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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

December 24, 2012

Leading the Past Week

Welcome to the last Financial Services Update of the year as we will take a break for the holidays but return on January 7th. Last week ended with a flurry of activity but little action, as both sides traded rhetoric as the "Plan B" solution for the fiscal cliff fell off the rails. As the President left for Hawaii, he seemed resigned to a short term deal.

More on the fiscal cliff debacle below, but as 2012 comes to a close, we would be remiss if we didn't take a quick look back or share our perspective for what may lie ahead. As the year ends we find it has been more than two years out since the passage of the historic Dodd-Frank financial reforms and although regulators have written over 215 of the rules required by the Act, there are more than 200 rules waiting to be finalized. Though the FSOC has been up and running for some time, the Council has yet to designate nonbanks for additional oversight as systemically important institutions. However, as the SEC failed to move forward with reforms to the money market mutual fund industry, the FSOC stepped in and may muscle through reforms that would systematically alter the money market industry. And even though eight U.S. banks have been designated globally significant, and could be obligated to the full measure of the Basel III capital requirements, the rules themselves continue to encounter serious pushback from lawmakers, community banks and other stakeholders and have yet to go into effect.

Looking ahead to 2013, we have three new faces at the top of the key committee, which will certainly bring a change in tone and maybe substance as well. However, based on past precedence, industry efforts to mitigate the impact of Dodd-Frank are not likely to be confided solely to the halls of Congress, as we anticipate that industry may continue to use judicial and regulatory strategies to slow, overturn, or gut portions of the Dodd-Frank Act. As with the 112th Congress, any attempts to make sweeping changes to the reforms or repeal the law are expected to be unsuccessful. Whether or not there is an appetite to take on technical changes to the law in

Congress, as many industry stakeholders hope, remains to be seen. We also anticipate the CFPB to increase its activity in 2013, as the Bureau is expected to tackle mortgage disclosure rules on integrating disclosures and setting underwriting and appraisal practices in addition to constructing a regulatory framework for large nonbank institutions offering consumer products. While it is unclear who will lead the Bureau once Director Cordray's term ends at the end of the coming year, it is anticipated that continued Republican opposition may prevent President Obama from getting a nominee through the Senate confirmation process. And of course, with one of the architects of the CFPB now a member of the Senate, and the Banking Committee, it could provide for even more fireworks.

Fiscal Cliff

Thoughts turned to what the "Plan C" will be for the fiscal cliff negotiators after House Speaker Boehner unexpectedly pulled his "Plan B" from the vote schedule on December 20th due to a realization that they did have the votes to pass the plan. Afterwards, Boehner seemed to wash his hands of the matter, effectively forcing Senate Minority Leader Mitch McConnell (R-KY) to continue the negotiation process with the White House. While most conservative Republicans in the House would oppose any deal put forth by the Senate, McConnell and Majority Leader Reid will have to move forward with a plan which can be sent to the House. On Friday, McConnell called on the Senate to take up the House-passed plan which extends all tax cuts for one year, while Reid called on the House to vote on the Senate-passed plan before leaving for the Holidays.

With both Chambers leaving for the Christmas Holiday, and while the Senate is set to return, it is unclear whether the House will be back for votes before the New Year, it is becoming ever more likely that the U.S. will go over the cliff, at least for a brief period. Although some believe that the markets have already baked in this possibility –even though the rapid selloff following the Plan B debacle may indicate otherwise – there remains a real prospect that US Rating could be impacted. For example, Fitch Ratings warned lawmakers on December 19th that the country's credit rating could suffer if the U.S. is allowed to go over the cliff, or even come close to going over and Standard and Poor's downgrade of the U.S. credit rating came with a call for the U.S. to cut deficits. Of course, these warnings haven't impacted the sale of Treasuries and the government's borrowing costs have since fallen sharply, so maybe they are less concerned about ratings then they were last August.

Legislative Branch

Senate

Senate Passes Bill to Study Too Big to Fail Perceptions

Late on Thursday, the Senate passed a bill that Senators David Vitter (R-LA) and Sherrod Brown (D-OH) sponsored that would direct the Government Accountability Office (GAO) to study if the largest financial institutions receive an unfair advantage due to the perception that they are "too big to fail." Specifically, the bill would have the GAO explore if banks with more than $500 billion in assets enjoy favorable pricing of their debt or treatment as a result of inflated credit ratings resulting from a belief that the government would bail them out. Although measure passed through the Senate by unanimous consent it is unclear whether the House will take it up. Of course, having now passed as a standalone measure, the GAO is likely to be more receptive to taking up the request if it comes in non-statutory form next year.

Corker Will Support Galante Nomination to FHA Commission
Last week Senator Bob Corker (R-TN) announced he will support the confirmation of acting Federal Housing Administration (FHA) Commissioner Carole Galante. Corker previously indicated he would block any nominee but said a recent letter from Galante, in which she pledged to make significant changes to underwriting mortgage requirements, indicates she would be an "accountable commissioner" with "resolve and expertise" in the best interest of the taxpayer. In addition to promising to increase underwriting criteria for FHA borrowers with FICO scores between 580 and 620, Galante said she intends to increase down payment requirements and insurance pricing and that the FHA will toughen underwriting requirements for new borrowers who have been foreclosed on in the last seven years. Galante's letter said new reforms will be in place by January 31st, including a moratorium on reverse mortgage products.

House of Representatives
Waters Calls on CFTC to Delay Cross-Border Derivatives Rules
In a letter sent December 18th, incoming Ranking Member of the Financial Services Committee Maxine Waters urged CFTC Chairman Gary Gensler to delay compliance with cross-border requirements of Dodd-Frank derivatives rules, currently scheduled to go into effect January 1st. On December 20th, a bipartisan group of fourteen Representatives from the House Agriculture Committee also wrote to the CFTC asking for details on how it intends to regulate cross-border derivatives transactions. CFTC Commission Bart Chilton has also called for a delay of the cross-border swaps rules. Chilton, testifying before the House Agriculture Committee earlier in December said the delay would "give markets and participants time to comply with the new regulatory environment and also would provide assurance to global markets and regulators that we are not causing unnecessary market disruptions." On December 21st, the CFTC voted 4 to 1 to delay compliance with the cross-border rules.

Seven New Democrats to Join House Financial Services Committee
On December 20th, the Democratic Steering and Policy Committee recommended six incoming freshman join the House Financial Services Committee in the 113th Congress. These include Representatives-elect Bill Foster (D-IL), Dan Kildee (D-MI), Patrick Murphy (D-FL), John Delaney (D-MD), Kyrsten Sinema (D-AZ), and Joyce Beatty (D-OH). Representative Terri Sewell (D-AL) already received the steering committee's recommendation last week, bringing the total new Democratic members on the panel up to seven. These members will join 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).

The same day, incoming Chairman of the Committee Jeb Hensarling (R-TX) announced that Representative Gary Miller will be the Vice Chairman of the panel and Representative Lynn Westmoreland (R-GA) will be Committee whip. Hensarling also announced the subcommittee chairs for the 113th Congress: Representative Randy Neugebauer (R-TX), Insurance, Housing and Community Opportunity; Representative Shelley Moore Capito (R-WV), Financial Institutions and Consumer Credit; Representative Scott Garrett (R-NJ), Capital Markets and Government Sponsored Enterprises; Representative Patrick McHenry (R-NC), Oversight and Investigations; and Representative John Campbell (R-CA), Domestic Monetary Policy and Technology.

Executive Branch

Federal Reserve

Fed Updates Supervisory Approach to Large Financial Firms

On December 17th, the Fed issued a Supervision and Regulation letter outlining changes to the agency's approach to regulating large financial firms. The updates reflect a new focus on the stability of the financial system and broader economy as a whole, while making improvements to the Fed's plans for resiliency of individual firms. In a release on the letter, the Fed said it is "intended to provide greater clarity about supervisory objectives and expectations so that institutions and the general public can better understand the Federal Reserve's focus in supervising these large firms."

Treasury

Treasury to Wind Down GM TARP Investment Over Next 12 to 15 Months

On December 19th, the Treasury announced, as part of its efforts to wind down its investments in the Troubled Asset Relief Program (TARP), that it will fully exit its investment in General Motors (GM) within the next 12 to 15 months. Currently, the Treasury holds 500.1 million shares of GM common stock which GM will purchase 200 million shares of at $27.50 per share by the end of the year. The remaining shares will be sold by "various means in an orderly fashion" over the following months.

CFPB

Bureau Launches Public Inquiry on Impact of CARD Act

On December 19th, the CFPB announced that it is seeking public comment on how the Credit Card Accountability Responsibility and Disclosure Act of 2009 (CARD Act) has impacted consumers and the credit card market. In 2011, the Bureau found that the CARD Act had already largely curtailed the practice of hiking interest rates on existing cardholder accounts and had substantially reduced consumer late fees and nearly eliminated overlimit fees. The request for information seeks to gather additional information on the effect of the law, including: the terms of credit card agreements and practices of credit card issuers; the success of protections against unfair or deceptive acts; changes in the cost and availability of credit; and the use of risk based pricing.

CFPB Plans Mortgage Policy Field Hearings for New Year

The CFPB will hold two field hearings on mortgage policy in January. The first hearing will be on January 10th in Baltimore, Maryland and the second will be on January 17th in Atlanta, Georgia. The hearings will feature remarks from CFPB Director Richard Cordray, as well as testimony from consumer groups, industry representatives, and members of the public.

CFTC

Foreign Owned Banks Exempted from Dodd-Frank Rules

On December 20th, CFTC staff in the Division of Swap Dealer and Intermediary Oversight (DSIO) issued a no-action letter providing relief for certain U.S. banks that are wholly owned by non-U.S. swap dealers. The letter would make it easier for foreign owned banks conducting business in the U.S. to avoid portions of the Dodd-Frank Act required by dealers. Banks seeking this relief would need to file a claim with the CFTC and would have to meet certain conditions, such as already being regulated by the OCC, Fed or FDIC.

CFTC Approves Rules on Business Conduct for Swap Dealers and Major Swap Participants

On December 18th, the CFTC approved interim final rules for swap dealers and major swap participants who would otherwise be required to comply with certain business conduct and documentation requirements. The rule changes, which became effective upon publication in the Federal Register, are intended to provide swap dealers and major swap participants with more time to come into compliance with regulations. The interim final rules are open for comment for 30 days.

SEC

SEC Plans Roundtable for February on "Tick Sizes"

On December 21st, the SEC announced details of its February 5th public roundtable to explore the impact of how minimum pricing increments—known as tick sizes—will affect the securities markets. The roundtable will be divided into three panels addressing tick sizes' impact on small and medium sized companies, the impact on securities markets, and the potential methods for analysis of the issues, including whether and how to conduct a pilot for alternative minimum tick sizes. The Jumpstart Our Business Startups (JOBS) Act of 2012 allows the agency to adjust tick sizes and mandated a study examining the effects of decimalization on initial public offerings (IPOs) and small and middle capitalization companies.

SEC Enforcement Director Will Step Down

On December 20th, Bloomberg reported that SEC Enforcement Director Robert Khuzami plans to step down as early as January. Khuzami was hired in 2009 in the wake of the Bernie Madoff scandal to help restore the image of the Commission. Sources familiar with the story say Khuzami notified acting SEC Chairman Elisse Walter earlier this month and Walter has been discussing a replacement with the other three commissioners.

GAO

Study Finds Regulators Did Not Quantify Dodd-Frank Costs

On December 18th, the GAO released a report reviewing agencies' regulatory analyses required by various federal statutes for all 54 regulations issued to implement the Dodd-Frank Act. The report found that agencies generally considered, but typically did not quantify or monetize, the benefits and costs of these rules. The GAO also found that agencies informally coordinated on 19 of the 54 rules but they did not go a step further to eliminate differences between the rules. The report recommended that agencies more fully incorporate the OMB guidance into their rulemaking policies and that the Financial Stability Oversight Council (FSOC) put in place formal interagency coordination policies.

Miscellaneous

BPC Launches Dodd-Frank Working Groups

On December 17th, the Bipartisan Policy Center (BPC) announced five new working groups that will evaluate the Dodd-Frank Wall Street Reform and Consumer Protection Act and make recommendations on implementation and potential changes to the 2010 financial reforms. The BPC's announcement noted that the working groups will examine five areas of Dodd-Frank: systemic risk; resolution of failing financial firms; capital markets and the Volcker rule; consumer financial protection; and regulatory architecture. The announcement follows on a speech that Senator Mark Warner made at the Center, where among other things, he outlined his vision for Dodd-Frank reforms, including an independent leader to replace the Treasury secretary as head of the Financial Stability Oversight Council (FSOC) and greater authority for the body to resolve differences among federal agencies in areas such as derivatives reform. Warner, who will continue on the Banking Committee next year, has also publicly said he anticipates that the Senate Banking Committee will begin work on a Dodd-Frank corrections bill at some point in the new year.

International

Basel Committee Proposes Revisions to Securitization Framework

On December 18th, the Basel Committee on Banking Supervision released proposed changes to the current capital rules, with the goal of making existing requirements "more prudent and risk sensitive" and "mitigate mechanistic reliance on external credit ratings." The proposed changes have the potential to increase set-aside requirements for banks with securitization exposures. Banks have through March 15th to submit comments on the revisions which the Committee will use in conjunction with a study on the impact of the changes to craft a final version of the proposal later in 2013.

The proposal creates two "hierarchies" for the securitization framework that are not present in current rules. The new framework consists of a standardized approach (SA) that would be used by banks for the asset class comprised of the underlying pool of securitized exposures and an internal ratings-based (IRB) approach used by banks to assess credit risk for the asset class comprised of the underlying pool of securitized exposures. The hierarchies also differ in the approach to certain types of exposure and the flexibility given to jurisdictions or to banks to opt out. Still, both hierarchies use a risk-weight floor to guard against model risk.

UPCOMING HEARINGS

There are no hearings scheduled.