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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

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Leading the Past Week

With Congress trying to resurrect its end of the year business from the smoldering ruins of the supercommittee, the other major story, was in Europe and whether the Eurozone could be saved and financial contagion could be mitigated. The markets appeared to have heaved a collective sigh of relief on Wednesday following news that five international central banks agreed to provide liquidity to struggling banks and the possibility of a new 'fiscal compact' to strengthen the Eurozone. Returning to domestic issues, in addition to dealing with their year-end wrap-up (including extending the payroll tax cut, unemployment insurance and the so-called "doc fix", along with funding the government) this past week saw a renewed focus on the oversight of the implementation of Dodd-Frank, coincidentally at the same time that the other namesake of the law, Barney Frank, announced that he will not stand for reelection in 2012. First, at a Senate Agriculture hearing ostensibly intended for Dodd-Frank oversight, but which turned into an examination about the failure of MF Global, where both sides used the collapse of the firm as an example either for additional regulations or why additional regulations would not work. Then, the House Financial Services Committee approved a series of bills aimed at altering the Dodd-Frank Act's handling of derivatives and Swap Execution Facilities and a Senate Committee considered bills related to capital formation. Finally, it also appeared that there could be movement on one of the most controversial provisions of Dodd-Frank as it was announced that a procedural vote to consider the nomination of Richard Cordray to be CFPB director, could take place as early as this week.

Legislative Branch

Senate

Senate Democrats Announce Possibility of Procedural vote to move Cordray Nomination for Vote:

Last week, Senate Democrats floated the possibility of a procedural vote this week on Richard Cordray to be the Director of the CFPB. While almost all Senate Republicans oppose the nomination, Democratic aides said that they may try to force the issue with a cloture vote on December 8th. The Senate Banking Committee approved Cordray's nomination in a party line vote on October 6th; however, there is almost a unified Republican front in opposition to Cordray, with only Republican

Senator Scott Brown having announced he supports the nomination. In a May letter to President Obama Republicans announced that they would block any nominee until the structure of the Bureau is changed. In July, the House approved H.R. 1315 to change the structure of the agency; however, notwithstanding the irony that the original version of the Financial Reform bill, passed under House Democratic rule, contained a similar structure, Democrats continue to oppose the changes which, they say, would undermine the agency.

Not surprisingly, the Administration continues to vocally support moving forward with Cordray's nomination. On December 1st, Treasury Secretary Tim Geithner renewed the call for the agency to come into its full powers with a director the CFPB may not regulate non-depository institutions including payday lenders and student loan issuers. Raj Date, Treasury Special Adviser for the CFPB said in remarks December 1st that a director is needed to ensure that non-banks "play by the same rules as everyone else." Ranking Member of the House Financial Services Committee Barney Frank (D-MA) also commented on the need for a director, saying large banks already faced with CFPB regulation have been placed at a competitive disadvantage to non-banks offering similar services. Nevertheless, the banking industry remains a staunch opponent of Cordray's nomination before changes to the underlying structure of the Bureau.

Senate Banking Considers Capital Formation Legislation:
On December 1st, the Senate Banking Committee met to discuss capital formation issues and two bills centered on easing securities legislation to aid in capital formation: S. 556, to amend the securities laws to establish certain thresholds for shareholder registration and S. 1791, the Democratizing Access to Capital Act. These bills are similar to a series of bills approved by the House in November dealing with small business access to capital and SEC requirements.

Despite having similar bills pass the House, and having the support of the White House, there was not uniform support for the legislation at the hearing. A securities regulator who testified at the hearing, warned Senators that easing restrictions on small and start up firms' ability to raise funds through crowdfunding and online could have negative impacts, including an increase in the possibility for fraud and barriers for the regulators ability to address fraud. Taking a contrarian view were those who advocated that crowdfunding represents a "powerful new tool" for capital formation.

Agriculture Committee Meets for Dodd-Frank Oversight; Focus on MF Global:
On December 1, the Senate Agriculture Committee held a hearing to conduct continued oversight of the Dodd-Frank Act and hear from Chairmen of the CFTC and SEC, Gary Gensler and Mary Schapiro. While the hearing was intended to discuss implementation of financial reform legislation at the CFTC and SEC, the majority of the hearing instead focused on the bankruptcy of MF Global and steps agencies are taking to protect consumers' segregated accounts and pursue civil penalties and enforcement action. While MF Global ultimately stole the spotlight, Chairman Gensler's prepared testimony provided a good overview of where his agency stood on a variety of ongoing rulemaking efforts, including an upcoming CFTC vote on segregated accounts, transparency and harmonization internationally and among prudential regulators. Chairman Schapiro's opening statement focused on SEC implementation of Title VII of the Dodd-Frank Act (dealing with derivatives) and an upcoming schedule for implementation. Both regulators touched on finalization of key definitions such as swaps, swaps dealer and security based swap, agreeing that definitions, which are due by the end of the year are instead going to slip and will not be published until sometime early next year.

However, instead of focusing on the implementation of Dodd-Frank, the majority of lawmakers quizzed the witnesses on the recent collapse of MF Global. This issue is not going to go away anytime soon, as there is a House Agriculture hearing slated for December 8th, another Senate Agriculture hearing scheduled for December 13th, and House Financial Services hearing on the 15th. Moreover, the House Agriculture Committee voted December 2nd to subpoena former MF Global Chairman and former US Senator Jon Corzine in order to ensure his appearance before the Committee. Senator Schelby (R-AL) has also written to the CFTC Inspector General Roy Lavik asking for a report on all the agency's activities related to MF Global and to look into Chairman Genlser's recusal from the investigation.

Bill Introduced to Facilitate Small Business IPOs:
A bipartisan bill introduced on December 1st by Senators Charles Schumer (D-NY) and Pat Toomey (R-PA) aims to create jobs by expanding small business access to investment capital through exemptions from certain SEC regulations. The Reopening American Capital Markets to Emerging Growth Companies Act (S. 1933), would permit companies with less than $1 billion in annual revenue to schedule initial public offerings (IPOs) without having to meet various reporting requirements for a period of five years or until their size exceeds established limits. The reform is endorsed by both the IPO Venture Task Force, created by the Department of the Treasury; and the President's Council on Competitiveness – panels that include industry representatives and venture capitalists.

The exemptions would permit company executives to certify internal processes in lieu of paying for external auditors – as mandated by the Sarbanes-Oxley Act; to refrain from filing public financial statements with the SEC until they reach 500 private shareholders, to solicit investments through new channels of communication – including online; and to allow bank analysts to recommend the company's IPO even if it is underwritten by their institution. Opponents of the legislation suggest that it will weaken investor protections, by permitting companies to solicit investments without providing detailed and transparent performance data. If passed the legislation could affect 11 to 13% of companies that fit its "emerging growth" category.

House of Representatives
Barney Frank Announces He Will Retire at End of Term:
After 30 years serving on Capitol Hill, this week Representative Barney Frank announced he will retire at the end of his 16th term. Frank cited age, redistricting and other factors as the primary reasons for not running for reelection. With Frank's announcement, Congress will lose not only an advocate for low-income housing but also one of the forces behind the 2008 financial bailout and historic financial reform named for him. The battle over who will replace Frank for the top Democratic spot on the House Financial Services Committee appears to have solidified behind Representative Maxine Waters (D-CA), the most senior Democrat on the Committee, though the cloud of an ethics probe may eventually complicate things, but any speculation of an immediate challenge were squelched when Representative Carolyn Maloney (D-NY), the next most senior member of the panel, took herself out of the running.

Meanwhile, those opposed to the Dodd-Frank Act on the House Financial Services Committee are seeing potential for rewriting portions of the financial reform in Frank's absence next. A Republican aide close to the Committee was reported as saying: "Ranking Member Frank's departure means that there is now one less obstacle in repealing the job-killing components of the onerous Dodd-Frank regulation." Lacking Frank's wit and ability to out-debate his opponents, Democrats on the Committee will likely be challenged in efforts to defend the Dodd-Frank Act. Notably, one area in which Republicans may see success defanging financial reform is the CFPB, where Republicans hope to impose additional Congressional controls and oversight.

House Financial Services Approves Changes to Dodd-Frank Derivatives Provisions:
On November 30th, the House Financial Services Committee approved three bills that would change the way the Dodd-Frank Act handles the regulation of derivatives. The Committee approved by voice vote the Swap Execution Facility Clarification Act (H.R. 2586) to ban the CFTC and SEC from implementing specific clearing, margin and collateral requirements at swap execution facilities (SEF). The panel also approved the Business Risk Mitigation and Price Stabilization Act (H.R. 2682) by voice vote which would prohibit regulators from establishing margin requirements on derivatives end users. H.R. 2779, a bill to exempt inter-affiliate swaps from clearing, margin and collateral requirements put in place by the Dodd-Frank Act was approved by a vote of 53 to zero. Chairman Spencer Bachus (R-AL) noted that all three bills "will bring much-needed certainty to the over-the-counter derivatives market" and will promote competitiveness in markets.

Only H.R. 2586 was substantially debated, with some Democrats—despite bipartisan sponsorship—skeptical of the legislation for its potential to lessen transparency in swaps trades. Representative Maxine Waters (D-CA) stressed that implementation of Dodd-Frank "is best left to the SEC and CFTC and the rulemaking process." However, Representative Scott Garrett (R-NJ) sponsor of H.R. 2586 said the bill is necessary to fix a "material disagreement" between Congressional intent and the CFTC's proposed SEF rules. Despite the success of all the bills in the Financial Services Committee, the legislation still needs to go through the House Agriculture Committee before the full House can take them up.

FHA Mortgage Insurance Shortfall Probed by House Financial Services:
On December 1st, before the House Financial Services Committee, Housing and Urban Development (HUD) Secretary Shaun Donovan, told members that the Federal Housing Administration's (FHA) Mortgage Mutual Insurance Fund reserve ratio has become dangerously low and may require a bailout to shore up the fund. The fund's capital reserve ratio currently stands at 0.24 percent of outstanding mortgages.

Currently, the FHA backs approximately a third of all new mortgages or home purchases which Chairman Spencer Bachus (R-AL) faulted as crowding out the private sector. "The private sector cannot compete with FHA's 100 percent loan guarantee," said Bachus. Republicans also expressed concern that the highest loan limit available today is backed by the FHA, not by the private sector. Donovan countered these concerns by emphasizing FHA's responsibility to provide alternatives—especially for low- or middle- income buyers—at a time when the private housing market is weak. While Shelly Moore Capito (R-WV) expressed that Congress would not stand for bailout of the FHA, many on the Committee were skeptical that the FHA could continue to provide mortgage insurance without additional capital. Nevertheless, Donovan stressed that the agency is developing alternatives to a bailout such as dipping into the FHA's cash reserve fund.

House Democrats Wary Over Self Regulation of Financial Advisers:
On December 1st, a senior staffer with the House Financial Services Committee expressed that Ranking Member Barney Frank (D-MA) along with a number of Democrats on the panel are suspicious of the ability of self-regulatory organizations' (SRO) to effectively oversee investment advisers and instead

would prefer to see an increase in the SEC's budget to let the agency handles this task. The comments as House Financial Services Chairman Spencer Bachus (R-AL) has floated a discussion draft of legislation to create SROs to oversee advisers. The staffer was part of a panel, sponsored by the Consumer Federation of America, which also touched on the SEC uniform fiduciary standard. Barbara Roper, Director of Investor Protection at CFA, expressed that although there is consensus within the Commission on the fiduciary standard little progress has been made.

Executive Branch

CFPB

CFPB Requests Comment on Streamlining Inherited Regulations:

On November 29th, the CFPB released a notice and request for information on the ways in which to streamline fourteen consumer regulations inherited from other regulators under the Dodd-Frank Act. The notice seeks public comment on what regulations are "most in need of updating or elimination because they are outdated, overly burdensome or unnecessary." Not only does the notice state the Bureau is seeking ways in which to simplify and update regulations, it wishes to standardize definitions across all consumer protection regulations. The Bureau will also use public comments to create an "appropriate schedule" for undertaking its efforts. The CFPB has already identified 'Regulation P' which requires banks to give annual notice to customers about privacy policies and practices. The Federal Reserve designed the rule to protect privacy; however, the CFPB asks if an exemption is in order for banks who do not share consumer information.

CFPB Releases Initial Findings of Credit Card Complaint Collections:

On November 30th, the CFPB announced initial observations from the Consumer Response System collection of consumer credit card complaints. Since July 21st, the Bureau has received over 5,000 complaints related to credit cards many of which reflect that consumers struggle to grasp the terms of credit cards. The agency has already begun to work with credit card companies to resolve the complaints and took action on over 3,100 of the complaints received.

Special Adviser for the CFPB, Raj Date, said that the early analysis of credit card data has given the Bureau "a snapshot of how the consumer finance markets are working." The Consumer Response System started scaling up its operations on December 1st to take complaints on residential mortgages and will be prepared to handle complaints on all consumer financial products and services by the end of 2012. Financial institutions have been skeptical of how the agency plans to use the data collected through the Consumer Response System, with the American Bankers Association noting that the CFPB's collections on credit cards represent "less than one-tenth of one percent" of all credit accounts in the US.

CFTC

CFTC to Meet to Consider Final Rule on Investment of Customer Funds:

On December 5th, the CFTC will meet to consider two proposed rules, a notice of proposed rulemaking and a proposed interpretation of retail commodity transactions. The notice of proposed rulemaking relates to the system for making a swap available for trade. The two proposed rules for consideration involve investment of customer funds held in an account for foreign futures and options transactions and foreign boards of trade. As it stands, funds may freely invest funds from customer accounts in securities of government-sponsored entities, municipal securities, money market mutual funds, certificates of deposit, commercial and corporate paper, foreign sovereign debt, and "in-house transactions." However, the October 2010 proposed rule would change where customer funds may be invested and limit the amount of the investment. The recent collapse of MF Global has increased attention on the rule as scrutiny over the firm's handling of customer funds increases.

SEC

New SEC Data Mining Initiative Finds New Cases of Fraud at Hedge Funds:
Over the past three weeks the SEC has filed four new fraudulent hedge fund cases as part of the Commission's initiative to form cases around data analysis as opposed to outside tips. SEC data analysts use a system dubbed an "aberrational performance inquiry" which examines returns and outliers. The new processes for identifying fraud have led to SEC action on three hedge funds and six people in one month. Speaking on the new data analysis, Enforcement Director Robert Khuzami said the SEC is "reviewing reviewing registration documents for high-risk investment advisers to determine who is lying about their educational achievements, their business affiliations, and their assets under management" because stopping small infractions prevents larger fraudulent activities from the same bad actors.

OCC

OCC Releases Proposed Rule for Stripping Credit Ratings from Standards Evaluation:
On November 29th, the Office of the Comptroller of the Currency (OCC) proposed a rule under the Dodd-Frank Act to remove references to credit ratings from standards used to evaluate investment portfolios. The proposed rule would require banks to develop "appropriate" alternative standards for credit worthiness of investment securities, securities offerings and foreign bank capital deposits. The rationale for the rulemaking comes from the use of credit ratings to rate subprime mortgages which contributed to the financial crisis.

The new standard for 'investment grade' securities under the proposal would be if an issuer has "an adequate capacity to meet financial commitments under the security for the projected life of the asset or exposure" and banks must be able to "determine that the risk of default by the obligor is low and the full and timely repayment of principal and interest is expected." Regulators have called the rulemaking "one of their biggest headaches" as banks still rely heavily on ratings and the possibility that the ban will conflict with the adoption of Basel III capital and liquidity structures. Commenters on the proposal are also opposed to the rule and have urged regulators to preserve the use of credit ratings.

FDIC

Deposit Insurance Fund back in the Black
This past week the Federal Deposit Insurance Corporation (FDIC) announced that its fund which insures bank deposits once again has a surplus after accruing a deficit of almost $21 billion at the height of the financial crisis. As of the September 30th the fund has a balance of $7.8 billion caused by premiums collected by the FDIC outstripping losses due to bank failures. This news should only likely to further increase calls by larger banks to modify the assessment formula that the FDIC uses.

<u>European Debt Crisis</u>

European Debt Crisis Forestalled with Central Bank Aid and Possible EU 'Fiscal Compact:'
On November 30th, as European banks continued to face funding gaps and deleveraging, the Federal Reserve, the Bank of England, the European Central Bank, the Bank of Japan, the Bank of Canada and the Swiss National Bank announced a plan to help banks borrow and lend money. The plan, which seeks to delay the reckoning of the European debt crisis, expands an existing Fed program which allows foreign banks to borrow at low interests rates. Despite policymakers' best efforts to stress that the

Fed's program will not solve the underlying debt problems, markets responded dramatically with the Dow closing up almost 500 points that day. A statement released by the central banks said: "The purpose of these actions is to ease strains in financial markets and thereby mitigate the effects of such strains on the supply of credit to households and businesses and so help foster economic activity."

Also in the works is a European Central Bank (ECB) proposal to funnel central bank loans through the IMF in order to increase funds available to counter the sovereign debt crisis. Sources reported to be familiar with the negotiations said ECB President Mario Draghi approved the plan. Negotiations will likely continue up until the December 9th EU Summit; however, details already emerging suggest that a deal would involve a "fiscal compact" with more stringent debt control measures. German Chancellor Angela Merkel, who has long called for changes to treaties that would address overspending, renewed her call on December 2nd before the German Parliament, calling for a new "union of stability." Merkel's speech combined with Draghi's hints at new means of countering sovereign debt left global equity markets with their best week in three years.

Miscellaneous

Massachusetts Sues Five Major Banks for Deceptive Loan Practices and Forecloses:

On December 1st, the Massachusetts Attorney General Martha Coakley filed lawsuits against Bank of America, Citigroup, Wells Fargo, JP MorganChase, GMAC and its subsidiaries, and the Mortgage Electronic Registration System Inc. The law suit alleges that the banks participated in illegal foreclosures and loan servicing practices. Coakley also cited the banks' resistance to signing on to a multistate settlement to resolve the claims as justification for her actions. While Coakley has made clear her loss of faith in the multistate negotiations, Tom Miller, Iowa Attorney General and a leader of the negotiations said Coakley expressed willingness to "evaluate the joint state-federal settlement" which he hopes will be reached soon. Still, the Massachusetts suit could come to play an important role in driving a settlement because if the multistate negotiations fall through banks would likely be facing similar suits from a variety of states.

Fitch Gives US a Negative Outlook:

Following the failure of the Supercommittee to reach a compromise on comprehensive deficit reduction, Fitch Ratings updated the United States' stable outlook to negative. While the US maintains its 'AAA' rating, the negative outlook "reflects declining confidence that timely fiscal measures necessary to place U.S. public finances on a sustainable path will be forthcoming." The negative outlook means that the likelihood of a downgrade from Fitch is fifty percent greater over the next couple of years. However, Standard & Poor's and Moody's refrained from downgrading the US as the Supercommittee's failure will cause $1.2 trillion in sequestration.

UPCOMING HEARINGS

On Monday, December 5th at 9am, the House Financial Services Committee will hold a field hearing to discuss how new regulations are impacting financial institutions, small businesses and consumers in Illinois.

On Tuesday, December 6th at 10am, in 2128 Rayburn, the House Financial Services Committee will hold a hearing on the Stop Trading on Congressional Knowledge (STOCK) Act.

On Tuesday, December 6th at 10am, in HVC-210 Capitol Visitor Center, the House Ways and Means Committee and Senate Finance Committee will hold a joint hearing on the tax treatment of financial products.

On Tuesday, December 6th at 10am, in 538 Dirksen, Senate Banking, Housing and Urban Affairs Committee will hold a hearing titled "Continued Oversight of the Implementation of the Wall Street Reform Act."

On Tuesday, December 6th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit Subcommittee will hold a hearing on legislation to improve the examination of depository institutions.

On Wednesday, December 7th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing on the Private Mortgage Market Investment Act.

On Wednesday, December 7th at 2pm, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Subcommittee on Financial Institutions and Consumer Protection will hold a hearing on enhanced supervision, focusing on a new regime for regulating large, complex financial institutions.

On Wednesday, December 7th at 3pm, in 2128 Rayburn, the House Financial Services Subcommittee on Oversight and Investigations will meet to consider the issuance of a subpoena to compel the attendance of a witness at the subsequent hearing to examine the MF Global Bankruptcy.

On Thursday, December 8th at time TBA, in 2128 Rayburn, the House Financial Services Subcommittee on Insurance, Housing and Community Opportunity will mark up pending legislation: the RESPA Home Warranty Clarification Act of 2011 and the Homes for Heroes Act of 2011.

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

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.