securities firms from risking their own capital in speculative trades, both Goldman Sachs and Morgan Stanley announced their plans to spin off proprietary-trading desks last week. At Morgan Stanley, the head of prop-trading will be leaving to form a new firm, PDT Advisors, at the end of 2012. About 60 of his colleagues are expected to join him there, and some analysts predict that he may raise as much as \$1 billion, post-spinoff. At Goldman, which only has one prop-trading desk remaining, the team has begun raising money to form a new hedge fund that will launch in 2Q2011 and be London-based. This will be the final departure of prop-traders from Goldman, and will mark the end of a very profitable period for the firm, which at its zenith traded \$11 billion of its capital.

On a related note, the Securities Industry and Financial Markets Association (SIFMA) issued a report last Friday about the risk of unintended consequences from the implementation of the Volcker Rule. SIFMA suggested that without careful drafting the regulations could lead to reduced access to capital for small firms, a reduction in the overall efficiency of the economy, and high trading costs for investors.

The Federal Reserve is the entity charged with crafting regulations to implement the Volcker Rule, and they will go into effect on whichever date is earlier - 12 months after the final regulations are issued, or on July 21, 2012.

### SEC BEGINS LARGE PROBE INTO PRIVATE PLACEMENTS

Under U.S. law, domestic companies must register issuances of stock by the SEC unless they qualify for an exemption from registration, such as private placement issuances. Private placements, however, must be

valid and comply with all statutes and SEC rules in order for the exemption to apply. Recently, the SEC has begun investigating these stock issuances, and actually probing into the behavior of placement agents, secondary-market market makers, securities sellers, or even the issuers of shares, as opposed to mere information gathering. Specifically, the SEC sent information requests to participants involved in the issuances of four privately held, web-based companies, and is looking into the Goldman Sachs Group Inc. role in reselling a private placement issued by Facebook Inc.

There are several theories as to why the SEC is conducting these thorough investigations. Some say the SEC is trying to determine whether companies are purposely evading the Securities Exchange Act of 1934 provision that require companies with 500 or more shareholders to make certain disclosures. Others say that the SEC is looking into the role of intermediaries and placement agents involved in private placements, or the role of secondary markets that legally resell shares, or the potential undue influence by private-company issuers. The SEC may also be determining how to count the number of investors – whether a fund with 5,000 investors purchasing a private placement counts as 1 investor or 5,000 investors.

#### SENATORS PRESS CFTC TO CURB EXCESSIVE SPECULATION

Senators Bill Nelson (D-FL) and Maria Cantwell (D-WA), along with six other Senators, sent a [letter](#) to Commodity Futures Trading Commission Chair Gary Gensler earlier this week, urging the agency to “quickly and aggressively enact regulations aimed at curbing excessive speculation in commodity markets.” They specifically implored Gensler to “reject requests to exempt broad categories of derivatives, or to broaden the definition of bona fide hedging to include investment-related hedging.” The Senators would like the CFTC to set position limits for commodity derivatives, but Chairman Gensler has said in the past that the CFTC “does not set or regulate prices,” but rather is charged with ensuring that commodity markets are “fair and orderly to protect the American public.” The CFTC will be holding its next meeting (the ninth) to discuss crafting Dodd-Frank regulations on Thursday, January 20<sup>th</sup>.

The six other signatories to the Nelson/Cantwell letter were Sen. Bernard Sanders (I-VT), Sen. Carl Levin (D-MI), Sen. Robert Menendez (D-NJ), Sen. Patty Murray (D-WA), Sen. Sheldon Whitehouse (D-RI), and Sen. Ron Wyden (D-OR).

#### LEVIN URGES CFTC TO FOCUS ON TRADING ORDERS AND CLARIFY ITS AUTHORITY

Sen. Carl Levin also sent his own letter to the CFTC last week, in response to an advance notice of proposed rulemaking (NPRM) issued by the CFTC in October. In his letter, Levin urged the agency to propose rules that would provide it with “greater flexibility” to disrupt attempted market manipulations and abusive trading practices. The advance NPRM in question called for public comments on related rule proposals under Dodd-Frank, and noted that the proposed rule would hew closely to Dodd-Frank language making it illegal for individuals to conduct activity that “violates bids or offers,” conveys “intentional or reckless disregard for the orderly execution of transactions during the closing period,” or is related to “spoofing” (intending to cancel a bid or offer after execution in order to manipulate market prices).

Levin is the chairman of the Permanent Subcommittee on Investigations, and recommended many changes to the CFTC, including:

1. CFTC rules should be more restrictive, especially with respect to the nexus between futures, options, and equities markets.
2. The CFTC and SEC should coordinate enforcement activities.
3. The CFTC should adopt rules which “provide it with sufficiently broad authority to prevent and punish [the] wide range of manipulative and disruptive activities.”
4. The CFTC could strengthen any proposal by eliminating consideration of timing issues and “making it clear that timing considerations do not excuse manipulative or disruptive activity.”

#### SEC WHISTLEBLOWER PROGRAM VULNERABLE TO BUDGET CUTS

This spring, the SEC will be finalizing its whistleblower bounty program, and like many other Dodd-Frank initiatives, the SEC’s ability to secure funding will impact its capacity to do so. The SEC, which like most of the federal government is currently being funded at FY2010 levels due to a “Continuing Resolution” that expires on March 4<sup>th</sup>, is concerned that the Republican-controlled House will endeavor to diminish the 18 percent increase requested by the SEC for FY 2011. Section 922 of the Dodd-Frank Act authorizes the SEC to award voluntary whistleblowers who voluntarily provide original information. The ability to pay whistleblowers will not be affected because the bounty comes from recoveries made by the SEC, not Congress. However, budget constraints could slow the SEC’s ability to stand up the new Whistleblower Office and process claims.

According to a former SEC official, the whistleblower program will not likely diverge greatly from the most recent SEC proposal, and the agency will likely stick to a compromise, “middle ground” approach. Hundreds of comments received by the SEC indicate that there is disagreement over the definition of what constitutes a “voluntary” whistleblower. Another contentious provision of the whistleblower program relates to protection of whistleblowers from retaliation by their employers, even if they are not eligible for rewards. Proponents assert this would protect good-intentioned employees who may have inaccurate information, whereas opponent companies want to maintain the ability to deal with malicious whistle-blowing. Given the contentious nature of this proposal we fully anticipate that it will come under Congressional scrutiny, though not until 4Q2011 at the earliest and more likely in 2Q2012.

#### MASSACHUSETTS COURT ISSUES IMPORTANT FORECLOSURE RULING

Last week, the Massachusetts Supreme Court made headlines with its decision in U.S. Bank National Association v. Ibanez. The ruling held that two foreclosures were invalid because the trustees (in separate securitizations), U.S. Bank and Wells Fargo, failed to demonstrate that they held an interest in the mortgages when they foreclosed and put the properties in question up for sale. The case is expected to spur more foreclosure challenges in Massachusetts, as the ruling will apply retroactively, however the case also has the potential to exacerbate the already large backlog problem, as plaintiffs in other states will attempt to use the Massachusetts case as persuasive law. Please see Mintz Levin’s analysis of the case [here](#).

#### MUTUAL FUNDS MONEY FUND INDUSTRY REMAINS OPPOSED TO FLOATING NAV; SUPPORTS LIQUIDITY FACILITY

Participants in the money market mutual fund industry are fighting against a recommendation by the President's Working Group on Financial Markets to move such funds to a floating net asset value. The PWG admits this would be a “dramatic change for a nearly \$3 trillion asset-management sector that has

been built around the stable share price.” The recommendations are aimed to reduce the funds' susceptibility to runs due to the perception that the funds carry little or no risk. The PWG suggested changes to strengthen the framework of money funds in three alternative ways:

- 1) Replacing the stable net asset value with a floating net asset value
- 2) Implementing a two-tier system of stable and floating net asset value, with added protections for stable net asset value funds
- 3) Creating a two-tier system with stable net asset value funds limited to retail investors

The proposal has received opposition since the SEC first proposed the measure with opponents arguing that the move would cause investors to abandon funds, harming state and local finances and increasing systemic risk. The PWG also suggested creating a private emergency liquidity facility to augment new SEC liquidity requirements. This proposal was met with approval from the industry for its promise to strengthen money market funds in times of severe market stress.

#### UPCOMING HEARINGS

*Although the House will be in session next week, there are no hearings relevant to financial services scheduled. The Senate will be in recess until the week of January 24<sup>th</sup>.*