ML Strategies Update

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# Financial Services Legislative and Regulatory Update

Leading the Past Week

As the first full week of the Federal government's sequestration comes to a close, the effects have been palpable. The Dow Jones closed just shy of 14400, after hitting a 52 week high earlier in the day. The Department of Labor announced Friday that the economy added 236,000 jobs in February, significantly higher than the consensus prediction of around 165,000 and that unemployment now stood at 7.7 percent. Earlier in the week, the Fed's latest beige book found that the US economy is continuing along a moderate growth trend. While these last three metric's are on a month lag, the bullish nature of the equity markets, coupled with tangible loss in services, has complicated the Administration's "sky is falling" rhetoric surrounding the impact of the sequester.

Against the backdrop, significant attention and ink was devoted to the President's decision to put on a charm offensive, which included dining with a group of Republican Senators, and apparently putting a grand bargain on the table. According to some, the time frame for getting this deal done will expire in late July or August when the debt ceiling will need to be extended again. So until then, it seems like the President intends to swing for the fences, which begs the questions, if he strikes out will he be able to play "small ball" for the rest of his term?

Legislative Branch

**Senate**

*Bipartisan Swaps Push-out Fix Introduced in Both Chambers*

On March 6th, Senate and House lawmakers introduced bipartisan legislation to modify the swaps 'push-out' provisions of the Dodd-Frank Act. Specifically, the legislation addresses provisions in Section 716 of the financial reforms that require banks with access to deposit insurance or the Fed's discount window "push out" their derivatives trades to separate affiliates that retain their own capital. These bills would modify the requirements in section 716 to reign in some of the prohibitions on swaps trading within depository institutions. In the Senate the bill was introduced by Senators Kay Hagan (D-NC), Pat Toomey (R-PA), Mark Warner (D-A), and Mike Johanns (R-NE). While in the House, the proposal is championed by Representatives

Randy Hultgren (R-IL), Jim Himes (D-CT), Richard Hudson (R-NC) and Sean Patrick Maloney (D-NY). Last year a similar bill was introduced in the House, but was never considered by the full House of Representatives.

*Senate Banking Examines Bank Secrecy Act and Money Laundering Enforcement*
On March 7th, the Senate Banking Committee head from representatives from the Fed, the OCC, and Treasury on compliance with Bank Secrecy Act regulations and the enforcement of anti-money laundering laws. Both lawmakers and regulators agreed on a need for new disclosure rules for money laundering and additional methods for identifying bad actors, such as allowing businesses to provide information regarding suspected money laundering with the assurance that they wouldn't be civil or legally liable. Notably, Senator Elizabeth Warren (D-MA) generated significant attention for her questions, which included hammering the regulators on the "too big to jail" theme. Interestingly, both David Cohen, Treasury undersecretary for terrorism and financial intelligence, and Thomas Curry, Comptroller of the Currency, pushed back on Senator Warren's criticisms, while also pledging that they would focus additional attention on going after bankers that knowingly violate the Bank Secrecy Act.

*Shelby takes aim at Dodd-Frank*
On March 5th, Senator Richard Shelby, former top Republican on the Senate Banking Committee, introduced two pieces of legislation aimed at clarifying and streamlining the implementation of the Dodd-Frank Act. According to the Senator's press release, the first of these bills is intended to correct "numerous drafting errors" in the law and makes "non-substantive" technical corrections. The second bill, known as the Financial Regulatory Responsibility Act of 2013 (S. 450), is more substantive in nature and would require regulators to conduct enhanced economic analysis and justification of their regulations. S. 450 was cosponsored by Banking Committee Ranking Member Mike Crapo (R-ID) as well as Senators Mike Johanns (R-NE) and Saxby Chambliss (R-GA).

*Senator Menendez Introduces Bill to Reform FHA Reverse Mortgage Program*
On March 7th, Senator Robert Menendez (D-NJ) introduced legislation to allow the FHA to make policy changes necessary to avoid a bailout at the end of the fiscal year. The "HECM Stabilization Act of 2013" (S. 469), provides additional powers to HUD to process and implement policy changes through letters to lenders, bypassing the more time consuming rulemaking process. The legislation would also empower the FHA to revamp its Home Equity Conversion Mortgage (HECM) program which was put on hold due to an inability to make quick changes to address losses. Menendez's bill would allow the FHA to make changes to help save the program, including reducing the amount of money given to borrowers at origination, allowing the FHA to assess borrowers to determine if a HECM would be affordable, and establishing escrow accounts with lenders to prevent foreclosures from tax and property insurance delinquencies.

*Sanders Introduces Legislation to Give Consumers Access to Free Credit Scores*
On March 6th, Senator Bernie Sanders (I-VT) and Representative Steve Cohen (D-TN) respectively introduced legislation that would grant consumers free access to the credit scores used by banks and other institutions to make lending decisions. The Fair Access to Credit Scores Act of 2013 would amend the Fair Credit Reporting Act to add credit scores to free credit reports that consumers are already entitled to annually. The legislation also mandates that the free score received by consumers is accurate and would crack down on deceptive marketing practices within credit monitoring services. Joining Mr. Sanders as original cosponsors were Senators Dianne Feinstein (D-CA), Barbara Boxer (D-CA), Frank Lautenberg (D-NJ) and

Robert Menendez (D-NJ). In the House, Mr. Cohen was joined by his colleagues Representatives Eleanor Holmes Norton (D-DC), Albio Sires (D-NJ), Marcy Kaptur (D-OH), John Conyers (D-MI), Raul Grijalva (D-AZ) and William Lacy Clay (D-MO).

*Senate Agriculture Leadership Requests Public Comment on CFTC Reauthorization*
On March 7th, Chairman Debbie Stabenow (D-MI) and Ranking Member Thad Cochran (R-MS) sent a letter to stakeholders asking for public comment on the reauthorization of the Commodity Exchange Act. The letter says that the Committee has no predetermined ideas or legislative text of how to approach the reauthorization but "believe[s] that it is important to have conversations about a broad range of CFTC-related issues including market oversight, agency oversight and resources and statutory authorities." The letter requests information on how the Committee should approach the CFTC's implementation of the Dodd-Frank Act and recent market failures such as MF Global.

**House of Representatives**
*House Monetary Policy Subcommittee Holds Hearing Examining Fed Monetary Policy*
On March 5th, the House Financial Services Subcommittee on Monetary Policy and Trade held a hearing to examine the risks of the Fed's monetary policy. Witnesses included Alan Meltzer of Carnegie Mellon University, David Malpass, President of Encima Global, John Taylor of Stanford University, and Joseph Gagnon, Senior Fellow with the Peterson Institute for International Economics. Three of the four witnesses were highly critical of the Fed's zero interest rate policies and bond purchases, which have triples the Fed's balance sheet to almost $3 trillion. While better than expected February jobs numbers may ease future criticisms, concerns over the Fed's monetary policy have brought significant criticisms from Republican lawmakers and to date, House Republicans have already introduced more than five bills to reform the Fed's monetary policies.

*Financial Services Subcommittee Examines GSE Role in Financial Crisis*
On March 6th, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Entities held a hearing titled "Fannie Mae and Freddie Mac: How Government Housing Policy Failed Homeowners and Taxpayers and Led to the Financial Crisis." During the panel, Chairman Scott Garrett (R-NJ) said that is planning on introducing legislation to create a new housing finance system that will not include any taxpayer owned GSEs. As justification for this proposal, Garrett, and a number of the witnesses, focused on decisions made by the GSEs before the financial crisis, while in defense of the beleaguered companies, Representative Maloney (D-NY) noted that delinquency rates at Fannie and Freddie are lower than those in the private market. While Republicans and Democrats disagreed on the role of government in housing finance, there did appear to be a general agreement that it is necessary to avoid a bailout of the GSEs.

<u>Executive Branch</u>
**Treasury**
*FSOC Close to Designating First Round of Systemically Significant Companies*
On March 4th, Treasury Undersecretary for Domestic Finance Mary Miller said that the Financial Stability Oversight Council (FSOC) is close to finalizing its designation of the initial nonbank financial entities as "systemically significant". In remarks before the Institute of International Bankers, Miller said the Council is nearing the end of the designation process for the first set of companies and they hope to be able to vote "in the next few months." Firms designated as systemically significant will be subject to additional monitoring and increased standards.

**SEC**

*SEC Unanimously Advances New Rules for High Frequency Traders*

On March 7th, the SEC unanimously voted to propose new rules requiring certain key market participants to have comprehensive technology policies and procedures in place. The rule, known as Reg SCI, replaces the current voluntary compliance system with a mandatory one. Reg SCI is a broad proposed rule that, as drafted, will cover exchanges, self-regulated organizations (such as FINRA), alternative trading systems (such as dark pools), market data distributors and clearing agencies. Specifically, the proposed rule requires market participants to: establish procedures related to capacity, integrity, resiliency and security of technology systems; ensure systems operate in the manner intended and in compliance with applicable federal laws; take timely corrective action; notify the SEC and market participants when systems issues occur; and conduct annuals reviews and submit the findings, among other things.

While the SEC is short one Commissioner as Mary Jo White awaits Senate confirmation, Commissioners unanimously approved the rule—despite some disagreement over portions of the rulemaking. Notably, Commissioners Aguilar and Gallagher differed over a safe harbor provision for entities and employees who establish policies to comply with Reg SCI. While Aguilar expressed concerns, Gallagher said he appreciated the safe harbor as a method of encouraging good actors rather than playing "gotcha" by holding market participants strictly liable for "problems arising in incredibly complex systems." The SEC will be accepting public comment on the Reg SCI proposal for 60 days.

*SEC and FBI Partnering to Address Computerized Trading Threats*

Last week, the FBI confirmed that it has joined the SEC's Quantitative Analytics Unit in an effort to address threats raised through market manipulation resulting from sophisticated computerized trading systems. The Quantitative Analytics Unit has been investigating potential abuses posed by HFT firms and the users of dark pools. Stakeholders fear that traders using these off exchange methods are able to manipulate and destabilize the market through quote stuffing and other methods. The FBI, which has historically investigated issues of market manipulation, partnering with the SEC is being read as an attempt to strengthen the SEC's expertise and keep pace with ever-changing technology.

Even as the SEC voted to advance Reg SCI and the FBI partnership was announced, the North American Securities Administrators Association (NASAA) came out in favor of greater transparency in equity markets and the activities of high frequency traders and dark pools. NASAA has made oversight of "opaque market activities" a priority for the 113th Congress, saying HFT "appears to have potentially dangerous implications for ordinary 'mom and pop' investors." Chairman Elisse Walter has recently said that the agency is still examining "mixed evidence" to determine whether HFT harms or benefits the market.

**Federal Reserve**

*Fed IG to Evaluate CFPB's Enforcement Program*

Last week the Office of Inspector General for the Federal Reserve announced it will be evaluating the CFPB's integration of enforcement attorney's into the exam process. According to the IG's work plan, the body will be looking into a number of CFPB projects this year, but plans to begin its assessment of enforcement attorneys in the second quarter. Typically, enforcement lawyers do not participate in exams held by regulators and the IG evaluation will look into industry complaints about attorney presence in CFPB examinations. Specifically, the IG will seek to determine the potential risks associated with the CFPB's approach and the effectiveness of any safeguards the Bureau has put in place to "mitigate the potential risks associated with this examination approach." While Director Cordray has said he will accept feedback on this practice, he has no plans to change the participation of enforcement attorneys in exams.

*Fed Will not Revisit Interchange Cap Rule*
Last week, the Federal Reserve released a report summarizing information on the volume and value of interchange fee revenue, certain debit card issuer costs, and fraud losses related to debit card transactions in 2011. Notably, the Fed announced that it has no intentions of revisiting a rule which caps debit card interchange fees at 21 cents, citing a finding that 99 percent of covered issuers had average authorizing, clearing and settling costs below 21 cents in 2011, the same proportion as in 2009. The report also found that estimated debit card fraud losses are down from 2009, at $1.38 billion in 2011. The report was immediately seized upon by retailers as "deeply flawed" and in their release they hinted at pursuing legislative or other means to advance their efforts to further lower the cap.

*Volcker Laments Slow Implementation of Dodd-Frank, Obfuscation of Volcker Rule*
On March 4th, former Federal Reserve Chairman Paul Volcker said regulators should not be taking over two years to finalize regulations to implement the Dodd-Frank Act. Volcker, who admitted that the legislation was "complicated," said that the fact that the regulatory framework is still not in place "suggests something wrong or dysfunctional." Volcker also expressed disappointment at efforts that he believes have obscured his namesake rule. Volcker made his comments at the National Association for Business Economics, where he was being awarded with a Lifetime Achievement Award for Economic Policy.

**CFTC**
*Chairman Gensler to Stay at Commission Through December*
Last week, it was reported that the White House has asked Chairman Gary Gensler to serve a second term as head of the agency. Gensler, who has not made a decision as to whether he will remain for a second term, has said he will stay with the agency through December as he weighs staying that the Commission. However, top Senate staff and other CFTC Commissioners have said that they believe Gensler will depart the agency at the end of the year and that Gensler has been discussing other positions within the Administration outside of the CFTC. In the meantime, Gensler said he plans to continue to pursue the regulation of derivatives trading. If Gensler were to decide to stay on as Chairman beyond this year he would need to be reconfirmed by the Senate.

## Upcoming Hearings

On Tuesday, March 12th at 10am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Committee will hold a hearing to consider the nominations of: Richard Cordray, to be Director of the Consumer Financial Protection Bureau; and Mary Jo White, to be a member of the Securities and Exchange Commission.

On Wednesday, March 13th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Housing and Insurance will hold a hearing on the competitive advantages the Federal Housing Administration has relative to private mortgage insurers and how those advantages contribute to the crowding out of private capital in housing finance.

On Thursday, March 14th at 9:30am, in G-50 Dirksen, the Joint Economic Committee will hold a hearing titled "Flirting with Disaster: Solving the Federal Debt Crisis."

On Thursday, March 14th at 10am, in 1300 Longworth, the House Agriculture Committee will hold a hearing titled "Examining Legislative Improvements to Title VII of the Dodd-Frank Act."

On Thursday, March 14th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Oversight and Investigations will hold a hearing on the role of the Financial Stability Oversight Council and its role in determining which institutions are "too big to fail."

On Thursday, March 14th at 10am, in 2360 Rayburn, the House Small Business Subcommittee on Investigations, Oversight and Regulations will hold a hearing on regulations and their impacts on small businesses.

On Friday, March 15th, at 9:30am, in 342 Dirksen, the Senate Homeland Security and Government Affairs Permanent Subcommittee on Investigations will hold a hearing titled "JPMorgan Chase Whale Trades: A Case History of Derivatives Risks and Abuses."

On Tuesday, March 19th at 10am, in 2128 Rayburn, the House Financial Services Committee will hold a hearing on the Federal Housing Finance Agency.

On Wednesday, March 20th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit will hold a hearing on how federal regulations affect small financial institutions.

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