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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

November 21, 2011

Leading the Past Week

This past week saw Congress pass the first "minibus" appropriations, even as the wheels came off that strategy and it appears the remaining spending bills will get wrapped up in one large omnimbus vehicle. The bill that passed this week included a one-third budget cut for the CFTC—even as their Dodd-Frank Act responsibilities increase. Also of note in the minibus bill was language that reinstated an increase in the conforming loan limit – albeit only for FHA loans – as the limits for GSE and VA loans remains at the lower level. Interestingly, this increase came as there was renewed attention on the solvency of the FHA and while Congress continued to batter the FHFA over its handling of bonuses for executives at Fannie and Freddie. However, despite being able to execute one of its true constitutional responsibilities, most, if not all of the attention was focused on the Supercommittee, which headed into the last full week before its statutorily imposed deadline to make its report. Staring down the barrel of its own deadline, the Supercommittee careened towards two options that can be best described with the pop culture catchphrases of "great success" (i.e., any type of deal) or "epic fail" (no deal at all). Late on the day on Sunday it sounded like the whole thing was going down in flames, as both sides positioned for the expected failure, and recriminations.

Supercommittee Update:

Even as last week we learned that the US government financed a $98 billion budget deficit in the month of October, bringing the country only $245 billion from hitting the $15.2 trillion debt limit, the Supercommittee appeared to make little to no progress with less than a week to reach a deal. Congressional leadership began to play a larger role in discussions; however, multiple new sources reported that leadership has begun to warn members that the Supercommittee is unlikely to reach their $1.2 trillion goal.

It appears most on the Supercommittee have also given up on the prospect of reaching a comprehensive deal and began to float alternatives to avoid sequestration last week. Representative Xavier Becerra (D-CA) said the Committee was hearing more and more "talk of trying to do some of it now—a down payment now—and the rest later." Similarly, Representative Jeb Hensarling (R-TX), floated the idea of a "two-step process" for reaching their goal. Such a "down payment" or "two-step" deal could come in the form of tax or entitlement reform farther down the road. However, Becerra warned that the Committee would not be able to take a victory lap for proposing vague tax reforms but rather would need to offer specific proposals which the CBO can then score. Becerra said: "if the instructions aren't very clear, CBO is not going to give you much relief."

Not only does it look as if a proposal will largely kick the can down the road, the debate over any real deal appears to have ended and become more about political posturing than deal making. In remarks on November 17th, Speaker John Boehner (R-OH) urged the Committee to avoid sequestration, panning Democrats for failing to come back with a counter proposal to the plan Republicans offered two weeks ago. Democrats has responded by calling Republican offers unreasonable with Minority Leader Nancy Pelosi criticizing Republicans' desire to extend the Bush tax cuts "not balanced."

With only days remaining before a deal must be reached fears have begun to emerge over how a failure will play with the markets and investors—already cowed by the European sovereign debt crisis. While the Moody's and other major ratings agencies have said a failure will likely not result in a further downgrade, some analysts have predicted that a failure or a punt could undermine already shaky consumer confidence heading into the holiday shopping season.

<u>Legislative Branch</u>

Senate

HUD, FDIC Nominations Likely to Proceed More Quickly than Other Banking Nominations:
On November 17th, three top banking and housing nominees received strong bipartisan support in the Banking, Housing and Urban Affairs Committee hearing on their nominations. No Senator expressed concerns with any of the three nominees: Thomas Hoenig to be FDIC Vice Chairman, Carol Galante to be FHA Commissioner and Maurice Joes to be Deputy HUD Secretary. While Ranking Member Richard Shelby (R-AL) said he would support a quick confirmation for all three regulators—in addition to Martin Gruenberg to be FDIC Chairman and Thomas Curry to be Comptroller of Currency— it remains unclear when the Committee will vote.

Scott Brown Announces Support for Cordray to be CFPB Director:
On November 18th, Senator Scott Brown (R-MA) endorsed the nomination of Richard Cordray to be the first Director of the CFPB. In a statement by spokesman John Donnelly, Brown not only "supports the Cordray nomination" but also "believes it deserves an up or down vote on the Senate floor." Although Brown's support is an encouraging step in Cordray's nomination, it will likely remain at an impasse so long as the 44 other Republican Senators who have vowed to block any director remain opposed. Notably, Brown is currently locked in a fight for his Senate seat this election season with Elizabeth Warren, who many credit as the intellectual force behind the creation of the Bureau and who was, prior to announcing her run against Brown, responsible for standing up the Bureau.

House of Representatives

House Financial Services Committee Approves Bills to Guide Swaps Rulemakings:
On November 15th, the House Financial Services Committee approved a series of four bills to clarify Congressional intent of the Dodd-Frank Act over swaps regulation. The bills include: Representative Scott Garrett's (R-NJ) Swap Execution Facility Clarification Act (H.R. 2586); Representative Garrett's the SEC Regulatory Accountability Act (H.R. 2308); Representative Steve Stivers' (R-OH) H.R. 2779, to exempt inter-affiliate swaps from certain regulatory requirements put in place by the Dodd-Frank Wall Street Reform and Consumer Protection Act; Representative Francisco Canseco's (R-TX) the

Retirement Income Provision Act (H.R. 3045); and Representative Nan Hayworth's (R-NY) Swaps Bailout Prevention Act (H.R. 1838).

H.R. 2308 directs the SEC to undertake a more rigorous cost-benefit analysis prior to promulgating rules including 'clearly identifying' the problem the regulation seeks to resolve and an assessment of any less costly regulatory alternatives. Garrett said his legislation mirrors the January executive order directing agencies to weigh costs, benefits and job creation factors before regulating. Representative Carolyn Maloney (D-NY), a strong opponent of Garrett's bill, offered a failed amendment to strike the bill's language charging that the "bill foes too far especially in light of the budgetary constraints" at the SEC.

Unlike H.R. 2308 Garrett's second bill, H.R. 2586 had bipartisan support. H.R. 2586 would bar the CFTC and the SEC from adopting swaps rules that: require participants to receive or respond to quote requests; require a swap execution facility to display or delay quotes; require trading systems to interact with another in the same execution facility; and limit the ways market participants can use to undertake swaps transactions. Representatives Robert Hurt (R-VA) and Maloney both agreed during the hearing that the bill would address rules that go beyond the Congressional intent of the Dodd-Frank Act.

STOCK Act Gains Momentum Following 60 Minutes Interview:
Last week, following "60 Minutes" coverage of the legislation, the Stop Trading on Congressional Knowledge Act, or STOCK Act, (H.R. 1148) gained additional traction in the House. The legislation, cosponsored by Representatives Tim Walz (DFL - MN) and Louise Slaughter (D-NY), has been introduced on several occasions since 2006 and would bar Members of Congress from trading on nonpublic, political information in addition to requiring new registrations for "political intelligence" companies which acquire nonpublic information. Following the "60 Minutes" interview, Representative Barney Frank (D-MA) sent a letter to Chairman of the Financial Services Committee Spencer Bachus (R-AL) urging him "to act" on the STOCK Act. In response, the Financial Services Committee has announced it will hold a hearing on December 6th to discuss the legislation.

Additionally, Senators Kristen Gillibrand (D-NY), Jon Tester (D-MT) and Debbie Stabenow (D-MI), Claire McCaskill (D-MO), Amy Klobuchar (D-MN), Dick Durbin (D-IL), Richard Blumenthal (D-CT) and Marco Rubio (R-FL) announced on November 18th they will be introducing companion legislation in the Senate.

House Committee Examines Internet Gambling Legislation:
On November 18th, the House Energy and Commerce Subcommittee on Commerce, Manufacturing and Trade met to discuss the potential benefits and risks associated with creating a national framework that would permit states to opt into online gambling. The Internet Gambling Regulation, Consumer Protection, and Enforcement Act (H.R. 1174) introduced by Representatives Barney Frank (D-MA) and John Campbell (R-CA) would permit online gambling with regulatory oversight exercised by the Department on the Treasury. An alternative proposed by Representative Joe Barton (R-TX), the Internet Gambling Prohibition, Poker Consumer Protection, and Strengthening UIGEA Act of 2011 (H.R. 2366), would only permit online poker, allow oversight exercised by the Commerce Department, and would allow additional leeway for state regulators.

Concerns brought up by the assembled representatives and panelists addressed the already prolific online gambling behavior engaged in by Americans despite the UIGEA legislation that was intended to prohibit such financial transactions in addition to the risks associated with that behavior, with Americans engaging with unregulated and offshore gambling sites, along with the lost tax revenue were of particular concern. Concerns also arose in a Senate Committee on Indian Affairs hearing on the impact of internet gambling on Native American tribes who are concerned increased online access would impact gaming on tribal lands. Witnesses asked lawmakers to include a provision in any online gaming bill to make clear that tribal gaming facilities can extend their reach online and that tribes receive tax exemptions for online play.

Executive Branch

CFPB

CFPB Jointly Announces Standards to Determine Large Banks:

On November 17th, the CFPB jointly announced with the FDIC, Office of Comptroller of the Currency, NCUA and the Federal Reserve that they will be using the same standards to determine what financial institutions with over $10 billion fall under CFPB supervision. The FDIC has long recognized "large institutions" as those that report more than $10 billion in one full year and the CFPB will be adhering to the same standard. While smaller institutions will remain under the purview of prudential regulators, the Dodd-Frank Act gives the CFPB rule-making authority and enforcement power over larger institutions. Size determinations will be made by a common measure of asset size reported by institutions to regulators quarterly. Initial size determinations will be made based on reports filed by banks on June 30th 2011.

CFTC

CFTC Budget Gets Cut in Minibus Funding Measure:

On November 17th, Congress approved the first 'minibus' appropriations vehicle to fund three of the twelve annual appropriations packages, including funding for the Departments of Agriculture, Transportation, Housing and Urban Development, Commerce and Justice. The minibus funds the CFTC at $205 million, one-third of the President's request of $308 million which was meant to increase the budget to reflect the increased responsibilities of the CFTC under the Dodd-Frank Act. While the agreed upon budget allocation is a compromise between the Senate's original request of $240 million and the House's of $178 million, Ranking Member of the House Appropriations Committee, Norm Dicks (D-WA) said the funding was "not adequate."

Even as the agency's budget request was slashed, Commissioner Bart Chilton stressed the benefits of regulation over an industry that has never been subject to federal oversight. Before the Risk Management in Energy Trading Conference November 8th, Chilton posited that the new Dodd-Frank regulatory regime will "will foster a landslide of hiring in the financial sector" rather than trigger job loss as opponents of the reform legislation argue. Chilton also said he believed that the new regulations will force business to "devise new and innovative—and better—ways of doing business," which will lead to job growth. Chilton owned that the regulatory process does result in uncertainty—which regulators say stymies investment and growth—and gave position limit rules as an example of a regulation which will not move forward due to the need for a final "swap" definition.

Gensler Outlines Swaps and Clearing Priorities, Asks for Additional Resources:

On November 16th, CFTC Chairman Gary Gensler said he expects the Commission to adopt a final rule on how clearinghouses and futures commission merchants may invest private funds. Under current regulations, private funds may be invested in municipal securities, GSE securities, certificates of deposit, commercial paper, sovereign debt and money market mutual funds. Under the CFTC's proposed regulation, these investments would by capped by specific percentage thresholds. Though Gensler sought to underscore the "importance of maximizing protection of customer funds," Commissioner Scott O'Malia called on his fellow commissioners to "reconsider the proposal" to ensure additional transparency in these transactions.

In his remarks before the University of Chicago Law School, Gensler also listed other CFTC priorities, including finalizing rules on: "segregation for cleared swaps," limiting aggregate positions in the futures and similar swaps markets through speculative position limits rules, the types of swaps trade data that will be provided to the Commission, and real time swaps reporting rules. Thus far, the CFTC has approved 18 final rules of the fifty that were proposed since October 2010; however, given the passage of the minibus funding the CFTC at significantly lower levels than requested, the CFTC will be challenged in meeting their responsibilities with fewer resources. In his remarks, Gensler stressed the need for "additional resources consistent with the CFTC's significantly expanded mission and scope."

GAO

GAO Finds Financial Regulators should do more to Cooperate:

In a report released on November 10th, the GAO found that federal financial regulators must improve rulemaking coordination as they continue to implement the Dodd-Frank Act. The report found that financial regulators—including the CFPB—have no formal procedures for undertaking interagency cooperation. The report also found that the majority of cooperation is only done on an "ad hoc" basis which leads to abandoning the cooperative efforts "when disagreements arise or other work becomes pressing." Finally, the report studied how effective financial regulators are in estimating costs and benefits in the "spirit" of OMB guidelines. The study recommended the FSOC "work with the federal financial regulatory agencies to establish formal coordination policies that clarify issues such as when coordination should occur, the process that will be used to solicit and address comments, and what role FSOC should play in facilitating coordination."

FHFA

Fannie and Freddie Executive Bonuses Criticized by Congress:

Legislators expressed their frustration on Tuesday, November 15th about the $13 million in compensation approved by the Federal Housing Finance Administration (FHFA) for the top ten Fannie Mae and Freddie Mac executives. Edward DeMarco, acting Director of FHFA, the agency charged with supervising the two mortgage companies, appeared before the Senate Banking Committee to discuss why he believed it was necessary to approve the pay packages. While, Chairman Tim Johnson (D-SD) refrained from overt criticism, there was overall bipartisan opposition to the payments.

Senators grilled DeMarco on the justification for the pay given that both firms continue to report quarterly losses despite receiving $180 billion from the Treasury Department. He noted that pay for the executives has fallen to pre-2000 levels and said that the best way to reduce taxpayer commitment to the firms would be to eliminate them altogether. Although some legislators certainly favor that option, it will likely take time to sort out their $5 trillion in mortgage holdings and guarantees – representing 40% of the market. On the other side of the Capitol, the House Financial Services Committee reported Chairman Bachus' (R-AL) bill by a bipartisan vote of 52-4. H.R. 1221 the Equity in Government Compensation Act of 2011 would rescind the packages and would adopt the federal general schedule (GS) pay standards. If passed, it would likely test DeMarco's assertion that the higher current pay levels are necessary to retain the two firms' talented workforces.

HUD

FHA Receives Higher Loan Limits in Congressional Minibus:

As the Congress passed the first minibus appropriations package, the Department of Housing and Urban Development released an annual report finding that the FHA's insurance fund is on the verge of going broke. The report found that chances are "close to 50 percent" that upcoming losses will overcome the fund's capital resources for the next year; however, given the current political climate of stringent cuts, it is unlikely there will be a legislative fix to shore up the fund.

While Representative Scott Garret (R-NJ) has already voiced his opposition to a "bailout" of the fund, Representative Barney Frank has said there is no need to worry that the fund will go bust as, in the past, lawmakers have simply raised premiums the agency charges to insure mortgages. The HUD report comes as the Congress passed the appropriations minibus which actually increases conforming loan limits that can be insured by the FHA. Two months ago, loan limits were decreased to $625,500; however, the minibus would raise maximums to $729,750 through the end of 2013.

UPCOMING HEARINGS

There are no hearings scheduled as both the House and Senate are in recess for the Thanksgiving Holiday