Jason M. Rosenstock
Direct dial 202 434 7478
JMRosenstock@mlstrategies.com

Abby Matousek
Direct dial 202 434 7329
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 ISSUES UPDATE

October 29, 2012

Leading the Past Week

With less than two weeks remaining until the November 6th elections, this update offers highlights of what has been going on in the financial services world over the past few weeks. While all eyes in the country may be focused on Hurricane Sandy, as well as that Presidential race, other issues continue to percolate at the Capitol and throughout the Administration. Clearly, the primary concern, outside of the election, is how to deal with the fiscal cliff, which is the combination of the expiration of the so-called "Bush Tax cuts", the sequestrations, and potentially the need to raise the debt ceiling. This issue is also fast becoming a major concern for business leaders, and we are starting to see a group organize around the need to pressure Congress for a deal. In other news, banking groups and their allies continue to argue for relief from the Basel III capital rules, as lawmakers and industry endeavor to convince regulators to focus on simple leverage ratio-based rules, rather than implement the complex Basel standards in their entirety.

Fiscal Cliff

On October 26th, reports emerged that the fiscal cliff is already negatively impacting the U.S. economy. A National Association of Manufacturers report projects that if Congress fails to act, nearly 6 million jobs could be destroyed through 2014, pushing the unemployment rate back up to 12 percent. With fears growing over the cliff, Bloomberg reported that Jamie Dimon, CEO of JPMorgan Chase, hosted a meeting of over 75 New York-area chief executives to garner support for a campaign addressing the U.S. deficit and averting the fiscal cliff. The CEOs seek financial support and action for the Fix the Debt campaign, which was founded by Alan Simpson and Erskine Bowles.

On the heels of Dimon's meeting, over 80 CEOs gathered at the October 25th opening of the NYSE, citing the fiscal cliff and the debt as detracting from economic recovery and job growth.

The business leaders called the debt the "number one problem in our country" which causes uncertainty which impedes "long-term capital investment decisions." While the group supports additional revenue from taxes, it does not support an increase, but rather an overhaul of the tax code to provide additional revenue; Republicans, who oppose a tax increase may oppose this unless offset by additional tax cuts. The CEOs have raised $30 million which they intend to use for public awareness, advertising and educational events.

The NYSE opening and Dimon meeting are the most recent developments in a string of business leaders coming out publically to urge Congress and the President to avoid the fiscal cliff. On October 18th, the top 15 executives of large insurance companies and financial institutions—such as Bank of America, Allstate, Credit Suisse, Wells Fargo & Company, and Citigroup—asked policy makers to put aside politics to "negotiate a bipartisan agreement as quickly as possible to prevent us from going over the fiscal cliff so that we can avoid the damage to the economy and the markets that inaction will cause."

With business coalescing around the need for a deal, while not endorsing any specific plan, Warren Buffet warned last week that it is quite possible the U.S. will go off the fiscal cliff "for a short period of time." Buffett said the outcome of the fiscal cliff will depend on the outcome of the presidential election and the personalities of the House and Senate Leaders.

<u>Legislative Branch</u>

Senate

Senators Call for Additional Attention to Leverage Ratios in Basel III Rules

Senators Sherrod Brown (D-OH) and David Vitter (R-LA) are calling on regulators to rely less on Basel III capital rules when looking to reduce risk and implement leverage ratios. In a letter sent to regulators on October 18th, the Senators asked the Federal Reserve, FDIC and OCC to "focus on the level of pure tangible common equity at financial institutions," and not on "more and more complex capital regulations." The Senators echo calls by former FDIC Chairman Sheila Bair and Bank of England officials who have urged more attention to leverage ratios in capital rules, which currently exist in Basel rules but secondary to risk considerations.

In addition to concerns over leverage ratios' role in capital rules, many are calling on regulators to reconsider the U.S. version of the Basel framework. On October 23rd, in the face of heavy opposition from community banks, Comptroller of the Currency Thomas Curry reiterated his belief that community banks should not be exempted from all of the new capital rules. While a number of groups have expressed concerns that small banks will be burdened by the new rules and need additional time to comply with the new standards. For example, the ICBA is urging regulators to exempt small banks and the ABA, SIFMA and Financial Services Roundtable have requested banks, particularly community banks, be given additional time to comply with the new capital rules.

Senator Warner Outlines Potential for Dodd-Frank Revisions

On October 18th, Senator Mark Warner (D-VA) gave a speech at the Bipartisan Policy Center, noting that it may be possible to enact changes to the Dodd-Frank Act in the next Congress.

While Senator Warner said that the fiscal cliff is the most pressing issue and must be addressed before automatic spending cuts and tax increases take effect on January 2nd, he stressed Congress must move beyond a "repeal or nothing" approach to Dodd-Frank. As part of these potential revisions to the financial reform legislation, Warner stressed he would like to see a number of changes to the law, including: an independent leader to replace the Treasury Secretary as the head of the FSOC, greater authority for the FSOC to resolve differences between agencies (such as those we have seen with derivatives reform), greater flexibility for implementation of the Volcker Rule, and changes to ensure small- and mid-sized financial institutions are treated distinctly from larger competitors.

House of Representatives

Franks Calls on Financial Fraud Taskforce to Reconsider Lawsuit Against JPMorgan

On October 22nd, Representative Barney Frank, retiring Ranking Member of the House Financial Services Committee, criticized the lawsuit against JPMorgan brought by New York Attorney General Eric Schneiderman, head of the President's mortgage fraud taskforce. In a statement, Frank explained JPMorgan acquired Bear Stearns—which allegedly packaged faulty loans into securities sold to investors—at the height of the financial crisis at the urging of the Federal Reserve and Treasury. Frank went on to say that financial actors who "misbehave" should be punished but that JPMorgan did a "good deed" by taking over Bear Stearns which "the bank would never have sought to acquire absent [government] urging." While JPMorgan CEO appears to agree with Frank, having previously said the bank did the government "a favor," a group of eleven organizations responded to Frank's comments with a letter expressing deep distress at the lawmaker's request for Schneiderman to reconsider.

<u>Executive Branch</u>

Federal Reserve

Rift Over Volcker Rule Brings Renewed Calls for Finalization by End of Year

With doubts over whether regulators will be able to finalize the Volcker Rule by the end of the year, a rift between regulators and the SEC has emerged. The Federal Reserve, FDIC and OCC already broadly agree on how a final Volcker Rule should be crafted but the SEC differs on how market-making should be defined in addition to how a bank's ability to invest in outside investment vehicles should be treated. As the SEC oversees brokers, which conduct market-making activities, the agency is also pushing for additional influence over decisions in these areas. SEC Chairman Schapiro addressed the issue at the SIFMA annual meeting saying it should not be a surprise that "given the different nature of the institutions that we regulate, that we have some different perspectives." While Schapiro said regulators have not given up on reaching a final product regulators can agree on, CFTC Chairman Gensler floated the possibility on October 23rd that it is possible for disparities to exist in versions of the Volcker Rule.

Amid concerns that a final Volcker Rule could vary across agencies or be delayed, Senators Carl Levin (D-MI) and Jeff Merkley (D-OR) wrote to the heads of the Fed, FDIC, OCC, CFTC and SEC requesting regulators resolve differences and finalize a final Volcker Rule as soon as possible. The Senators' request comes as Standard & Poor's released a new report estimating that the Volcker Rule could severely impact profits at large banks, potentially reducing "combined pretax earnings for the eight largest U.S. banks by up to $10 billion annually."

CFTC

CFTC Proposes New Regulations for Customer Protection

On October 22nd, the CFTC proposed new rules, amending existing regulations, which would enhance customers' protections and strengthen safeguards on the holding of money, securities and other property deposited by customers with futures commission merchants and derivatives clearing organizations. The proposal seeks to codify rules put forward by the National Futures Association on the calculation of funds in foreign accounts, internal controls for brokers and audits of accounts. The new regulations are prompted by the recent losses of customer money at MF Global and Peregrine Financial Group. The proposed regulations would also: require FCMs to hold sufficient funds in secured accounts to meet their total obligations; maintain written policies and procedures governing the maintenance of excess funds in customer segregated accounts; report to the CFTC and designated self-regulatory organizations on daily reporting of segregation and read-only direct electronic access to bank and custodial accounts; require adoption of policies and procedures for supervision and risk management.

CFTC Issues Final Guidance for International Data Sharing

On October 22nd, the CFTC issued final guidance that would remove some impediments foreign regulators may face when seeking to access information from swap data repositories (SDR). The guidance is prompted by concerns that foreign governments would have to sign confidentiality agreements and agreements to indemnify the CFTC and the data repository from potential litigation costs. In announcing the vote, Chairman Gensler said the guidance makes "clear that a foreign regulator will not be prevented from accessing data in which it has an independent and sufficient regulatory authority over the SDR and such data has been reported pursuant to the foreign jurisdiction's regulatory regime." The guidance was approved in a 3 to 2 vote, with Commissioners Sommers and O'Malia voting against the measure.

Technology Advisory Committee Announces Oct. 30 Meeting

On October 23rd, CFTC Technology Advisory Committee announced it will meet in Chicago on October 30th to discuss three significant issues facing the futures and swaps industries. The meeting will focus on automated and high frequency trading (HFT), the implementation of an automated technological solution to protect customer funds, and address Sections 1.73 and 1.74 of Commission regulations regarding technological challenges and possible Commission waivers.

SEC

SEC Adopts Final Risk Management Standards for Clearing Agencies

On October 22nd, the SEC adopted risk management and operation rules for clearing agencies which facilitate securities transactions. The new rule requires registered clearing agencies to maintain standards for risk management and operations. In addition, the rules set standards for measurement and management of credit exposure, margin requirements, financial resources, margin model validation, recordkeeping and financial disclosure requirements. The SEC has also posted a webpage detailing the new regulatory regime for security-based swaps and details what happens as a transaction occurs.

Industry Engaging on Money Market Reforms
On October 26th, the Investment Company Institute's (ICI) Money Market Working Group announced in a statement that top industry leaders are "engaging directly" with the SEC on potential reforms to the money market mutual fund industry. ICI stressed that they are making a "united effort to constructively build on the successes of the 2010 reforms." The group's statement comes after comments made by BlackRock's CEO Larry Fink on CNBC that industry would be meeting with Treasury and SEC officials to attempt to reach an "industry supported resolution."

CFPB

Federal Supervision Extended to Larger Consumer Debt Collectors
On October 24th, CFPB Director Richard Cordray published a rule that will allow the CFPB to supervise larger debt collectors. According to the rule, the Bureau will be able to supervise collectors with more than $10 million in annual receipts. In remarks at a meeting in Seattle, Director Cordray said the new supervision ensures that debt collectors competing fairly are not at a disadvantage. The rule, which takes effect January 2nd, will evaluate whether debt collectors have adequate methods of responding to consumer complaints and speak to customers without harassment or deception. Bureau examiners will also be evaluating whether debt collectors provide required disclosures, provide accurate information, offer consumer complaint and dispute resolution mechanisms, and communicate honestly with consumers.

CFPB Proposes Changes to Rules Impeding Stay-at-Home Spouses' and Partners' Access to Credit
On October 17th, the CFPB announced proposed changes to rules proposed under the Credit Card Accountability Responsibility Disclosure Act (CARD Act) which would make it easier for stay-at-home spouses to qualify for credit cards. Current regulations require a credit card issuer to evaluate a consumer's ability to make payments based on his or her independent income or assets before opening a new account; however, for those married people that do not work outside of the home these regulations would make it difficult or impossible to be deemed credit worthy. The proposed changes would add accessible income as a way to evaluate a consumer's ability to make payments. This accessible income must be money that the consumer has a reasonable expectation of being able to use, and it applies to all credit card applicants who are at least 21 years old, whether married or unmarried. After the Bureau's announcement, Representative Barney Frank (D-MA) released a statement applauding the CFPB's actions, saying the old language was intended to protect college students from exploitation, but put stay-at-home spouses and partners at a disadvantage.

White House

White House Considering Replacing Acting FHFA Head After Election
On October 24th, the Financial Times reported that the White House is considering replacing the Federal Housing Finance Agency acting Director Edward DeMarco after the election. DeMarco has long been an impediment to Democratic housing policies. Most recent in a

number of clashes with the White House over policy, DeMarco refused to implement a debt-reduction plan championed by the White House and, in the past, the agency declined to implemented suggested policies that would enable greater number to refinance mortgages. Administration officials are reported to be quietly reaching out to housing groups to come forward with potential candidates who would be named to the position through a recess appointment.

FSOC

FSOC Meets to Discuss Ongoing "Domestic Finance" Issues

On October 18th, the Financial Stability Oversight Board (FSOC) met to discuss "a number of topics related to domestic finance and international risk markets." This includes its continued review of nonbank financial companies that could be candidates for FSOC risk review and designation as systemically important financial institutions, including reportedly Prudential. The FSOC is also reported to have discussed money market mutual fund reforms, as Treasury Secretary Geithner, chair of the FSOC, has asked members to consider moving ahead independently if the SEC is unable to approve reforms put forth by SEC Chairman Schapiro.

<u>Miscellaneous</u>

British government report analyzes pros and cons of high-frequency trading

On October 22nd, the British government and the Foresight Programme released a two-year study on the impacts of high-frequency trading (HFT). The full report found that speed trading has largely offered benefits to ordinary investors, though isolated incidents of market instability may still result from heavy computer trading and can exacerbate large swings during a crisis. Still, the report indicated that regulators do not have enough data or expertise needed to address widespread concerns that faster traders succeed and profit at the expense or more traditional investors. John Beddington, head of Foresight Programme and chief scientific adviser for the British government, said that many concerns with high-frequency trading are simply unwarranted; however, David Lauer, who has previously testified negatively on the HFT industry, said the study downplays potential costs posed to investors and the lack of procedures to test HFT trading platforms.

Three Wireless Carriers Introduce Mobile Wallet System

On October 22nd, mobile providers Verizon, AT&T, and T-Mobile announced plans to roll out their mobile wallet system in Salt Lake City, Utah and Austin, Texas. Using the Isis mobile wallet and near-field communications (NFC), which organize checkout terminals for mobile payments, consumers will make purchases by having debit and credit card information encrypted on their phone. NFC technology requires hardware and software to be integrated on the mobile device itself and about 20 smart phone models are expected to be Isis compatible by the end of 2012. The Isis system will compete with other payment systems like Google Wallet, PayPal Here and Square. According to some industry observers, government regulators still do not fully understand how current financial transactions laws apply to the emerging mobile payment industry.

Cyber Attacks Hit U.S. Banks Five Weeks in a Row

On October 18th, Capital One, BB&T, and HSBC Bank indicated that they experienced another round of cyber attacks which disrupted online banking services. Websites of the three banks were hit with denial of service attacks from Russia and Iran, although no data or money appears stolen. The group known as Izz ad-Din al-Quassam Cyber Fighters claimed responsibility for the attacks and said they acted in response to a YouTube video criticizing Prophet Muhammad. U.S. Secretary of Defense Leon Panetta said those responsible will be held accountable. It remains unclear if the Iranian government is behind the actions, but security experts are concerned that the strong defenses of financial institutions have been infiltrated.

UPCOMING HEARINGS

The Senate and House Are in Recess