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Financial Services Legislative and Regulatory Update

Leading the Past Week

For the first time in a couple of years, the Christmas plans of Congress and their staff (except for the [Appropriations Committee](#)) are safe, as the Senate wrapped up its business last week, including the passing of the Murray-Ryan budget agreement by a 64 to 36 vote.

Then on the heels of better than expected employment numbers and a revised analysis stating that there was actually 4.1 percent growth in the third quarter, the Federal Reserve finally [announced](#) that it would [taper](#) its [quantitative easing](#) by \$10 billion dollars so that it would now only be pumping \$75 billion per month into the economy. Contrary to rumors that the taper would be detrimental to the economy, following the announcement, the dollar rose to a two week high against the euro, and the Dow jumped more than 290 points.

However, all was not good news for the Fed last week, as Chairman apparent Janet Yellen's confirmation was delayed until after New Years, and more importantly, they, along with the four other agencies issuing the Volcker Rule last week, had to put out another guidance document to try to stem compliance confusion about the rule. What is clear is that the rule is providing [real headaches to banks](#) trying to figure out how to comply with one of the more complex rules to come out of Dodd-Frank.

Finally, while the end of the year is [usually a great time to buy a car](#), this past week the CFPB took another step forward in its [regulation by guidance](#) of the auto finance industry by compelling Ally Financial to a settlement over alleged charges of disparate impact. Interestingly, while agreeing to the consent order, Ally noted that "based on the company's analysis of its business, it [did] not believe that there is measurable discrimination by auto dealers," highlighting a major point of contention in this issue, namely that the CFPB, to date, has refrained from sharing its analysis for any 3rd party review.

Legislative Branch

Senate

Yellen Confirmation Pushed to the New Year

Despite expectations that Janet Yellen would be confirmed as Chairman of the Federal Reserve before the Senate recessed for the holidays, Senate leaders agreed last week to move the final vote on Yellen to January 6th in order to accommodate Senator Rand Paul (R-KY), who had indicated that he would delay the vote on Yellen for as long as possible in order to leverage a vote on his bill to audit the Fed. The timing is not consequential, because Chairman Bernanke's term does not end until January 31st, and even if confirmed, Yellen wouldn't have assumed the Chairmanship until then.

Senate Judiciary Committee Examines Federal Arbitration Act

On December 17th, the Senate Judiciary Committee met to consider the current state of the Federal Arbitration Act (FAA). The hearing touched on a number of topics related to the issue of arbitration, including the Department of Justice's (DOJ) brief in the *Italian Colors vs. American Express* Supreme Court case, the CFPB's recent [study](#), and the cost comparison between arbitration and litigation. The hearing, which was chaired by Senator Franken (D-MN), also touched on his bill, the Arbitration Fairness Act (S. 878) that would invalidate agreements that require the pre-arbitration of employment, consumer, antitrust, or civil rights disputes, and was clear that the Chairman thought that would be a desirable result. Although not mentioned specifically, the outcome of the pending [FINRA v. Charles Schwab](#) case, could also add to the discussions on this issue.

Senate Finance Dives into Social Security, Retirement Crisis

On December 18th, the Senate Finance Subcommittee on Social Security, Pensions, and Family Policy held a hearing titled "The Role of Social Security, Defined Benefits, and Private Retirement Accounts in the Face of the Retirement Crisis." Witnesses included John Sweeny, Executive Vice President at Fidelity Investments, Robert G. Romasco, President of the AARP; Andrew G. Biggs of the American Enterprise Institute; and Dean Baker, co-Director of the Center for Economic and Policy Research. According to [some](#), the hearing was noteworthy for being a fairly serious discussion on how to deal with issues of retirement security rather than a retreat to predictable partisan talking points.

Banking Leadership Release Report on FHA Solvency Act

On December 19th, Senate Banking Committee Chairman Tim Johnson (D-SD) and Ranking Member Mike Crapo (R-ID) filed a [report](#) on the Committee's bill to provide the Federal Housing Administration (FHA) with additional powers to manage its insurance fund. The lawmakers point to a Congressional Budget Office (CBO) [report](#) that estimates the FHA Solvency Act would reduce discretionary spending by over \$500 million over five years.

Cornyn, Toomey Introduce Bill to Repeal FDIC Liquidation Authority

On December 19th, Senators John Cornyn (R-TX) and Pat Toomey (R-PA) [introduced](#) the Taxpayer Protection and Responsible Resolution Act. The bill would repeal Title II of the Dodd-Frank Act, which gives the FDIC authority to liquidate large failing institutions rather than putting them through the bankruptcy process. The legislation would create a new Chapter 14 bankruptcy filing for large financial institutions and outlines a process for a bridge company to be put in place during bankruptcy proceedings. Republicans have held that the liquidation authority granted by Dodd-Frank puts taxpayers at risk because the FDIC has access to a Treasury line of credit to pay for the costs of liquidation.

Senate Confirms Koskinen to Worst Job in Washington

On December 19th, the Senate confirmed John Koskinen to head the Internal Revenue Service (IRS) in a 59 to 36 vote. Koskinen's nomination is being viewed as a means of "fixing" the embattled IRS; Koskinen led Freddie Mac during the financial crisis.

Senate Banking Considers Commerce Nominee

On December 17th, the Senate Banking Committee met to consider the nomination of Arun Kumar to be Assistant Secretary and Director General of the United States and Foreign Commercial Service at the Department of Commerce. In his testimony, Kumar laid out goals for the post, including working to increasing U.S exports to other countries and seeking out additional direct foreign investment in the U.S.

Executive Branch

Federal Reserve

One Week Later, Questions Abound about Volcker Rule Compliance

Less than one week after its historic announcement of a sweeping new regulation, there were many questions about how banks were to comply with the Volcker Rule. Early in the week, both Senate and House Republicans sent letters to regulators about the implications of the proprietary trading ban on small banks. In a [letter](#), Chairman Jeb Hensarling (R-TX) and Representative Shelley Moore Capito (R-WV) cautioned that by treating certain investments as collateralized debt obligations backed by trust preferred securities (TruPS CDOs), small businesses will be faced with additional challenges in meeting capital requirements. In a separate [letter](#), Senate Banking Committee Ranking Member Mike Crapo (R-ID) urged regulators to clarify the portions of the rule so as to remove any uncertainty for small and mid-sized banks.

In response to these, and other concerns, regulators released a [FAQ](#) on December 19th, that clarified how banks can consider restructuring TruPS CDOs or change the rights of the security so as to divest it while remaining compliant with Volcker. Moreover, the FAQs state that these changes do not need to take place immediately, saying: "entities that have holdings in TruPS CDOs are not required to sell these holdings immediately under the final rules, but instead may use the conformance period to determine if they can be brought into conformance by the end of the conformance period, which is July 21, 2015."

Fed Will Use Independent Balance Sheet Projections for Stress Tests

In a [letter](#) to banks in the Federal Reserve System sent on December 16th, the Fed announced that it will use its projections of bank assets and liabilities to analyze capital plans as part of the 2014 stress tests. This represents a change in how the Fed evaluated banks' stress tests; previously, the Fed has relied on balance sheet projections provided by the banks that were then used to create projections of pre-provision net revenue, loan losses, risk-weighted assets, and other factors. These projections were then used to calculate capital ratios under stress test scenarios. According to the letter, these independent projections will "permit a more consistent horizontal analysis, one that features common assumptions regarding total borrowing by households and businesses and firms' market shares."

Fed Delaying Bank Leverage Cap

According to Bloomberg, the Federal Reserve, Office of the Comptroller of the Currency (OCC), and Federal Deposit Insurance Corporation (FDIC) will delay finalizing its leverage rule until the Basel

Committee finalized its leverage rating standard. In July 2013, U.S. regulators released a proposed rule in July that would require the largest banks to meet funding requirements more stringent than those outlined in Basel III. The industry has pushed for a delay so that the U.S. can be consistent with international standards.

Fed Releases Guidance on Risk Shifting

On December 20th the Fed released [guidance](#) advising large financial institutions to carefully evaluate transactions designed to reduce risk. The guidance cautions that reducing risk-weighted assets can be positive but some transactions can also result in residual risk, such as if risks are shifted to a less capitalized counterparty or affiliate.

Treasury

Treasury Writes to Congress Urging Continued Compromise on Debt Ceiling

On December 19th, Treasury Secretary Jack Lew wrote to House Speaker John Boehner (R-OH) urging congress to “take prompt action” to raise the debt ceiling. Lew referenced the bipartisan agreement that resulted in the budget agreement and urged Congress to continue the effort in order to raise the debt limit. In addition, Lew warned that it is unlikely that the Treasury’s extraordinary measure would be able to extend the debt limit much past the February 7th estimate.

Treasury Inks Several Additional FATCA Deals

On December 19th, the Treasury [announced](#) that the U.S. signed six additional bilateral agreements with jurisdictions to implement the information reporting and withholding tax provisions under the Foreign Account Tax Compliance Act (FATCA). The agreements will mandate that financial institutions in Malta, the Netherlands, Bermuda, Jersey, Guernsey, and the Isle of Man report bank account data to their government, which will share the information with the IRS.

Treasury Releases Annual OFR Report

On December 17th, the Office of Financial Research (OFR) released its [annual report](#) that found risks from the potential for instability to spread due to interconnectedness have “generally abated” since the previous year’s report. While the report highlighted the diminished risk of contagion in the financial market, it said there remain risks from runs and asset sales in the repo market, from automated and high-frequency trading, and from uncertainty about the U.S. fiscal outlook.

CFPB

Bureau Continues Efforts to Alter Auto Lending Market

On December 20th, the CFPB and DOJ announced their first cooperative lending [enforcement action](#), a \$98 million Ally Financial settlement over allegations of discrimination against minority borrowers in its indirect auto lending program. Ally will pay \$80 million in damages to harmed African-American, Hispanic, and Asian and Pacific Islander borrowers and \$18 million in penalties. The CFPB and DOJ determined that more than 235,000 minority borrowers paid higher interest rates for their auto loans between April 2011 and December 2013 because of Ally’s discriminatory pricing system. In March, the CFPB issued a bulletin outlining plans to hold indirect auto lenders accountable for unlawful discriminatory pricing.

CFPB Sues First Online Lender

Last week the CFPB initiated its first online payday lending [lawsuit](#) against Western Sky, alleging the online lender violated federal consumer protection laws when it tried to collect money for invalid loans.

CashCall, of which Western Sky is a subsidiary, is said to have engaged in unfair, deceptive, and abusive lending such as debiting funds from checking accounts to pay for loans that were illegal under state law. The Bureau is requesting CashCall refund consumers in addition to paying additional damages.

CFPB Releases Final Regulation Z Rule

On December 17th, the Bureau released a [final rule](#) implementing annual adjustments under the Card Accountability Responsibility and Disclosure Act of 2009 (CARD Act) and the Home Ownership and Equity Protection Act of 1994 (HOEPA). The final rule sets the 2014 annual minimum interest charge disclosure threshold and penalty safe harbor fees under the CARD Act. The rulemaking also sets the 2014 HOEPA threshold for some closed-end home mortgage loans.

Bureau Calls for Disclosure of Campus Financial Agreements

On December 17th the CFPB [called](#) for financial institutions to publicly disclose agreements with colleges and universities to market debit, prepaid, and other products to students. In conjunction with this request, the Bureau released its annual [report](#) on college credit card agreements, which showed a decline of 23 percent in college agreements from 2011 to 2012.

CFPB Releases 2013 Financial Report

The CFPB released its [FY2013 Financial Report](#) analyzing the agency's performance and structure. The report details the four transfers from the Board of Governors of the Federal Reserve that totaled \$518.4 million. The report also highlights the Bureau's enforcement actions which yielded \$384 million to 2.1 million consumers.

Fed OIG Report Advises CFPB to Outline Approach to Integrating Enforcement Attorneys into Exams

On December 16th, the Office of the Inspector General (OIG) for the Fed released a [report](#) advising the Bureau to "determine the appropriate level of enforcement attorney integration into examinations by reassessing the potential risks associated with the practice against the potential benefits and document the results of the assessment." The report points to a February 2012 policy set forth by the CFPB as being insufficient in detailing the implementation approach. The CFPB reconsider its approach to integrating enforcement attorneys in an internal review finalized in November. The results of this internal review were not incorporated in the OIG report.

SEC

SEC Proposes JOBS Act Fundraising Exemption

On December 18th, the SEC voted 5-0 to propose a [rule](#) outlining changes to Regulation A that would increase the amount small companies can raise without registering with the SEC from \$5 million to \$50 million. The increase was mandated by the Jumpstart Our Business Startup (JOBS) Act and preempts state law for offerings above the current \$5 million cap. There is some concern that preempting state securities laws will decrease oversight while also not addressing problems with difficulties faced by issuers seeking to raise smaller amounts of capital. Still, speaking on the vote, Chairman White said the proposal will provide an "effective, workable path to raising capital that, very importantly, also builds in necessary investor protections."

SEC Posts Record Enforcement Fines

Chairman Mary Jo White [announced](#) last week that the agency had collected \$3.4 in in monetary sanctions ordered against wrongdoers. The fines, 10 percent more than collected in FY 2012, were a record for the agency.

CFTC

Bowen Nominated to Replace Chilton at CFTC - Wetjen Will Be Acting Chairman

On December 19th, President Obama nominated Sharon Bowen to fill Commissioner Bart Chilton's seat on at the CFTC. Bowen, a partner at Latham & Watkins, currently serves on the board of directors of the Securities Investor Protection Corporation. Bowen's nomination is one of several to fill opening spots at the CFTC. Earlier in the year, Timothy Massad was nominated to replace Chairman Gensler and Christopher Giancarlo was selected to replace Jill Sommers. It is unclear when the Senate Agriculture Committee will schedule these hearings. In the interim, on December 16th, the CFTC [unanimously elected](#) Commissioner Mark Wetjen to serve as Acting Chairman following Chairman Gary Gensler's departure.

FDIC

FDIC Outlines Need for Interest-Rate Risk Management

On December 19th the FDIC's Winter 2013 issue of *Supervisory Insights* contained an article, "Industry Trends Highlight Importance of Effective Interest-Rate Risk Management." The piece notes that a low interest rate environment has led many banks to change their asset mix and risk profiles and examines how these changes have resulted in increased interest rate risk exposure.

OCC

OCC Releases Semiannual Risk Profile

On December 19th, the OCC released its [Semiannual Risk Perspective](#), a report that lays out risks to the banking system. The OCC found that banks are increasing their tolerance for risk, loosening underwriting standards, in an effort to compete for limited lending opportunities in an environment of weak loan demand and fewer credit-worthy borrowers. The report also reiterated previous warnings about the risk of market volatility and price risk.

OCC Reports Lower Trading Revenues

A December 18th [report](#) by the OCC found that U.S. bank trading revenue fell 15 percent from the previous year in the third quarter to \$4.5 billion. This is also down 38 percent from the second quarter. Kurt Wilhelm, Director of the Financial Markets Group at the OCC explained by noting that client demand tends to diminish toward the end of the year but also that uncertainty associated with the Federal government shutdown compounded this usual slowdown.

FHFA

FHFA Asks for Comment on GSE Limits – Watt Announces Delay on Planned Fee Increase

On December 16th, the Federal Housing Finance Agency (FHFA) requested comment on a proposed reduction in the size of loan limits for Fannie Mae and Freddie Mac. The FHFA is considering lowering the guarantee amount for the GSEs to \$400,000 nationwide while lowering limits in more expensive areas to \$600,000. Comments are being accepted through March 20, 2014 and no changes will be made until all comments are considered, according to the [news release](#).

On December 20th, soon to be former Congressman and future FHFA Director Mel Watt [announced](#) that he was delaying a previously planned increase in the fees that Fannie and Freddie charge banks to guarantee mortgages. Citing the planned fees as too steep and too sudden, Watt didn't give a time frame, or indication, for when the fee increase might be put back in place.

Upcoming Hearings

The Senate and House of Representatives are in Recess.