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## FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

December 19, 2011

### Leading the Past Week

In what now accounts for standard operating procedure, the past week saw a flurry of last minute activity, as the threat of having to stay in Washington, DC for the week before Christmas appeared to provide the leverage necessary for Congress to finish up much of its end of the year business. While a trillion dollar year-end spending bill, described by one conservative freshman House Republican as a “crap sandwich” provides operating funds for the government through the end of the fiscal year, as of late on Sunday, it wasn’t clear whether Congress would also pass an extension of the payroll tax deduction, and other critical expiring policies. Although the Senate cleared a bill on a rare Saturday session before adjourning for the year, it appears that House Republicans are in a state of revolt and are now demanding the Senate return to conference the payroll tax bill. These end of the week theatrics overshadowed what was a relatively banal week, with continued hearings into the debacle that has become the MF Global bankruptcy taking center stage. In other news, despite rumors that the President would push the CFPB Director nomination via a recess appointment, the week closed with the reality that the nomination got sent back to the White House. Around the agencies, the FDIC proposed a rule address treatment of mutual insurance holding companies during the liquidation and rehabilitation process and the CFPB asked for comment on two new mortgage closing prototype forms.

### Legislative Branch

#### *Congress Approves Year-End Megabus’ Spending Package:*

Following an uncertain week during which the federal government began to prepare against a possible government shutdown, Congress finally reached a year-end spending deal. The deal funds discretionary appropriations approximately 1 percent less than FY 2011 levels, at \$19.9 billion down from \$21.7 billion. This is 16 percent less than that sought by President Obama in his February 2011 Budget proposal.

However, while Democrats were able to fend off some of the efforts to use the appropriations process to cut funding for Dodd-Frank implementation, not all agencies were spared. Notably, the SEC will

receives a slightly, \$136 million increase, however, the \$50 million reserve fund required by the Dodd-Frank Act was slashed in half. However, the CFTC and the Administration were able to win increased budget flexibility for the agency. While the funding levels for the Commission will not be increased from last month's minibus spending agreement, the new 'megabus' allows the CFTC to transfer \$10 million between the information technology account and its salaries and expenses account. This should allow the CFTC to increase staffing capabilities to oversee new rulemakings required by the Dodd-Frank Act. Additionally, Democratic supporters were able to preserve the current funding structure of the CFPB from Republican efforts to bring the Bureau into the "normal" appropriation process.

Despite several 'wins' for supporters of the Dodd-Frank Act, Republicans were able to insert provisions aimed at increasing transparency of financial reform efforts. One such provision requires the OMB to report to Congress on the costs of implementing the Dodd-Frank Act.

## Senate

*Corzine Grilled; MF Global Debacle Turns into 'He Said, He Said:'*

On December 13<sup>th</sup>, Former Chairman and CEO of MF Global, Jon Corzine, appeared before the Senate Agriculture Committee to discuss the recent bankruptcy of his firm and the possible misuse of customer funds resulting in a shortfall of approximately \$1.2 billion. The hearing expanded on a House panel's investigation the previous week, with lawmakers digging down on comments Corzine made suggesting transfers from client accounts could have resulted from a misinterpretation of intent by employees. Corzine stressed to lawmakers that he "never gave instructions anybody could misconstrue" and until the night before the bankruptcy, he believed "the people and systems at MF Global were protecting customer funds."

Henri Steenkamp, CFO of MF Global, and Bradley Abelow, President and COO, testified along with Corzine and told the panel they still do not know the location of the missing funds. Despite assurances from the MF Global representatives that there were no misdeeds at the firm, Chairman of the CME Group, Inc. Terrence Duffy told the Committee that a senior MF Global official told his organization and the CFTC that Corzine knew of a loan made with segregated customer funds.

In a House Financial Services Committee hearing the following day, Corzine responded to Duffy's assertions, suggesting that Duffy referred to transfers to JP Morgan Chase in London which he had been told were approved and appropriately transferred. Corzine told lawmakers: "Although the last few days of MF Global were chaotic, I did not instruct anyone to lend customer funds to MF Global or any of its affiliates, nor was I told that anyone had done so." Despite repeated assurances, some Members were skeptical of Corzine's testimony. Representatives also critiqued witnesses from the CFTC and SEC for lack of communication between the two agencies as MF Global proceeded to bankruptcy. Said CFTC General Counsel Dan Berkovitz: "if there is not something to that would raise a red flag, there wouldn't necessarily be communications" and MF Global had "clean" reports.

*Senate Banking Panel Approves Nominations to HUD and FDIC in Face of GOP Opposition to FHA Nominee:*

On December 13<sup>th</sup>, the Senate Banking Committee approved three of President Obama's nominees to top banking regulatory positions. The nomination of Carol Galante to be Assistant Secretary of HUD was approved by a vote of 13 to 9. However, Republican committee members opposed Galante's nomination citing concerns of sufficient leadership skills to head the agency. Senator Bob Corker (R-TN) was the only Republican to vote in favor of Galante's nomination, despite threatening a hold of her nomination pending structural reforms to Fannie Mae and Freddie Mac. Galante has served as

acting FHA Commissioner since July, a period during which Senator Jim DeMint charged she has shown “a lack of vision to change the course of the FHA and in fact appeared to be of the opinion that more of the same is a way to move the agency forward.”

While Galante’s nomination will be an uphill battle, the nomination of Thomas Hoenig to be Vice Chairman of the FDIC and the nomination of Maurice Jones to be Deputy Secretary of HUD were both easily approved by voice vote. If approved by the full Senate, Hoenig would take the position of Martin Gruenberg, current acting Chairman of the FDIC. Hoenig was lauded by Republicans on the panel, for his time serving on the Federal Reserve Board where he frequently opposed decisions of the Fed to increase stimulus measures.

*Senate Banking Committee Examines FHA Oversight of GSEs:*

On December 13th, at a Senate Banking Committee hearing, FHFA Inspector General Steve Linick told lawmakers that insufficient financial examiners within the agency undercuts their ability to conduct oversight over Fannie Mae and Freddie Mac. Specifically, the IG’s office found that they have been unable to review key aspects of the GSEs’ operations such as management of foreclosed properties. Linick outlined several factors which contribute to the shortfall in examiners, including a lack of qualified candidates and uncertainty over the fate of the GSEs. Insufficient examinations were also found to extend to the 12 Federal Home Loan Banks, some of which have experienced capital shortfalls and have invested in shady mortgage-backed-securities. One solution offered by Linick was to order Fannie, Freddie and the Federal Home Loan Banks to improve internal risk management to compensate for inadequate oversight.

Ranking Member of the Committee Richard Shelby (R-AL) implied that fault for the shortfall in examinations lay with Congressional Democrats and the Administration for not including housing finance in the Dodd-Frank Act; said Shelby: “serious problem exists in large measure because the perceived short-term nature of the conservatorship makes it difficult for FHFA to hire enough qualified examiners.” Nevertheless, Democrats have been cautious to make sweeping changes to the housing finance sectors as the FHA and GSEs are the currently the backstop of the secondary mortgage market. Chairman Johnson (D-SD) commented, that larger housing finance reform must go “hand in hand” with the need to improve the floundering housing market.

*Committee Approves Insider Trading Bill Without ‘Political Intelligence’ Provisions:*

On December 13<sup>th</sup> Senator Lieberman (I-CT), in an effort to garner additional support for the Stop Trading on Congressional Knowledge (STOCK) Act to ban insider trading by Congressmen and staff, dropped the controversial reporting requirement that would have required ‘political-intelligence’ consultants to register and file public disclosures as do lobbyists. The new bill language directs the Senate Select Committee on Ethics to propose rules to bar senators and aides from using information not available to the public to make personal investments and directs the GAO to study the impacts of ‘political-intelligence’ firms on investors and markets. The Senate Homeland Security and Government Affairs Committee approved the altered bill in a 7 to 2 vote the following day

**House of Representatives**

*Financial Services Subcommittee Approves Bills to Alter Dodd-Frank Act Whistleblower and Risk Retention:*

On December 14<sup>th</sup>, the Capital Markets and Government Sponsored Enterprises Subcommittee of the House Financial Services Committee approved two measures aimed at increasing private investment in the mortgage market and modifying whistleblower rules. Representative Michael Grimm’s (R-NY)

Whistleblower Improvement Act of 2011 (H.R. 2483) would require whistleblowers to report to their employers before notifying the SEC of misconduct in order to receive a reward, except in the event the employer lacks anonymous reporting or anti-retaliation policies. The Private Mortgage Market Investment Act, introduced by Representative Scott Garrett (R-NJ), seeks to open up private investment in the mortgage market by establishing standard underwriting criteria for mortgages and creating standard guidelines governing the performance of mortgage-backed securities. The bill would also do away with the Dodd-Frank Act's risk retention provisions. H.R. 2483 passed the committee in a vote of 19 to 14 and the Private Mortgage Market Investment Act was approved by a vote of 18 to 15.

*Financial Services Committee Reviews Bill to Increase Small Business Access to Capital:*

On December 15<sup>th</sup>, the Capital Markets and Government Sponsored Enterprises Subcommittee heard testimony on a bipartisan bill, H.R. 3606, which would increase small business access to the capital markets by creating a new category of participant: Emerging Growth Companies (EGCs). The legislation would gradually phase in regulations for ECGs over five years or until the company is deemed large enough to handle the costs of a public offering. Chairman Spencer Bachus (R-AL) said the legislation "will help the private sector lead our economy to a robust recovery" by reducing costs associated with going public for smaller firms.

Executive Branch

**CFPB**

*CFPB Releases New Mortgage Closing Forms – Seeks Comment:*

Last week, the CFPB released two additional prototype forms designed to simplify and combine the Truth in Lending disclosure and the HUD-1 settlement statement received at closing. One prototype is similar to the current HUD-1 form which consumers while the second is similar to the CFPB prototype form received when consumers first apply for mortgages. The new designs are based on over 3,000 comments collected by the CFPB on previous prototypes. The Bureau is currently collecting comments on the two new forms with the goal of "one combined form that is easier to understand and use for consumers and industry."

**SEC**

*Gallagher Outlines Thoughts for Agency As Newest Commissioner:*

On December 14<sup>th</sup>, the newest SEC Commissioner, Daniel Gallagher, said any further rulemakings overhauling the money market mutual fund industry could be "premature and possibly unnecessary." Gallagher said that until the effects of the May 2010 reforms are fully analyzed, the agency will not be able to know the risks of the money market funds and warned against "pre-judging the outcome" of the rulemaking which could "skew" the SEC's analysis. In addition to his remarks on the money market industry, at an event sponsored by the Chamber of Commerce, Gallagher also advocated for management and operations reforms at the agency.

In other comments, Gallagher said it is important to keep the floating net asset value (NAV) on the table, despite industry opposition to moving off of a stable NAV. Finally, Gallagher proposed Congress place additional authority with the SEC to regulate non-bank broker dealer holding companies and commented that the FSOC systemically important financial institution designations will be "burdensome" but could also have "unintended, positive consequences."

*Boston Consulting Group Study Indicates Adviser Oversight Cheaper at SEC as Opposed to an SRO:*

On December 15th, a study by the Boston Consulting Group found that paying a self-regulatory organization (SRO) to oversee the securities industry would cost up to twice as much more than enhancing the SEC examination program. The study found that FINRA examination of the industry would cost between \$540 million and \$610 million and creating a new SRO would cost between \$610 million and \$670 million per year. However, increasing SEC capabilities to examine the industry would cost only \$240 and \$270 million each year. Additionally, in a survey conducted along with the study, a healthy majority of advisers said they SEC oversight is preferable to that of FINRA—even if it were more costly. The study was commissioned by the Certified Financial Planner Board, the Financial Planning Association, the Investment Advisor Association, the National Association of Personal Financial Advisors and TD Ameritrade Institutional.

Despite support for SEC oversight, the SEC found, in a report required by the Dodd-Frank Act, that it lacks the resources to examine the adviser industry. The report listed three solutions to this finding: 1) funding the SEC examinations through user-fees; 2) creating a new SRO for advisers; or 3) expanding FINRA's responsibilities. FINRA has made clear that it would like to become the new SRO for advisers, despite opposition from the industry to the SRO model. Congress is expected to address the issue in the New Year and Representative Spencer Bachus (R-AL) has already released a discussion draft of legislation to create one or more new SROs.

## **FDIC**

*FDIC Proposes Rule on Treatment of Failing Mutual Insurance Holding Companies:*

On December 13<sup>th</sup>, the FDIC proposed a rule which would classify a mutual insurance holding company as an insurance company in the liquidation and rehabilitation process. The rule is designed to square the treatment of insurance holding companies with the treatment of companies under state insolvency systems as directed by the Dodd-Frank Act. In order for a mutual insurance holding company to qualify for treatment like an insurance company, it would also need to fall under insurance laws of the state it is located in and could not be subject normal bankruptcy proceedings. Additionally, the company in question's largest US subsidiary would have to be an insurance company or an insurance stock holding company for the rule to apply. The FDIC will be taking comments on the rule through February 13<sup>th</sup>.

## UPCOMING HEARINGS

*The Senate has adjourned until January 23<sup>rd</sup> and there are no relevant hearings scheduled in the House of Representatives for next week.*