ML Strategies Update

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Jason Rosenstock
JRosenstock@MLStrategies.com

Abby Matousek
Amatousek@MLStrategies.com

Follow us on Twitter: @MLSFinRegUpdate

ML Strategies, LLC
701 Pennsylvania Avenue, N.W.
Washington, DC 20004 USA
202 296 3622
202 434 7400 fax
www.mlstrategies.com

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Financial Services Legislative and Regulatory Update

Leading the Past Week

Contrasted with the story of the economic recovery, and how the biggest banks were announcing profitable earnings reports, the top story of the past week was how the rhetoric against the so-called Too Big to Fail banks was once again ratcheted up. This time by Dallas Fed President Richard Fisher, no bleeding heart liberal himself, who put forward a scathing report on how and why it was necessary to break up the biggest banks. Despite this broadside against the nation's largest financial institutions, the remain able to successfully influence Washington remains, as evident by the fact that the FSOC's announcement of an extension to the comment period for its proposal to regulate money market funds.

On Capitol Hill, things were quiet, as the Capitol prepared for President Obama's Inauguration and the House had a short week before the Republican conference left for its retreat. The biggest news emanating from that retreat was that the House would be voting on a bill to temporarily raise the debt ceiling for three months when it returns this week. While initial reports suggested that the measure would be tied to preventing members from getting paid if they didn't produce a budget, there was some confusion as to whether such a proposal would violate the 27th Amendment.

Even as Congress continues to ease back into the new year, regulators and the Administration remain busy in rolling out new rules implementing Dodd-Frank. For example, this past week, the CFPB finalized several rules last week including new mortgage servicer rules and two new standards for access to appraisal reports. Also, the Treasury and the IRS jointly finalized the FATCA rules intended to curb evasion tax through foreign accounts.

Legislative Branch

House of Representatives

Democrats Name Ranking Members to House Financial Services Subcommittees

On January 15th, the Democratic caucus of the House Financial Services Committee announced that their ranking members for the 113th Congress will be: Representative Carolyn Maloney (D-NY) for the capital markets subcommittee, Representative Gregory Meeks (D-NY) for financial institutions subcommittee, Representative Michael Capuano (D-MA) for the insurance and housing subcommittee, Representative Lacy Clay (D-MO) for the domestic and international monetary policy subcommittee, and Representative Al Green (D-TX) for the Oversight and Investigations Subcommittee. House Financial Services Republicans announced new subcommittee chairs last month. The House Appropriations Committee also announced the makeup of the Financial Services Subcommittee which will be chaired by Representative Ander Crenshaw (R-FL).

Lawmakers Meeting with Banks to address Cyber Threats and continued Cyberattacks
Recent cyberattacks on banking institutions including PNC, Wells Fargo, Citigroup, and others have prompted renewed calls for action in the House. With the failure to advance cybersecurity legislation still fresh, Representative Patrick Meehan (R-PA), the Chairman of the House Homeland Security Subcommittee on Cybersecurity, Infrastructure Protection, and Security Technologies, has already begun meeting with members of the banking community on ways in which to approach the issue. Representatives Carolyn Maloney (D-NY) and Gregory Meeks (D-NY), both members of the Financial Services Committee, have also called for their peers to hold hearings in the 113th Congress. There have long been fears that banks and other industries that are deemed critical infrastructure are too vulnerable to cyber threats.

Democratic Lawmakers File Brief in Support of Resource Extraction Rule
On January 16th, twelve Democratic Representatives filed an amicus brief with the U.S. Court of Appeals for the District of Columbia expressing support for the SEC's resource extraction rule. The rule implements a provision of the Dodd-Frank Act that mandates oil, gas, and mining companies listed on U.S. exchanges disclose to the SEC payments they make to governments for the extraction of oil and mineral resources. The lawmakers are responding to a suit filed by the American Petroleum Institute, the Chamber of Commerce, and others alleging that the agency used a flawed-cost benefit analysis and failed to carve out exemptions for non-transparent governments. The list of Members signing the amicus brief includes Representatives Edward J. Markey (D-Mass.), Maxine Waters (D-Calif.), Eliot L. Engel (D-N.Y.), Jim McDermott (D-Wash.), Gregory W. Meeks (D-N.Y.), Betty McCollum (D-Minn.), Jim Moran (D-Va.), Earl Blumenauer (D-Ore.), André Carson (D-Ind.), Sam Farr (D-Calif.), Peter Welch (D-Vt.), and Barbara J. Lee (D-Calif.).

Markey Pushed SEC to Address High Frequency Trading
On January 18th, Representative Ed Markey (D-MA), so far the only declared Democrat running in the special election to replace Senator Kerry, wrote to SEC Chairman Elisse Walter to remind the agency that it has authority to limit high frequency trading (HFT), and to urge the Commission to act against HFT using this authority. Markey, called HFT a "clear and present danger" to the safety and stability of financial markets and thus the SEC should "immediately promulgate rules that restrict or eliminate the practice." He asked the Commission for a response to his request by February 7th.

<u>Executive Branch</u>
Federal Reserve
Dallas Fed Releases Proposals on Ending Too Big to Fail

On January 17th, the Federal Reserve Bank of Dallas unveiled a proposal to end "too big to fail." President of the Dallas Fed Richard Fisher previewed the proposal in a speech at the National Press Club the day before the release, saying the plan would restructure "too big to fail" firms into multiple business entities with the goal of downsizing commercial banking operations. Among its reforms, the proposal calls for limiting access to federal deposit insurance and the discount window to only traditional banking activities by commercial banks and their customers. Banks' parent companies and all other units (such as insurance of brokerage branches) would not have access to a Federal backstop. As such, the plan would also require customers of shadow banking affiliates to release disclosures stating their operations are not guaranteed by the Federal government.

In his remarks, Fisher said the report should appeal to "Democrats as well as Republicans" and noted that it seeks to correct for some of the complexities of the Dodd-Frank financial reforms. While the plan is said not to require major Congressional action to implement, Fisher named Senators David Vitter (R-LA), Sherrod Brown (D-OH) and former Senator Jim DeMint as having "expressed a favorable view toward the approach. As expected, Fisher's report drew praise from the Independent Community Bankers of America (ICBA) who lauded the proposal, saying "policymakers need to act now to address the too-big-to-fail problem because we cannot afford to continue this government backstop for systemically dangerous institutions."

Treasury

Treasury and IRS Issue Final Regulations Implementing FATCA

On January 17th, the Treasury Department released the final rules for the Foreign Account Tax Compliance Act (FATCA). Congress enacted FATCA in 2010 to target non-compliance and tax evasion by U.S. taxpayers using foreign accounts and requiring foreign financial institutions (FFIs) to report to the IRS information about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. The final rules build on intergovernmental agreements in order to foster international cooperation, increase tax collection and streamline the registration process for FFIs. However, the final rule does exempt some retirement and mutual funds from foreign financial institution reporting.

Under the rules, there are three ways in which FFIs can comply with the law: banks can report U.S. taxpayer information on accounts with more than $50,000 in assets directly to the IRS or by using one of two model agreements signed with foreign governments. For FFIs that do not comply with the FATCA rules, there will be a 30 percent tax on U.S. payments beginning in 2014.

Treasury/Fed Announce Full Repayment of TALF Investment

On January 15th, the Treasury Department and the Federal Reserve announced the full repayment with interest of its investment through the Term Asset-backed-securities Lending Facility (TALF), which was created to help unlock credit for consumers and businesses during the financial crisis. Under TALF the New York Fed lent $71 billion to highly rated investors, leading to the issuance of close to 3 million auto loans, over than 1 million student loans, close to 900,000 loans to small businesses, 150,000 other business loans, and millions of credit card loans. The accumulated fees of $856 billion generated by TALF now exceed the $556 billion total principal amount of TALF loans outstanding.

FSOC Extends Comment Deadline for Money Market Reform Proposals

At the request of SEC Chairman Elisse Walter, the FSOC extended the comment deadline for proposals to reform money market mutual funds. The comment period now extends through February 15th to allow additional time for the public to review, consider and comment on the recommendations. Prior to this extension, public comments on the proposed recommendations were due by January 18th.

CFPB

CFPB Finalized Final Mortgage Servicing Rules and Protections

On January 17th, the CFPB released final rules setting mortgage servicing standards to protect against the foreclosure problems that characterized the housing crisis. The rule contains a number of new requirements, including:

- Restricting dual-tracking;
- Requiring notification of foreclosure alternatives and loss mitigation options;
- Requiring direct and ongoing access to servicing personnel;
- Access to a fair review process;
- Provision of clear monthly mortgage statements, early warnings before rate adjustments and options for avoiding 'force-placed' insurance; and
- Prevention of runarounds including properly crediting payments, error resolution, accurate recordkeeping and documentation.

Announcing the new regulations, CFPB Director Richard Cordray said the rules will "ensure fair treatment for all borrowers and establish strong protections for those struggling to save their homes." The National Consumer Law Center lauded the rules for addressing "broad problems in the mortgage servicing industry" but expressed concern that there wasn't enough done to address loan modification problems that arose during the housing crisis. A sentiment expressed by the Ranking Member of the House Financial Services Committee, Maxine Waters (D-CA) who said in a statement that she felt the regulations should do more to protect against foreclosure abuses, and as a result will push for additional protections against dual-tracking and stronger rights to appeal.

CFPB Issues Final Rule on Access to Appraisal Reports, Adopts Rule on Higher-Priced Mortgage Loans

On January 18th, the CFPB released a final rule that will require mortgage lenders to provide applicants with free copies of all appraisals and other home-value estimates. The rule also requires creditors to inform consumers within three days of receiving an application for a loan of the consumer's right to a copy of all appraisals.

The same day, in partnership with several other federal regulatory agencies, the Bureau also adopted a related new rule that establishes special requirements concerning appraisals for higher-priced mortgage loans. The goal of the rule is to enforce against fraudulent real estate flipping by ensuring lenders obtain a second appraisal on a home if the seller bought the property for a lower price in the previous six months. The rule also requires creditors to disclose to applicants information about the purpose of the appraisal and provide consumers with a free copy of any appraisal report.

CFPB Exploring A Role in Retirement Savings Regulation
Last week, Bloomberg News reported that CFPB Director Cordray indicated the Bureau is considering taking actions to weigh into the retirement savings industry. Should the Bureau move forward it would be the agency's first attempt to regulate the $19.4 trillion consumer investment market. While Director Cordray did not provide details on specifics, he said the Bureau is exploring what its authority in this area is. Currently, the industry is primarily regulated by the SEC and the Department of Labor, but the Bureau has in the past interpreted its Dodd-Frank mandate as broad authority to promote coherent policy across the Federal government. Furthermore, through its Office of Financial Protection for Older Americans, it has a mandate to protect seniors. Additional speculation is that the Bureau would focus on the "consumer" interactions of the industry (i.e., marketing, public disclosures etc.) and avoid a fight with the SEC / CFTC on the "business" side of the industry (i.e., the investments and asset management).

SEC
Commissioner Gallagher On Money Market Reforms, Volcker
Even as the FSOC announced it would extend the deadline for comments on its money market mutual fund proposals, SEC Commissioner Daniel Gallagher told participants at a U.S. Chamber of Commerce event that he is hopeful the SEC will be able to address money market mutual fund reforms in the near future. Gallagher has expressed support for reforms that would move to a floating NAV and restrict the speed at which investors can withdraw money during a run but opposes proposals that would increase capital buffers. Gallagher, a Republican member of the Commission said he expects a 4-0 vote on reforms in the first quarter of 2013.

At the same event, Gallagher criticized regulators' efforts in implementing the Volcker Rule ban on proprietary trading. "The entire rulemaking exercise so far has been carried out in a manner that has wasted the resources of all the agencies involved," said Gallagher. Specifically, Gallagher faulted regulators for placing the SEC in a secondary role in the process, saying that the SEC, which regulates the securities market should play a larger role in drafting regulations that would affect "that quintessential market-making activity." In other remarks, Gallagher said he expects the agency will proceed with its Dodd-Frank cross-border proposals and the Jumpstart Our Business Startups (JOBS) Act crowdfunding rules soon.

SEC to Expand Continuous Review Program
According to a Bloomberg report, the SEC is planning to expand the continuous review program, which was launched in 2009 to enhance agency scrutiny of registered companies' publically filed financial materials for institutions that received support through the Troubled Asset Relief Program (TARP). According to this report, the SEC intends to move ahead with expanding reviews as soon as February with the intention of expanding the program beyond its current focus on large financial services firms.

The continuous review differs from the regular review process in that it looks at all filings and other documentation on an ongoing basis as opposed to analyzing a company's Form 10K once every three years, as mandated by the Sarbanes-Oxley Act.

<u>Upcoming Hearings</u>

On Tuesday, January 22nd at 1:30pm, the House Ways and Means Committee will hold a hearing on the debt limit.

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