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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

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Leading the Past Week

Whatever happened in the world of financial services last week became immediately irrelevant in the wake of the tragic events of Newtown Connecticut. Our thoughts and prayers continue to be with the families of the victims.

Fiscal Cliff

After a week that appeared to show little progress towards inching closer to a deal, the media was salivating over reports on Saturday evening that Speaker Boehner was offering to let rates go up on those making $1 million dollars or more in exchange for major cuts in entitlement spending. With the President publicly focusing on his role has mourner-in-chief, it is unclear how the Speaker's offer was received, however, if one were to infer the comments from a senior Administration official on late Friday, who was quoted as saying: "We are in the same place—Boehner has not given on revenue and has not identified any cuts that he wants in exchange for rates...." then perhaps the Speakers offer will be well received.

Based on a variety of factors, it very well may be that the publicly perceived distance between the White House and the Speaker on revenues and cuts might be actually be much narrower behind closed doors. However, it would seem the other major sticking point, the debt ceiling, could be a much harder needle to thread. The President has made it clear that he would like to eliminate the anachronistic *kabuki dance* of having Congress raise the debt ceiling, and the Republicans have made it equally clear that they believe whatever disadvantages they have in this debate about taxes is equally in their favor on raising the debt ceiling. With that posture in mind, both sides are digging in, and therefore it shouldn't be a surprise that if the President and Speaker ultimately go over the cliff, it will, more likely than not, be about the debt ceiling and not revenue.

With negotiations publicly stalled this past week, Democrats and Republicans on the Hill are preparing fallback legislation. The Democratic plan, which has already been approved by the Senate, extends for one year all Bush tax cuts except for those earning more than $250,000. A growing number of Republicans appear prepared to vote for this plan as a last resort to being tagged with the blame for raising taxes on January 1st. Republicans are also exploring ways in which to delay the cliff, by voting to push the $550 billion in tax increases and the $109 billion in spending cuts to the next year and are also preparing legislation that would extend the "doc fix," which has become embroiled in the fiscal cliff debate.

As negotiations continue and Congress explores last minute 'plan Bs,' Federal Reserve Chairman Ben Bernanke continued his cautionary tale that the fiscal cliff is already taking a toll on the economy and the White House and Congress must act. In a press conference following last week's FOMC meeting Bernanke told reporters: "Why are markets volatile? Why is business investment among its weakest levels during the recovery?...All of these things, at least to some extent, can be traced to the anticipation and concern over the fiscal cliff." Bernanke's warning was echoed by Fitch Ratings earlier in the week, who released a brief statement cautioning that should the U.S. go over the fiscal cliff, "the recent home price improvement trend could be reversed."

Legislative Branch

Senate

Measure to Extend Unlimited Deposit Insurance Fails in Senate

On December 13th, S. 3637, a bill which would have extended the Transaction Account Guarantee (TAG) program for two years, fell on a procedural measure, when a Senate raised a budget point of order and supporters of TAG couldn't get 60 Senators to vote to waive it. TAG, which was created during the financial crisis to provide full FDIC insurance of noninterest bearing transaction accounts, is now expected to expire at the end of the year meaning that $1.5 trillion in deposits will become uninsured on January 1st.

Despite assurances from the FDIC that community banks have sufficient liquidity to manage TAG's expiration, reactions to the failure were seen almost immediately, for example Delaware Treasurer Chip Flowers issued a statement directing banks holding the state's deposits to quickly set aside "sufficient collateral to ensure the safety and security."

Toomey Introduces Legislation to Increase FHA Powers

On December 13th, Senator Pat Toomey (R-PA) announced they were prepared to offer an amendment to give the Federal Housing Administration (FHA) more power to raise revenue, with the goal of avoiding a bailout in 2013. Toomey's amendment is identical to the FHA Emergency Fiscal Solvency Act of 2012 (H.R. 4264) which passed the House of Representatives overwhelmingly 402-7. The measure would give the FHA the power to raise premiums above current law and increase the FHA's enforcement powers against banks writing fraudulent mortgages. Toomey, had intended to attach the measure as an amendment to the failed TAG extension but Senate leadership prevented amendments to the bill. However, there seems to a growing support for this proposal as Senate Banking Committee Chairman Tim Johnson (D-

SD) sent a letter to the House Financial Services Committee Chairman Spencer Baucus (R-AL) expressing support for the House passed legislation and broadening the FHA's powers to raise premiums.

Senate Passes ATM Fix, CFPB Privacy Legislation
On December 11th, the Senate unanimously approved legislation addressing uncertainty over the protection of information shared with the CFPB (H.R. 4014) and to simplify fee disclosure requirements for ATMs (H.R. 4367). Senate Banking Committee Chairman Tim Johnson (D-SD) authored identical legislation, S. 3394, earlier this year to make these changes. The first piece of legislation amends the Federal Deposit Insurance Act to ensure that information shared with the CFPB remains privileged and cannot be disclosed to an outside party, such as those involved in a lawsuit. The second measure strikes the Electronic Funds Transfer Act (EFTA) provision requiring two separate notices about ATM fees, removing the physical placard requirement.

House of Representatives
House Passes Revised Legislation Amending Gramm-Leach-Bliley Act Privacy Notices
On December 12th, the House passed by voice vote the Eliminate Privacy Notice Confusion Act, which would eliminate annual privacy policy notifications requirements for financial institutions if there had not been any changes to the policy during the year. A vote on the bill was postponed the preceding week due to complaints that closed-door changes had been made to the legislation. In response to these concerns, House leaders removed two provisions; one which dealt with how financial institutions share customer information with affiliates and the other that would have allowed state-licensed institutions to step sending annual updates so long as they met other confidentiality regulations.

House Democrats Express Support for Principal Reduction
On December 11th, 19 Democrats on the House Oversight and Government Reform Committee sent a letter to the leadership of the Senate, House and the President calling for principal forgiveness to be included in any deal on the fiscal cliff. While the FHFA has said it does not support the proposal, the letter makes the argument that principal reduction would provide support to troubled homeowners, help heal the housing market and be a benefit to taxpayers. The letter went on to say that "at a minimum" the relief included in the fiscal cliff deal should be less costly than foreclosure.

Financial Services Committee Examines Impact of Volker Rule
On December 13th the House Financial Services Committee met to consider the Volcker Rule and its impact on markets, businesses, investors and job creation. Witnesses included representatives from the Chamber of Commerce, Better Markets, the Investment Company Institute, and the Association of Institutional Investors. Testifying on behalf of the Association of Institutional Investors, Jeff Plunkett said the proposed rule would have broad consequences for investors—despite Congressional intent that the Volcker Rule only apply to proprietary trading activities of large banks. Plunkett, said that asset managers rely on banks to execute trades and that "well more than half of institutional investment adviser transactions consist of

trades with banks, including foreign banks." Industry fears that the rule could disincentivize bank dealers from facilitating transactions due to compliance costs and uncertainty.

As an alternative to the Volcker Rule, the U.S. Chamber of Commerce testified that higher capital requirements—as opposed to a ban on proprietary trading—would serve to stabilize the financial system. Thomas Quaadman, testifying for the Chamber told lawmakers that the Volcker rule would "make U.S. capital markets less robust" and the "lack of clarity in proposed regulatory provisions and the vagueness of the term 'proprietary trading' itself will cause financial institutions to scale back and even cease to offer some critical services they provide, reducing capital formation for non-financial businesses." While there are rumors about "technical fixes" to the Dodd Frank Act in the coming year, and modifications to Volcker would be at the top wish list of many banks, it is unclear if any changes to Section 619 would clear the Senate.

House Agriculture Holds Subcommittee Hearing on Dodd-Frank Derivatives Reform
On December 13th, the House Agriculture Subcommittee on General Farm Commodities and Risk Management met to consider testimony from CFTC Commissioners Bart Chilton and Jill Sommers on Dodd-Frank derivatives implementation and international implications. Sommers, chair of the CFTC's Global Markets Advisory Committee, told lawmakers that the agency must be careful in not acting "outside the jurisdictional limits set by Congress" and that Dodd-Frank provisions on derivatives do not apply to activities outside the U.S. "unless those activities have a direct and significant connection with activities in or effect on commerce in the United States." However, Chilton told the Subcommittee that, at the current stage of implementation, the CFTC should consider coordinating with the EU and work to coordinate and finalize implementation at the same time—limiting the potential for regulatory arbitrage.

Also testifying before the Subcommittee were Masamichi Kono, Vice Commissioner for International Affairs for the Financial Services Agency of Japan and Patrick Pearson, Internal Market and Services Directorate General for the European Commission. The foreign regulators told lawmakers that the CFTC should adopt a regulatory scheme that would allow foreign regulators to "exercise appropriate regulation and oversight" over foreign entities and provide "appropriate deference to foreign regulators." Republicans have long been critical of the CFTC's efforts to implement derivatives provisions; however, at the hearing Representative David Scott (D-GA) also expressed concerns, saying "poor coordination both with other domestic regulators and foreign regulators are real and are very damaging to U.S. companies."

House Republicans Allege White House Unduly Influencing CFPB
On December 14th, House Republicans released a staff report alleging that the White House has compromised the Bureau's regulatory independence and has attempted to "influence CFPB policies." The report, which argues that the CFPB threatens credit access in the U.S., goes on to consider the legality of the appointment of Richard Cordray to the head of the Bureau. The report was spearheaded by Financial Services Subcommittee Chairman Patrick McHenry (R-NC) and Chairman of the full Committee Darrell Issa (R-CA) who said, "for the foreseeable future, continued Congressional oversight of this new agency will be necessary to ensure that the CFPB

does not reduce credit access and that the CFPB's broad unchecked powers are not exploited for the Administration's partisan agenda." A CFPB spokesperson responded to allegations in the report the same day, saying: "As an independent regulator, it is important to meet with other government officials—including members of Congress and their staff, the administration, our fellow banking regulators and state and local government leaders. This dialogue allows us to further our mission of protecting consumers."

Sewell added to Financial Services Committee Member

On December 12th, Minority Leader Nancy Pelosi (D-CA) announced that the Democratic Steering and Policy Committee recommended Representative Terri Sewell (D-AL) join the House Financial Services Committee. Sewell will join the new Republican members Representatives-elect Andy Barr (R-KY), Tom Cotton (R-AR), Robert Pittenger (R-NC), Ann Wagner (R-MO) and Representatives Randy Hultgren (R-IL), Mick Mulvaney (R-SC), Dennis Ross (R-FL), and Martin Stutzman (R-IN). Further additions are still anticipated.

<u>Executive Branch</u>

Federal Reserve

December FOMC Meeting, Bernanke Expresses Optimism on Completing Volcker

On December 12th, the Federal Open Market Committee announced the economic projects from its December 11th and 12th meeting. The Fed will continue its expansionary tactics of bond buying and intends to keep interest rates low to encourage borrowing, forecasting that the main interest rate will remain unchanged until 2015, when they expect the jobless rate to fall to between 6 percent and 6.6 percent. The Fed will supplement their current $40 billion per month purchases of mortgage bonds with an additional $45 billion in monthly Treasury purchases once their Operation Twist program expires at the end of the month.

In a press conference following the FOMC announcement, Ben Bernanke addressed a number of issues including the fiscal cliff and the pending implementation of the Volcker Rule. On the Volcker Rule, Bernanke said regulators have made "quite a bit of progress" in finalizing the regulation and expects it to be completed by early 2013. While there are questions as to whether all the agencies required to write the rule, the Fed, OCC, FDIC, SEC and CFTC, must complete the rule at the same time, Bernanke said "there is quite a bit of agreement" between the agencies.

Fed Approves Proposed Guidelines for Regulation of Foreign Banks

On December 14th, the Fed issued for public comment a proposed rule to regulate foreign banks with operations inside the U.S. The rules largely mirror Dodd-Frank proposals for the regulation of large domestic banks and hew closely to the outline offered by Governor Tarullo in a speech in late November. The rules will be open to public comment for 90 days.

Treasury

FSOC Discusses SIFI Designations at Meeting

At a December 13th meeting, the Financial Stability Oversight Council (FSOC) discussed potentially designating money market mutual funds as systemically important. The FSOC is expected to begin designating firms as systemically important in the coming year. In addition to discussing systemically important designations, the FSOC reportedly also considered in its closed meeting Dodd-Frank cross-border derivatives transaction rules and issues around access to mortgages.

BlackRock Attempts to Addresses Concerns with FSOC's Money Market Fund Proposal
In a December 13th comment letter to the FSOC, the asset management company BlackRock shared concerns with the Council's proposed recommendations for overhauling the regulation of the money market mutual fund industry and offered an alternative proposal on how to reform the market. Rather than moving funds from a fixed to floating net asset value (NAV) or instituting new capital buffers, as the FSOC had proposed, BlackRock suggested keeping the fixed NAV and imposing a one percent "standby liquidity fee" to halt runs.

CFPB

Bureau Announces Policy Allowing Companies to test New Disclosure Programs
On December 13th, the CFPB announced a proposed policy to allow companies to test new consumer disclosures on a case-by-case basis. The effort is part of Project Catalyst, an effort to collaborate with technology entrepreneurs to foster consumer-friendly innovation in the financial marketplace. As part of the proposed policy, the Bureau would approve limited exemptions from federal disclosure laws for companies to test new kinds and methods of disclosure. The CFPB will look to three criteria in deciding whether to grant a waiver: consumer understanding, cost effectiveness and minimization of consumer risk.

FDIC

FDIC, Bank of England Plan to Work Together on Orderly Liquidation of Large Firms
On December 10th, at a meeting of the FDIC's Systemic Risk Advisory Committee, officials at the FDIC and the Federal Reserve said the two agencies are engaged in discussions on ways to guarantee a smooth implementation of Dodd-Frank provisions to resolve large nonbank financial firms. The FDIC sees large amounts of holding company debt as key to the agency's strategy but there remain concerns about how these holding companies will react to the higher costs of issuing debt and other restrictions on capital distributions. Addressing these concerns, Chairman Martin Gruenberg suggested that the Fed work to ensure these firms have the appropriate level of debt. Also speaking at the meeting was Paul Tucker, Deputy Governor of the Bank of England. Tucker felt that the FDIC's approach could revolutionize market discipline practices and said the U.K. is prepared to "in principle" let the FDIC handle the resolution of large U.S. entities with major operations in the U.K.

Formalizing Tucker's statements, the FDIC and Bank of England released a paper in advance of the meeting outlining that the two countries will follow similar approaches to orderly resolution by concentrating on the holding company. While there seems to be much cohesion already between the two countries, Tucker expressed concerns about how cross-border resolution would work—especially as it involves conflicting bankruptcy laws. Additionally, the FDIC may face political challenges in its efforts to implement the wind down provisions of the Dodd-Frank Act as House Republicans have passed legislation taking away liquidation powers from the FDIC—under the premise that failing firms should be resolved through the bankruptcy system.

FDIC Approves FY2013 Budget
On December 11th, the FDIC approved its Fiscal Year 2013 operating budget. The agency's budget will be $2.7 billion, a decrease of 18 percent for the coming year. The agency plans to decrease funding for managing banks in receivership by 40 percent and reduce staff by 687 positions. In announcing the budget, Chairman Martin Gruenberg said, "the budget approved today is consistent with the slow but steady recovery in the U.S. banking industry over the past three years."

CFTC
CFTC Wins Court Battle on Rule to Require Mutual Fund Registration.
On December 12th, the U.S. District Court for the District of Columbia rejected a challenge to the CFTC's rule requiring mutual funds with commodities investments to register with the agency. The Chamber of Commerce and the Investment Company Institute filed the lawsuit in April, arguing that the CFTC did not properly weight costs and benefits when drafting the rule. The case is one of a number brought by the industry as part of a broader pushback against CFTC implementation of the Dodd-Frank Act.

HUD
FHFA to Review Pay Increases at Fannie and Freddie
On December 10th, the Federal Housing Finance Agency (FHFA) Inspector General released a report on reforms of top executive pay at Fannie Mae and Freddie Mac and plans for oversight of compensation. In a letter sent to the Inspector General, the FHFA said it plans to review promotions and increases in compensation starting in 2013. Pay has been frozen at the GSEs for three years and new CEOs hired for both companies will make 89 percent less than their predecessors. As part of the effort to review pay, Fannie and Freddie will report monthly to the FHFA to help "monitor promotions, increases and new hires on a continuous basis."

OCC
OCC Approves Sale of MetLife Bank Deposit Business to GE
On December 12th, MetLife announced that the Office of the Comptroller of the Currency (OCC) issued a conditional approval of GE Capital's acquisition of approximately $6.5 billion in bank deposits from MetLife Bank. In its press release, MetLife said it will work with the FDIC and the Fed to take the necessary administrative steps to deregister as a bank holding company. The company has been attempting to leave the banking business since the Fed rejected its plan to boost dividends for investors.

UPCOMING HEARINGS

On Tuesday, December 18th at 9:30am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Subcommittee on Securities, Insurance, and Investment will hold a hearing titled "Computerized Trading Venues: What Should the Rules of the Road Be?"

On Wednesday, December 19th at 10am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Subcommittee on Financial Institutions and Consumer Protection will hold a hearing titled "Making Sense of Consumer Credit Reports."