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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

March 5, 2012

Leading the Past Week

Despite the full throated defense of the Dodd-Frank Act, it was a challenging week for proponents of America's Financial Regulatory Reform. First, Chairman Bernanke publicly spoke what had been privately whispered for weeks – that the Fed would be unable to finalize the rule in a timely manner – and subtly added that it would take the Fed considerably more time than the law's July deadline. Then, CFTC Chairman Gensler appeared before the House Agriculture Committee to discuss the agency's 2012 agenda, where in addition trying to appease those in Congress who equate rising gas prices with oil speculation, he also continued to take bruising questions about the Commission's implementation of Dodd-Frank, while at the same time his fellow Commissioner Scott O'Malia took the unprecedented step of urging the OMB to conduct more stringent cost-benefit analysis of the Commission's Dodd-Frank rulemakings.

However, in addition to relitigating the past, Congress continues to press forward on a variety of issues. Despite the very real concerns that the relationship between the White House and House Republicans has deteriorated beyond repair, we will see this week a bill, that among other things will ease restrictions on start-ups seeking to raise capital funding, come to the floor that has the support of House Republicans and (at least sections of it) the White House. In addition, it is clear that the White House and Congress are laying the ground work for comprehensive tax reform, as Secretary Geithner visited the Hill for an off-the-record meeting with the top tax legislators. Whether this reform is enacted this year (less likely) or in 2013 (more likely), the foundation for this effort is beginning to be laid now.

Legislative Branch

House of Representatives

House GOP Introduces Package of Small Business Capital Access Bills:

On February 28th, the House Republicans announced they will introduce the Jumpstart Our Business Startups (JOBS) Act, a package of six bills designed to increase small business access to capital. The package includes Representative Ben Quayle's (R-AZ) Capital Expansion Act (H.R. 4088) which would raise the SEC shareholder registration threshold from 500 to 2,000 and increase the deregistration threshold from 300 to 1,200 shareholders. Similarly, the package includes Representative David Schweikert's (R-AZ) H.R. 2167, the Private Company Flexibility and Growth Act, which would raise the SEC threshold from 500 shareholders to 1,000, but does not address deregistration. The package also includes: the Access to Capital for Job Creators Act (H.R. 2940); the Entrepreneur Access to Capital Act (H.R. 2930); the Small Company Capital Formation Act of 2011 (H.R. 1070); and Reopening American Capital Markets to Emerging Growth Companies Act of 2011 (H.R. 3606).

The package of bills is similar to measures sent to Congress by the Obama Administration, prompting a rare moment of agreement between House Majority Leader Eric Cantor (R-AZ) and the White House. In response to the JOBS Act, the White House said "the President is encouraged to see that there is common ground between his approach and what Congressman Cantor outlined today." As three of the bills included in the JOBS Act have already passed the House by large margins and two bills already having been cleared by the House Financial Services Committee, the unveiling is being derisively referred to by House Minority Whip Hoyer as the "Just Old Bills" package.

House Agriculture Grills Gensler on 2012 CFTC Agenda with a Special Focus on How the CFTC Intends to Deal with Congressional Concerns about Speculation:

At the February 29th House Agriculture hearing to examine the CFTC's 2012 agenda, Chairman Gensler took a beating from lawmakers as rising gas prices triggered a backlash against speculators. In response to questioning from Representative Joe Courtney (D-CT) on the prevalence of $4 gas prices and the need for the CFTC to provide relief, Gensler said that the position limit rule—voted on last October—cannot take effect until the agency and the SEC can jointly agree on the definition for swaps and until the CFTC collects one year of market data to calibrate limits. Representative Jeff Fortenberry (R-NE) also pressed Gensler on speculation, asking if position limit rules would mitigate prices. Gensler responded that position limits "are one part to ensure the integrity of the market" but also would benefit the public. It is clear that some Democrats are eager to link speculation in the oil markets as a driving factor in the increase in gas prices, because the same day as the hearing, three senior House Democrats—Representatives Barney Frank (D-MA), Ed Markey (D-MA), Henry Waxman (D-CA) and Elijah Cummings (D-MD), respectively the Ranking Members on the Financial Services Committee, the Natural Resources Committee and the Oversight and Government Reform Committee—wrote to Gensler to urge the CFTC to "fully implement" the position limits rule "as quickly as possible." Citing data that the price of gas is a result of speculators taking advantage to "drive oil prices even higher"

Speculation wasn't the only issue where Gensler received the frustration of committee members, as he was also pressed on end-user issues and international regulatory cooperation. Committee

Chairman Frank Lucas (R-OK) questioned Gensler extensively on the status of the end-user community in swaps rulemaking. Gensler stressed that while thousands of end-users will be exempt from swap dealer requirements those end-users that are "making a market" for swaps, such as "the largest integrated oil companies" may fall under swaps rules. Gensler added that the final rule will accommodate end-users that may also be market makers. Additionally, Gensler reinforced a theme that has become common at financial oversight hearings: regulators are coordinating with their international counterparts. Gensler confronted comments that US regulators are acting "unilaterally," saying regulators are actively coordinating with international partners. Another topic of discussion was Gensler's role in the MF Global proceedings and how the CFTC is seeking to strengthen protections for segregated customer funds.

<u>Executive Branch</u>

Federal Reserve

Chairman Ben Bernanke came before Congress as part of his Humphrey-Hawkins obligation and testified before the House Financial Services Committee on February 29th and before the Senate Banking Committee March 1st to discuss the economy and monetary policy. Before both chambers, Bernanke stressed that additional accommodative monetary policy is needed to support the recovery and resist shocks from Europe, the housing market and elsewhere. Bernanke stressed "with the unemployment rate elevated and the inflation outlook subdued, the [Federal Open Market] Committee judges that sustaining a highly accommodative stance for monetary policy is consistent with promoting" the Fed's twin responsibilities of unemployment and inflation. Notably, the Chairman also encouraged Congress to do more to shore up the economy, as the Fed's are limited.

Bernanke also addressed attempts to limit risk in money market mutual funds, on which the SEC is expected to propose reforms soon. Bernanke, while he did not specifically endorse one method, indicated he favored capital buffers and limits on redemptions rather than moving to a floating net asset value (NAV). The Chairman also touched on the Volcker Rule, telling lawmakers that it is unlikely the Fed will finalize the rule to meet the July effective date for the proprietary trading ban. When asked about the potential impacts of the delay, Bernanke told lawmakers that the Fed would "certainly make sure that firms have all the time they need to respond," continuing in reference to the two-year phase in period, "and I think two years will probably be adequate in that respect."

Finally, with regard to America's fiscal policy, Bernanke stressed that lawmakers should seek to eliminate the primary deficit, the deficit not counting interest payments, within ten to fifteen years. Echoing comments made to the House, Bernanke told the Senate panel that "once you eliminate the primary deficit so that current spending and current revenues are equal, that means the ratio of your debt to GDP will stabilize." In doing so, he urged lawmakers should look beyond the ten year time horizon, to plan for costly entitlement programs, and avoid immediate fiscal cuts so as not to undermine recovery efforts.

CFPB

CFPB Begins Complaint Collection on Bank Account Issues:

On March 1st, the CFPB starting accepting complaints from consumers concerning bank checking and saving accounts—products already under the Bureau's supervision and enforcement purview. This represents the beginning of the third phase of the Bureau's complaint program which began taking complaints on credits cards in July and complaints about mortgages and home loans in December. Specifically, complaints will be centered on five aspects of bank accounts: account opening, closing and management; deposits and withdrawals; debit and ATM cards; money transmitting; and problems related to low account funds. No complaints in this area have been collected yet, but the CFPB has noted concern with the rise in usage fees attached to many of these products.

The Bureau's complaint systems manual sets the expectation that banks respond to complaints within 15 days with the goal of closing all complaints within 60 days. Complaints that remain unresolved are open to enforcement action and complaints that go untouched for 30 days or complaints that remain "in progress" for over 60 days are likely to be subject to investigations. The Consumer Response System has already seen a large, positive response collecting more than 20,000 complaints, including approximately 7,000 concerning mortgaged and approximately 12,000 concerning credit cards.

Treasury

Geithner Meets with Tax Legislators to Open Discussions on Corporate Reform:

On March 1st, Treasury Secretary Timothy Geithner met privately with top tax legislators, including House Ways and Means Committee Chair and Ranking Member Dave Camp (R-MI) and Sander Levin (D-MI) and Senate Finance Committee Chair and Ranking Member Max Baucus (D-MT) and Orrin Hatch (R-UT). According to published reports, while both sides pushed Geithner for more details of the Administration's corporate tax plan, no specifics were provided. It sounds like this was more of a preliminary discussion, and that this group will continue to meet in the coming weeks, which is a good thing, because there are already several issues of contention that have already emerged which may become topics of discussion. For example, the Administration's framework provides for a "worldwide" system of taxation but Chairman Camp's proposal would overhaul the system into a territorial system and drop the tax rate to 25 percent. (See below for more on this difference). Administration officials maintain that a 25 percent corporate rate is unattainable unless coupled with extreme cuts to popular programs or without reforms outside of the corporate tax system. Another possible sticking point is the Administration's proposed minimum tax on foreign business earnings. While lawmakers and business have expressed concern over the new tax, the Treasury has described the tax as a means of balancing "the need to stop rewarding tax havens and to prevent a race to the bottom with the goal of keeping U.S. companies on a level playing field with competitors when engaged in activities which, by necessity, must occur in a foreign country."

Treasury Warns Against Territorial Tax System:

On February 27th, Department of Treasury Tax Legislative Counsel, Liza Zarlenga, said that the Obama Administration believes a move to a territorial tax system could increase the motivation for companies to move operations overseas. The framework proposed by the Obama Administration confronts this challenge with a "hybrid" approach said Zarlenga which is designed to tax overseas earnings and maintain the system of worldwide taxation. The framework is designed to present a "logical place to start" a discussion in Congress while leaving room for negotiation.

The Administration's tax framework makes recommendations in five major ways: 1) reducing the corporate tax rate from 35 percent to 28 percent; 2) strengthening manufacturing; 3) strengthening foreign tax systems; 4) streamlining, simplifying and reducing small business taxes; and 5) increasing tax fairness while not adding to the deficit.

Fannie Mae to Request Additional $4.6 billion from Treasury:
In a continued display of the dysfunctional federal housing finance system, Fannie Mae announced that is requesting an additional $4.6 billion from the Treasury following losses of $2.4 billion last quarter. Fannie Mae said the last quarter's loss resulted from loans originated before 2009, falling interest rates and weakening property prices. Fannie Mae's request will bring the total received from Treasury to $116 billion, $20 billion of which is owed to taxpayers as a dividend of its government bailout.

The request puts additional pressure on efforts to reform these government sponsored entities (GSEs) and their regulator, the Federal Housing Finance Agency (FHFA). (See section below for more on FHFA) The Obama Administration has proposed allowing Fannie and Freddie to reduce the mortgage principal hoping to decrease delinquency rates and raise the housing prices. Still, Republicans fear that decreasing borrowers' principal will only serve to increase losses at the GSEs, deepening the taxpayers' contribution to shore up the housing market.

SEC

Gallagher Urges Caution and Restraint in Implementing Dodd-Frank:
In a speech before the Credit Suisse Global Equity Trading Forum, on February 17th, SEC Commissioner Daniel Gallagher warned that certainty resulting from finalizing Dodd-Frank Rules "should not come at the cost of hasty and ill-conceived regulatory initiatives." Gallagher focused on the costs that the reform legislation will impose on market participants and the industry and the uncertain nature of the scope of the "reconfiguration" of the markets. He continued saying this puts regulators "in a difficult position, because the markets and the public need regulatory guidance and certainty, but that certainty can and should not come at the cost of hasty and ill-considered regulatory initiatives that will damage the real economy that Dodd-Frank ostensibly is designed to protect." Still, Gallagher said that if regulators meet their responsibilities properly, they can ensure that rules, such as the Volcker Rule, meet "the aims of Congress without destroying critically important market activity explicitly contemplated by the statute."

CFTC

Federal Judge Denies Request for Preliminary Injunction to Halt Position Limits Rule While Case is pending:
On February 27th, a federal judge declined a request for a preliminary injunction to stop implementation of the CFTC's position limits rule to curb excessive speculation. However, the judge, Robert Wilkins, indicated he intends to rule quickly on whether to temporally halt the CFTC's implementation of rules to curb excessive speculation across 28-comodities, including oil and gas. Wilkins expressed the concern that Congress could direct the CFTC to impose position limits on commodities without detailed study or cost benefit considerations. However, no matter Wilkins final decision on the fate of the position limits rule, it is likely the ruling will be appealed to the U.S. Court of Appeals for the District of Colombia. Even as signs point to a contentious rode ahead for the position limits rule, oil and gas prices continue to rise across the country.

O'Malia Presses for OMB Review of Swaps Regulation:
In a letter to acting OMB Director Jeffrey Zients, CFTC Commissioner Scott O'Malia requested that the OMB conduct a thorough cost-benefit analysis before adopting swaps rules. The letter charges that the CFTC "failed to carefully and precisely identify a clear baseline against which [it] measured costs and benefits and the range of alternatives under consideration in this rule. The letter expands on O'Malia's dissent to the business conduct rules for swap dealers and major swap participants. "I have reached a tipping point and can no longer tolerate the application of such weak standards to analyzing the costs and benefits of our rulemakings," wrote O'Malia, continuing that the CFTC's "inability to develop a quantitative analysis, or to develop a reasonable comparative analysis of legitimate options, hurts the credibility of this Commission and undermines the quality of our rules."

FHA

FHA Officials Hopeful that Insurance Increases will Keep Fund Solvent Through 2013:
On February 28th, Housing and Urban Development (HUD) Secretary Shaun Donovan told members of the Senate Banking Committee that Federal Housing Administration (FHA) will not know until the end of 2013 if increasing its upfront and annuals fees for borrowers will be able to restore the FHA's capital reserves to acceptable levels. A November independent audit of the agency's Mutual Mortgage Insurance Fund found that fund's capital reserve ratio was at .24 percent—far below the mandated level of 2 percent. The mortgage insurance premiums are set to increase on April 1st with annual fees increasing by 120 basis points and charges to borrowers rising from 1 percent of loan value to 1.75 percent. Donovan said he expects this increased capital collection will keep the fund solvent through FY 2013 assuming loan performance is maintained. Should the agency require additional capital to shore up the fund, the FHA has room to further increase annual premiums and the House Financial Services Committee is expected to consider draft legislation this month to allow increases in premiums of up to 2 percent.

International

Euro zone – Greek Bailout Package in Doubt – Bondholders pressured to Acquiesce to "Haircuts" of 75% or more:

Efforts to put the Greek, and potentially the entire Euro zone credit crisis to bed were delayed last week following demands that Greece offer additional evidence it will institute significant spending cuts and reforms. As a result, Euro zone members delayed over half of the €130 billion bailout package, pending a "detailed assessment" by the European Union and IMF on 38 specific issues by the end of this week. In the announcement, European officials stressed that the decisions to withhold funds were not political but rather "technical" such as the €300 million budget gap resulting from unemployment benefit restructuring. Notably, the ultimate deal will not trigger the payout of credit default swaps according to the International Swaps and Derivatives Association, but it will not be consummated until after Greek credit holders sign off on a debt swap plan that has them incur a "wicked large haircut."

UPCOMING HEARINGS

On Monday, March 5th at 3pm, in 2359 Rayburn, the House Appropriations Subcommittee on Financial Services and General Government will hold a hearing on proposed fiscal 2013 appropriations for the Federal Trade Commission.

On Monday, March 5th at 4pm, in 2141 Rayburn, the House Judiciary Subcommittee on Courts, Commercial and Administrative Law will hold a hearing on the Security in Bonding Act of 2011.

On Tuesday, March 6th at 10am, in 2359 Rayburn, the House Appropriations Subcommittee on Financial Services and General Government will hold a hearing on proposed fiscal 2013 appropriations at the Securities and Exchange Commission.

On Tuesday, March 6th at 10am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Committee will hold a hearing titled "Spurring Job Growth through Capital Formation While Protecting Investors."

On Tuesday, March 6th at 10am, in 215 Dirksen, the Senate Finance Committee will hold a hearing titled "Tax Reform Options: Incentives for Capital Investment and Manufacturing."

On Tuesday, March 6th at 2pm, in 2128 Rayburn, the House Financial Services Committee will meet to consider its "Views and Estimates" report that will be forwarded to the House Budget Committee for use in drafting the 2013 concurrent budget resolution.

On Wednesday, March 7th at 2pm, in 2359 Rayburn, the House Appropriations Subcommittee on Financial Services and General Government will hold a hearing on proposed fiscal 2013 appropriations at the Department of Treasury: Office of the Inspector General.

On Wednesday, March 7th at 9:30am, in 2128 Rayburn, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing on the operations of the Securities Investor Protection Corporation (SIPC).

On Wednesday, March 7th at 2pm, in 562 Dirksen, the Senate Special Aging Committee will hold a hearing titled "Opportunities for Savings: Removing Obstacles for Small Business."