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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

December 12, 2011

Leading the Past Week

The theme of the past week was a contrast between stasis and action. Stasis in Europe, where talks continued in an effort to save the Eurozone (and perhaps the American economy) and also with Democratic efforts to pass the nomination of CFPB Director Cordray. Action, as multiple congressional committees prepared to use former Senator Jon Corzine as a proverbial piñata to vent their frustration with the MF Global fallout, at the agencies (including the CFPB), which continued to announce and commence the process for rolling out new regulations.

Legislative Branch

Senate

Both Sides Believe they are Scoring Political Points with CFPB Bureau Fight:

In an event that no one found even remotely surprising, an almost unified Senate Republican party succeeded in blocking the nomination of Richard Cordray to be the first director of the CFPB. The 53-45 vote failed to cross the 60 vote threshold needed to limit debate, with only Senator Brown (R-MA), voting in favor and Senator Snowe (R-ME) voting present.

Although the CFPB opened its doors in July of this year, it has been restricted from fully exercising its statutory powers until a Director is in place. With both parties believing that this issue plays well with their respective bases, we should anticipate future votes on the Cordray nomination, especially, because it appears that President Obama will not be able to push Cordray through as a recess appointment as it looks like Republicans will not allow the Congress to formally recess this year.

Dodd-Frank Oversight Hijacked by MF Global Collapse:

On December 6th the Senate Banking Committee convened a hearing to continue its oversight of the implementation of Dodd-Frank, however it became quickly apparent that the focus on the committee was not on Dodd-Frank, but on CFTC Chairman Gary Gensler's handling of the MF Global bankruptcy. While Gensler made clear that his recusal from the case was meant to avoid "distraction," likely derived from his from his prior relationship with MF Global CEO Jon Corzine, Republican

Senators on the panel accused Gensler of “ducking the responsibilities,” making “career-enhancement” moves and “evading questions” on the case.

While Chairman Gensler and the MF Global collapse became the primary focus for many of the lawmakers’ questioning, the hearing also featured SEC Chairman Mary Schapiro, Deputy Treasury Secretary Neal Wolin, Acting Comptroller of the Currency John Walsh, Acting Chairman of the FDIC Martin Gruenberg and Fed Governor Daniel Tarullo, and the panel was not spared their own questions on the Volcker Rule, qualified mortgage rulemaking and other issues about the implementation of the financial reform. During the hearing, it was clear that lawmakers were critical of the draft Volcker Rule released in October, echoing broader criticisms that the rule is overly complex and remains unclear—with over 400 questions on rule definitions, allowable trading activities, compliance and costs and benefits remaining unaddressed. In addition, lawmakers were concerned that the CFTC has yet to issue a proposal which Chairman Gensler said was due to limited staff and resources.

In addition to concerns over the Volcker Rule, lawmakers expressed concerns with the regulators’ delayed timeline, particularly in relation to qualified residential mortgages (QRMs) or high quality loans with the ability to be fully securitized. Previously, lawmakers and interest groups have urged regulators to reconsider their March QRM proposal. In regards to the CFTC’s timeline for upcoming rulemakings, Chairman Gensler said the agency will soon consider a swaps data rule, external business conduct rules for swaps markets and a real-time reporting of swaps rule.

Joint Committee Hearing Discusses Report on Taxation of Financial Products:

For only the third time since 1940, but the second time this year, the Senate Finance and House Ways and Means Committees met on Tuesday, December 6th to discuss a report released by the Joint Committee on Taxation. The 104-page document titled “Present Law and Issues Related to the Taxation of Financial Instruments and Products” was heralded by Ways and Means Chairman Dave Camp (R-MI), who suggested that it could “help demystify much of the murkiness” surrounding such practices. The sentiment was shared by Senate Finance Chairman Baucus (D-MT) who criticized the use of the “complex web of new products that mix debt, equity and derivatives,” to undermine the tax code in favor of businesses and individuals who can afford to navigate the array of products available.

Concerns with financial products were addressed by Thomas Barthold, the chief of staff for the Joint Committee on Taxation, who described a scenario in which individuals engaging in similar financial practices would be taxed at dramatically different rates. Such differences are often linked to options such as deferring taxation through various products and the 15% tax rate for capital gains. Still, solutions differ, with some witnesses arguing for market-to-market accounting to assign the fair value to products as a way reducing the incentive to defer taxation through them. However, other witnesses cautioned that changes to the system may cause a worse situation in the end, as new products will invariably be developed to exploit new loopholes. Moreover, any changes may have unintended negative network effects on other aspects of the economy. Notwithstanding the bipartisan desire for reform, those differences highlight the difficulty when it comes to providing the details.

Additional Measures Aimed at Increasing Capital Formation introduced in the Senate:

Last week, two additional bills were introduced aimed at increasing access to capital by reducing regulatory requirements within the SEC. On December 7th, Senator Kay Bailey Hutchison (R-TX) introduced S. 1941 which would amend the 1934 Securities Exchange Act to increase the shareholder reporting threshold from 500 to 2,000 shareholders. The bill mirrors Representative Jim Himes’ H.R.

1965 which passed the House on November 2nd by a vote of 420 to 2. Additionally, Hutchison's bill is identical to Senators Pat Toomey (R-PA) and Tom Carper's (D-DE) legislation (S. 1824) introduced on November 8th. While no markup has been scheduled for either bill, Senator Richard Shelby (R-AL) urged the Senate Banking Committee to "take action" on this and similar measures. Then on December 8th, Senators Jeff Merkley (D-OR) and Michael Bennett (D-CO) introduced the Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure (CROWDFUND) Act of 2011. The bill would legalize and regulate the ability to raise up to \$1,000,000 annually in startup capital for small businesses online. The bill also regulates the use of online crowdfunding through requiring basic disclosures to regulators and investors. With a Senate subcommittee set to hold a hearing on risks associated with capital raising, we expect these issues to remain at the forefront for another week.

MF Global Head Corzine Does the Congressional Circuit:

After taking his lumps before the House Agriculture Committee on Thursday, former Senator isn't done yet, as both the House Financial Services Subcommittee on Oversight and Investigations, and the Senate Agriculture Committee have subpoenaed him to testify before their committees. Corzine is expected to appear in the Senate on Tuesday, December 13th and in the House on Thursday, December 15th.

House of Representatives

Stock Act Markup Delayed:

On December 7th, the House Financial Services Committee announced that the markup of the Stop Trading on Congressional Knowledge (STOCK) Act, which was originally scheduled for December 14th, had been postponed. Although the Committee stated that the delay is due to the need for additional time for Members to study the legislation and the overlapping jurisdiction of five Committees, Politico reported that the delay resulting in frustrations expressed by Majority Leader Cantor that Chairman Bachus had moved the bill to markup without approval from House Leadership. Financial Services panel members have also been critical of bringing the bill to a markup with one Republican lawmaker reported as saying they will not bring up a flawed bill to provide political cover for Bachus.

Supporters of the legislation remain hopeful that public pressure brought on by the '60 Minutes' story on the STOCK Act will compel Republican leadership to act on the bill which would not only ban insider trading but increase transparency within "political intelligence firms." While lawmakers are largely focused on the legislation's ban on insider trading, Representative Louise Slaughter (D-NY) feels that increasing oversight of "political intelligence" firms that would use "Congressional information to influence their clients' stock portfolios" is the "most important part" of the bill. Additionally, despite broad support for the measure, it faces challenges. An attorney with the Congressional Research Service warned the legislation would likely "run into evidentiary issues" and Representative Francisco Canseco warned that the bill would lead to "political witch hunts." In response to these concerns, Ranking Member Barney Frank (D-MA) said he will work to "sharpen the legislation."

House Subcommittee Addresses Dodd-Frank and Homeownership with Three Bills: The House Financial Services Insurance, Housing, and Community Opportunity Subcommittee passed three bills on November 8th that would limit the powers of two agencies created by the Dodd-Frank Act, clarify home warranty law, and assist homeless veterans. The first bill, H.R. 3559 the Insurance Data Protection Act was sponsored by Representative Steve Stivers (R-OH). It would eliminate the subpoena power of two newly created agencies, the Federal Insurance Office (FIO) and the Office of Financial Research

(OFR), to solicit data directly from insurance companies. Touted as an effort to cut duplicative costs, the bill would require the agencies to secure the data from state regulators instead. In addition, it mandates that all non-public data collected by the agencies would need to remain private.

Subcommittee Chairwoman Judy Biggert (R-IL) sponsored the second bill, H.R. 3559 the RESPA Home Warranty Clarification Act of 2011. It clarifies existing law by specifically excluding home warranties from the Real Estate Settlement Procedures Act (RESPA). A second provision would require vendors to disclose the compensation they receive related to homeowner warranty inspections. The final bill, H.R. 3298 the Homes for Heroes Act of 2011 was sponsored by Representative Al Green (D-TX). The bill creates a Special Assistant for Veterans Affairs within the Department of Housing and Urban Development (HUD) to work with related agencies and non-governmental organizations to find homes for homeless veterans.

Executive Branch

CFPB

Bureau Unveils Simple Prototype Credit Card Agreement:

On December 7th, the CFPB unveiled a simplified credit card agreement as part of its “Know Before You Owe” initiative. The prototype form was released following a recent J.D. Power survey, which found that two-thirds of credit card users did not fully understand the terms of their agreements. Such misunderstanding persists despite passage of the Credit Card Accountability, Responsibility, and Disclosure (CARD) Act of 2009, which was designed to reduce the likelihood of unexpected rate and other fee increases. As previously noted by this update, the CFPB has received more than 5,000 complaints about credit cards, with individuals most often citing their confusion about the terms of the agreement.

To address this confusion, the new form would replace lengthy and fine-print heavy contracts with a simple, two-page document. The new document refrains from using industry jargon and is supplemented by a standardized list of key definitions. Although its use is voluntary, the CFPB is set to engage in a pilot program with Pentagon Federal Credit Union – one of the largest credit unions in the United States. In the meantime, the Bureau will continue to solicit feedback about the form from both banks and the public. Soon after its release, a spokesperson for the American Bankers Association applauded the effort as a good first step towards the Association’s long-held goal of devising simpler agreements.

CFTC

CFTC Adopts Rule on Client Fund Investments:

On December 5th, the CFIC unanimously approved a rule to prevent futures intermediaries from using customer funds in risky transactions. The rule will also prevent futures commission merchants from using funds in segregated accounts for in-house repurchase agreements. The rule was originally proposed in October 2010; however, gained importance in light of MF Global’s collapse and use of customer funds which still remain unaccounted for on the order of \$1.2 billion. The final rule is similar to the 2010 proposal with the exception of continuing to allow customer funds to be invested in government sponsored enterprises that are not guaranteed. The final rule also bans investments in sovereign debt and tightens requirements for money market funds.

At the December 5th meeting, the CFIC also proposed a rule to create a process whereby designated contract markets and swap execution facilities may make swaps available for trading and adopted a final

rule to end the practice of allowing US access to foreign boards of trade (FBOT) with a staff no-action letter in favor of registration. The CFTC said a registration system will increase legal certainty, transparency and standardization. In order to judge a potential registration, the CFTC will look for a regulator that “oversees the FBOT in a manner that is comparable to the CFTC's oversight.”

Legal Challenge Levied Against CFTC Position Limits Rule:

On December 2nd, the International Swaps and Derivatives Association (ISDA) and the Securities Industry and Financial Markets Association (SIFMA) announced they filed a legal challenge to the position limits rule recently approved by the CFTC. The rule in question, which only passed the Commission by a 3-2 vote, covers 28 energy, metals and agriculture products; however, the two trade groups feel the rule “may adversely impact commodities markets and market participants, including end-users, by reducing liquidity and increasing price volatility.” While supporters of the rule maintain it follows Congressional intent directing the CFTC to adopt “as necessary” position limit rules, detractors have long questioned the existence of excessive speculation.

In the release announcing the court challenge, the two industry groups called the process behind the rulemaking “procedurally flawed” and faulted the CFTC for not conducting “any meaningful cost-benefit analysis” and for lacking “findings as to the necessity and appropriateness of position limits.” The cost-benefit analysis angle will likely gain traction as the Business Roundtable and US Chamber of Commerce were successful in challenging the SEC's proxy access rule on that basis. Senator Carl Levin (D-MI) called the suit an effort “to chip away” at the Dodd-Frank Act and made clear that position limits are “vital to curb excessive speculation and price manipulation in commodity markets.” Commissioner Bart Chilton also defended the new rules saying the longstanding use of position limits work very well and the new limits “are in that same vein.”

CFTC Committee to Meet to Consider High Frequency Trade Rule:

On December 7th, the CFTC announced that the agency's Technology Advisory Committee will meet on December 13th to discuss swap execution facilities (SEF), high-frequency trading and data standardization. Commissioner Scott O'Malia said these agenda items “represent several interesting technology related subjects the commission will be dealing with [in 2012].” A CFTC release on the meeting said the SEF discussion will focus on the ‘expected’ direction of new swaps platforms and that discussion on high frequency trades will involve “defining, classifying, and observing” market participants and their role. Finally discussions over data standardization will address “universal product and legal entity identifiers, standardization of machine-readable legal contracts, semantics, and data storage and retrieval.”

SEC

SEC to take up its regulations about money market fund by March 31st, 2012:

As previously reported in this update, the SEC continues to push forward with its effort to “pursue further structural reform,” of the \$2.6 trillion money market fund industry. As SEC Chairwoman Mary Schapiro indicated on December 7th that she wants to continue to push for new rules to address “structural features that make money market funds vulnerable to runs.” Among the changes being considered are at least two changes to the way the funds are regulated: 1) requiring funds to possess a capital buffer and 2) allowing the net asset value (NAV) of funds, currently fixed at \$1, to float freely.

It is now appears that the SEC plans to issue proposed regulations altering the funds' regulatory regime no later than March 31, 2012. The politics of this issue remains in flux, with a coalition including

municipal and infrastructure financing authorities, the U.S. Conference of Mayors, and the Government Finance Officers Association having previously written that they favored strengthening the funds' regulatory regime but also that they are concerned about changing the product's structure. There is some semblance of Congressional unity on this, with two letters dated August 12th—one from Democrats urging Schapiro to keep a fixed NAV and another from Republicans reminding the Chairwoman that at a June 24th Subcommittee on Capital Markets and Government Sponsored Enterprises hearing the witnesses largely opposed a freely floating NAV. The Chamber is also critical of the idea of the freely floating NAV, saying the SEC may essentially eliminate the product in order to save it.

Schapiro Sheds Light on Crafting Broker Fiduciary Rule:

Last week, in an interview with Bloomberg, Chairman Mary Schapiro also shed light on the rulemaking process for broker fiduciary rules. Schapiro said the rule acknowledges the difference between investment advisors—who already must adhere to a fiduciary standard—and broker-dealers. Schapiro also said that the Dodd-Frank “statute makes it clear that principle-trading and proprietary products are OK, that charging brokerage commissions is OK” and that brokers will likely still be able to charge commissions and promote in-house products. While there is no statutory deadline for the SEC broker fiduciary rule, Schapiro indicated the rule will not be completed until sometime in 2012.

Speaking on other upcoming rulemakings, Schapiro indicated that rules to change executive pay packages for public companies including clawback provisions, company ratio disclosures and executive pay versus performance are expected to be brought up in mid-January. Additionally, Schapiro said the SEC remains hard at work as the Holiday season approaches and hopes to have a final “consolidated audit trail” rule approved in the coming weeks. In regards to upcoming rulemakings, the SEC is “redoubling” its cost-benefit studies, according to Schapiro.

FDIC

FDIC Releases Proposal to Do Away with Ratings as Indicator of Capital Needs:

On December 7th, the FDIC proposed a new rule overhauling how large banks may calculate the capital buffer needed to cover trading losses. The proposal replaces the use of ratings agency data with new methods for evaluating capital requirements. For securitized products, the FDIC proposal suggests banks assess capital needs in terms of how much capital is needed for the assets underpinning the security. For evaluating sovereign and bank debt, the FDIC proposes using the Organization for Economic Cooperation and Development classification system. Additionally, for non-financial corporate debt traded publically, the proposal calls for estimations based on leverage ratios, cash flow and stock volatility.

While the rule is only intended to affect banks with large trading business such as JPMorgan Chase and Bank of America, some analysts are predicting that smaller banking institutions could be indirectly affected as well. A representative from the American Bankers Association said “this proposal has implications far beyond its official scope.”

Miscellaneous

Robin Hood Tax Slowly Continues to pick up Support:

With the occupy movements continuing their efforts to direct populist anger at large financial institutions, and the global focus on the need to shore up government revenues, a tax on the trading of stocks, bonds and other financial instruments continues to slowly increase its popularity. The notion

has primarily gained traction abroad—with supporters such as German Chancellor Angela Merkel, French president Nicolas Sarkozy, George Soros and new Italian Prime Minister Mario Monti. “We all agree that a financial transaction tax would be the right signal to show that we have understood that financial markets have to contribute their share to the recovery of economies,” said Merkel.

Despite this traction in Europe, the Obama Administration has remained cool to the idea. An Administration official said that while the President is “sympathetic to the goals that a financial transactions tax is trying to achieve,” the Administration favors taxing large banks’ assets to discourage risky behavior. Although legislation has been introduced in both the House and the Senate ,which would levy \$3 in taxes for every \$10,000 in trades (S. 1787/H.R. 3313), even its sponsors acknowledge the challenges of passing the legislation.

UPCOMING HEARINGS

On Monday, December 12th at 10am, the House Small Business Subcommittee on Economic Growth, Tax and Capital Access will hold a field hearing titled “Is Uncertainty Contributing to the Jobs Crisis: The Views of Local Illinois Small Businesses.”

On Tuesday, December 13th at 10am, in 201 Capitol Visitor Center, the House Financial Services Subcommittees on Capital Markets and Government Sponsored Enterprises and Financial Institutions and Consumer Credit will hold a joint hearing on the proposed Volcker rule regarding the restriction of certain types of speculative investments.

On Tuesday, December 13th at 10am, in 538 Dirksen, the Senate Banking Committee will vote on three nominations: Mr. Maurice Jones, to be Deputy Secretary of the Department of Housing and Urban Development; Ms. Carol Galante, to be an Assistant Secretary of the Department of Housing and Urban Development; and Mr. Thomas Hoenig, to be Vice Chairman of the Board of Directors of the FDIC.

On Tuesday, December 13th at 10am, in 538 Dirksen, the Senate Banking Committee will hold oversight hearings on the Federal Housing Finance Agency which is responsible for overseeing the operation of Fannie Mae and Freddie Mac.

On Tuesday, December 13th at 2:30pm, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Subcommittee on Housing, Transportation, and Community Development will hold a hearing titled “Helping Homeowners Harmed by Foreclosures: Ensuring Accountability and Transparency in Appeals.”

On Wednesday, December 14th at 9:30am, in 538 Dirksen, the Senate Banking Subcommittee on Securities, Insurance, and Investment will meet for a hearing entitled “Examining Investor Risks in Capital Raising.”

On Wednesday, December 14th at 10am, in 201 Capitol Visitor Center, House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will markup pending legislation: the Private Mortgage Market Investment Act.

On Wednesday, December 14th at 10am, in 1100 Longworth, the House Ways and Means Subcommittee on Trade will hold a hearing on the prospect and potential economic impact of a Trans-Pacific Partnership.

On Thursday, December 15th at 10am, in 201 Capitol Visitor Center, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing to examine oversight, regulation and current issues facing the accounting and auditing profession.

On Thursday, December 15th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Insurance, Housing and Community Opportunity will hold a hearing on the Homeless Children and Youth Act of 2011.

On Thursday, December 15th at 2pm, in 201 Capitol Visitor Center, the House Financial Services Subcommittee on Oversight and Investigations will hold a hearing on the recent bankruptcy filing by the financial derivatives broker MF Global Holdings Ltd.