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## FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

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### Leading the Past Week

This past week marked the beginning of Presidential politics inserting itself into Congressional legislating as Mitt Romney's statement about the need to hold down student interest rates certainly played a large role in the House vote on Friday. We also watched how Congress and the Administration debate amongst themselves in implementing the Dodd-Frank Reforms, first as the House overwhelmingly passed a bill to "clarify" as-to-yet unfinalized rules on swap dealers, and then the regulatory back and forth about the scope of the Volcker rule saw its latest chapter, with 22 Senate Democrats writing the regulators to "fully implement" the law. In other news, there was yet another example of the US Government getting involved in the nascent, yet burgeoning field of mobile payments as the FTC held a daylong conference to bring various stakeholders together to address the myriad of issues facing companies, consumers and regulators.

### Legislative Branch

#### **Senate**

*Back and Forth on Volcker Regulations Continue as Senate Democrats Urge Banking Regulators to Fully Implement Rule:*

On April 26<sup>th</sup>, twenty-two Senate Democrats called on federal banking regulators to implement the Volcker Rule. In a letter led by Senators Jeff Merkley (D-OR) and Carl Levin (D-MI) lawmakers urged regulators to "fully implement a clear, strong, and effective Volcker Rule without delay." Lawmakers indicated that the rule is not perfect but that regulators should "adopt the best elements from the proposed rule; eliminate loopholes; draw clear lines based on objective data and observable markets; strengthen CEO and board-level accountability and public disclosure; and provide coordinated and consistent enforcement, including data sharing by regulators." The letter put forth this 'summer' as an ideal timeline for a finalized rule.

The letter and the underlying concerns are expected to begin a period of scrutiny on what constitute “good-faith planning efforts” by firms soon to be affected by the proprietary trading ban and how banking firms will use the two-year conformance period. According to some analysts the “good-faith” efforts can take two forms: 1) use of the conforming period to transition into Volcker compliance or 2) delaying compliance by two years. A delay of compliance efforts could significantly impact the implementation of the rule—especially if the two year conforming period is met with a court challenge further delaying the rule, and a future Congress, or President is less supportive.

*S Corps. Targeted as “Pay For” to stop Unpopular Student Loan Interest Rate Hike:*

Once again dueling “pay-fors” threaten to derail an otherwise popular bipartisan agreement on how to prevent the interest rate on federal student loans from doubling in June. On one side are the Senate Democrats and the White House, who want to payfor the bill by closing a loophole on certain S Corporations, specifically those with less than three shareholders who declare an income of \$250,000 or greater per year, in order to make those S Corps. pay employment taxes. On the other side of the debate are House Republicans who intend to offset the freeze with money from the Prevention and Public Health Fund or, “slush fund,” in the 2010 health care reform law. The House passed its version of the bill on Friday, and the Senate has yet to act, though both sides will use the recess period to paint the other as unreasonable in hope to get someone to “blink.”

*Senate Banking Committee Seeks Policy Lessons from Collapse of MF Global:*

On April 24<sup>th</sup>, the Senate Banking Committee heard testimony from Louis Freeh, bankruptcy trustee for MF Global, in a hearing examining lessons learned and policy implications of the MF Global collapse. Freeh sought to assure lawmakers that MF Global executives will not receive bonuses—especially in light of the \$1.6 billion still missing and owed to customers. The Committee also heard testimony from Robert W. Cook, Director of Trading and Markets at the SEC; Richard G. Ketchum, head of the Financial Industry Regulatory Authority (FINRA); Terrence A. Duffy, Chairman of the CME Group; and CFTC Commissioner Jill E. Sommers. Lawmaker at the hearing—in a departure from previous MF Global hearings—did not focus on past wrongs but rather sought to extract policy lessons and best practices from the bankruptcy. Among proposals put forth by witnesses was the idea of creating an insurance fund to cover commodities customer losses.

*Senate Finance Committee Examines Tax Reform Options and Impact on State and Local Governments:*

On April 25<sup>th</sup>, the Senate Finance Committee met to consider potential tax reform policies and the potential effects these federal policies could have on state and local fiscal policy and tax collection and revenues. Lawmakers discussed the potential need to overhaul tax treatment of municipal bonds, treatment of itemized deductions and the Alternative Minimum Tax (AMT) and the need for internet companies to collect sales taxes. Policy prescriptions in these areas included a uniform subsidy for bondholders, increasing AMT exemption levels and moving ahead with the Marketplace Fairness Act (S. 1832) which would require out-of-state internet retailers to collect sales taxes. Witnesses generally approved of any proposals that would create more horizontal coordination in the tax system, preserve state and local self-determination and

simplify the tax system, though there were concerns expressed about compliance burdens – particularly for smaller remote sellers. Witnesses also cautioned lawmakers not to do away with tax-exemptions for bondholders. Chairman Baucus cited Build America Bonds (BABs) as an alternative to tax breaks.

*Senate Banking Considers Refinancing Options for Homeowners:*

On April 25<sup>th</sup>, the Senate Banking Subcommittee on Housing, Transportation, and Community Development met to hear testimony on ways in which to aid homeowners in refinancing their homes. The subject of the hearing was a draft bill, the Helping Responsible Homeowners Save Money Through Refinancing Act which would allow borrowers with Fannie Mae and Freddie Mac backed loans refinance more easily so as to take advantage of low interest rates. The Federal Housing Finance Agency (FHFA) has been resistant to such changes, citing concerns that they have a duty to ‘preserve’ and ‘conserve’ their portfolios to avoid risk and loss to taxpayers. A witness at the hearing refuted this fear, citing a CBO study finding that for every 1,000 refinanced homes, there are 38 fewer defaults on Fannie and Freddie held loans—this could save GSEs an estimated \$24 billion depending on the number of refinancing under the bill.

## **House of Representatives**

*House Passes Bill to Exempt CFTC-Regulated Firms from Swaps Rules:*

On April 25<sup>th</sup>, the House passed H.R. 3336, the Small Business Credit Availability Act, by a vote of 312 to 111. The bill would exempt certain financial institutions that are regulated by the CFTC from being termed swap dealers or major swap participants under the Dodd-Frank Act, thereby avoiding the highest capital and collateral requirements. The bill exempts US branches of foreign banks from being termed swap dealers so long as they have swaps with customers that manage risk. While the CFTC is preparing an end-user exemption, the bill would also exempt small banks, credit unions and farm credit institutions from clearing requirements. Similarly, small banks and other institutions with less than \$1 billion in swap exposure would be excluded from the definition of a “financial entity.”

It is unclear whether this measure will be included in any technical corrections bill that the Senate may eventually consider—especially as advocacy groups have already spoke out against the measure. Bartlett Naylor, financial advocate for Public Citizen’s Congress Watch Division, warned that the bill would allow large banks to escape oversight, as the \$1 billion in aggregate swap exposure exemption translated to \$200 billion in notional value.

Meanwhile, across the pond, the European Commission is calling for the US to delay its implementation of swaps regulations. A recent letter sent to the Treasury Department, the SEC and the CFTC by Internal Market Commissioner Michel Barnier outlined fears that swap dealer registration rules for EU firms lack legal clarity in regards to what firms are required to do under new EU rules. In addition, the Institute of International Bankers has [commented](#) to the CFTC that it should consider “exemptive relief for investment firms and market operators based in jurisdictions with equivalent regulatory regimes.”

*House Democrats File Amicus Brief Supporting CFTC Position Limits Rule:*

Last week, seventeen House Democrats filed an amicus curiae brief with the US District Court for the District of Columbia supporting the CFTC position limits rule and underscoring that position limits for futures and derivatives contracts are the intent of Congress. The brief was filed the same day as 19 Senators—18 Democrats and independent Senator Bernie Sanders (R-VT) — filed a brief arguing that position limits are mandated by Congress.

*House Financial Services Members Introduces Bill to Promote Effective Investment Adviser Oversight:*

On April 25<sup>th</sup>, Chairman Spencer Bachus (R-AL) and Representative Carolyn McCarthy (D-NY) introduced the Investment Adviser Oversight Act of 2012 (H.R. 4624), a bill to shore up oversight of investment advisers through the creation of one or more self-regulatory organizations (SROs) to be funded by membership fees. The legislation amends the Investment Advisers Act of 1940 to provide for the creation of National Investment Adviser Associations (NIAAs) that must register with and be overseen by the SEC. The proposal gives the SEC the power to determine if the NIAA has the capacity to carry out its responsibilities and the power to suspend or revoke the NIAA's registration. On the same day, the Committee grilled SEC Chairman Mary Schapiro, who told lawmakers that, "at a time when there are extremely limited resources in the federal government, the need to leverage an SRO is critical."

*House Budget Hearing on Avoiding the Sequester:*

On April 25<sup>th</sup>, the House Budget Committee met to consider options to replace the budget sequester. Overall, lawmakers agreed that sequestration would hollow out U.S. national defense, limit investments in domestic discretionary spending priorities, and eliminate government services. The committee did not identify a clear path forward for avoiding the sequester, but the discussion entailed considerations of the President's budget proposal, as well as the House Republican and Democratic alternatives.

Executive Branch

**Federal Reserve**

*FOMC Statement Sees Economy Gradually Recovering:*

In a statement following the Federal Open Market Committee's two day meeting last week, Federal Reserve officials said they expect continued slow growth that will gradually accelerate, citing improved labor market conditions, the declining unemployment rate and increased household spending and business investment. As such, the Fed will refrain from additional steps to boost economic growth while maintaining the target range for federal funds at zero to 0.25 percent. Despite encouraging signs, the FOMC statement cautioned that the housing sector remains depressed, "strains in global financial markets continue to pose significant downside risks to the economic outlook" and inflation has somewhat increased—reflecting higher prices of crude oil and gas.

**CFTC**

*CFTC Could Delay Swaps Rulemaking through End of Year:*

On April 23<sup>rd</sup>, Bloomberg reported that 'a person briefed on the matter' said the CFTC may delay voting on some Dodd-Frank derivatives regulations until as late as the end of 2012. The

delay would provide temporary relief from swaps provisions that are scheduled to take effect July 16<sup>th</sup>. According to the source, Commissioners are preparing to complete regulations governing capital and margin requirements for non-cleared trades and on the international reach of regulations. The CFTC may decide to limit the reach of swaps rulemaking to provide more time for US regulators the comparability of overseas regulations.

## **SEC**

*Chairman Schapiro Testifies before House Financial Services Subcommittee:*

On April 25<sup>th</sup>, Chairman of the SEC Mary Schapiro appeared before the Capital Markets and Government Sponsored Enterprises Subcommittee in a hearing to conduct oversight of the Commission. Schapiro was confronted with defending SEC proposals to reform money market mutual funds, and encountered vocal bipartisan objection to the SEC's potential changes. In addition to Republicans attacking the plan, Representative Gwen Moore (D-WI) expressed particular concern about the possibility of moving floating-NAV, predicting that municipalities, which rely on MMFs, would no longer be able to utilize the product under a floating NAV, and Representative Stephen Lynch (D-MA) follow-up on Moore's concerns, cautioning that approximately 57 percent of short-term municipal debt is held in short-term MMFs.

Schapiro also faced criticism of the SEC's final rule to define municipal advisers, which would require that the advisers register with the SEC. In response to Representative Robert Dold's (R-IL) questions on the proposal, Schapiro said the SEC is working to tighten the definition of "investment strategies" and whether "traditional banking and trust activities," which are "otherwise regulated," need to be encompassed by the rule. Notably, Dold has introduced H.R. 2827, a bill to scale back the scope of the municipal adviser definition. The bill is pending before subcommittee with 32 cosponsors.

## **CFPB**

*CFPB Looking into Forced Arbitration:*

As part of a report required by the Dodd-Frank Act, on April 24<sup>th</sup>, the CFPB [announced](#) the launch of a study into how mandatory arbitration clauses baked into agreements for credit cards and other financial products affects consumers. The Bureau has yet to lay out a timeline for the study; however, comments will be accepted through June 23<sup>rd</sup>. The CFPB is not seeking comment on whether and how it should use its rulemaking authority in this area, but rather seeks comments on the prevalence of arbitration clauses and the types of consumer claims that result in disputes. The notice also asks for comment on what specific products the Bureau should focus on and if there are any preexisting studies or data that would contribute to the Bureau's study. Consumer groups were quick to laud the CFPB's announcement.

Meanwhile, Congress has also taken up the issues of forced arbitration in response to recent court rulings in this area. Senator Al Franken (D-MN) introduced the Arbitration Fairness Act of 2011 (S. 987) to eliminate forced arbitration as it relates to employment, customer and civil rights cases. Companion legislation (H.R. 1873) has been offered in the House by Representative Hank Johnson. Neither bill has been considered by committee nor are they likely to proceed in this Congress.

*ABA Suggests Changes to CFPB SBREFA Process:*

On April 25<sup>th</sup>, the American Bankers Association wrote to Richard Cordray, Director of the CFPB, Cass Sunstein, OIRA Administrator, and Winslow Sargeant, Chief Counsel for SBA's Office of Advocacy, suggesting improvements to the Small Business Regulatory Enforcement Fairness Act (SBREFA) review process. The [letter](#) expressed concern that the relatively short period of time given to Small Entity Representatives (SER) selection, preparation and participation undermines the goal of the panel process which seeks to gather information, increase collaboration and consensus with the goal of less burdensome regulations. Additionally, the ABA encouraged the CFPB to collect and make available to SERs third-party service provider information about costs.

## **FDIC**

*FDIC Projecting \$12 Billion in Bank Failures over Next Five Years:*

On April 23<sup>rd</sup>, the FDIC released a [memo](#), updating the outlook for the Deposit Insurance Fund (DIF). The FDIC estimates that between 2012 and 2016, bank failures will cost the DIF \$12 billion. This is down from last October, when the FDIC projected the cost to the DIF for years 2011 to 2015 to be \$19 billion. During the height of the crisis (2008-2011) estimated losses through bank failures was \$88 billion. However, the number of bank closings is trending down and the FDIC is predicting between 50 and 60 failures for 2012—down from the closings of 92 banks in 2011 and 157 in 2010.

Following a low point of negative \$20.9 billion at the end of 2009, the balance of the DIF has increased for eight straight quarters, and is currently valued at \$11.8 billion. This remains below the required reserve ratio of 1.15 percent of insured deposits—as of the end of 2011, the reserve ratio was 0.17. According the April 23<sup>rd</sup> update the FDIC expects the reserve ration to reach the required level by the second half of 2018. The reserve ratio will need to be strengthened further, as the Dodd-Frank Act requires it to reach 1.35 by September 30<sup>th</sup> 2020.

## **DOL**

*Groups Support DOL Electronic Disclosure Policy:*

On April 19<sup>th</sup>, seven organizations, including the Pension Rights Center and the AFL-CIO, sent a [letter](#) to DOL supporting current policy toward electronic communications with plan participants. The letter stressed that, with millions of workers without access to computers, changing the policy could deny individuals “vitally important information.” The letter goes on to laud DOL for providing “employers and financial institutions with sufficient latitude by allowing them to automatically provide information electronically to those people who work with their employer's computer network as an integral part of their day job.” Recognizing the costs to paper copies, the groups urged DOL to maintain worker choice for those without computer access at work. The letter opposes a March 27<sup>th</sup> letter from 15 retirement industry groups that requested DOL broaden its policy concerning electronic communications. Currently, DOL requires ERISA disclosures only be made electronically to plan participants that work on computers as part of their day-to-day work activities as well as those participants that consent to electronic disclosures.

## **HUD**

### *Administration admits GSE Reform is Stalled:*

On April 26<sup>th</sup>, HUD Secretary Shaun Donovan told the Senate Banking Committee that he does not “at this point have a specific timetable nor legislation [on GSE reform] completed to submit to Congress.” With the 2012 elections, few experts expect housing reform to begin this year and Chairman Johnson (D-SD) and most Senate Democrats are advocating for a slower approach. Despite the fact that the Administration doesn’t seem prepared to submit legislation, there are proposals floating in Congress—particularly on the House side. Representatives John Campbell (R-CA) and Gary Peters (D-MI) have proposed the Housing Finance Reform Act of 2011 (H.R. 1859) which would replace the GSEs with several smaller “housing finance guarantee associations” funded by private capital. Representatives Gary Miller (R-CA) and Carolyn McCarthy has offered the Secondary Market Facility for Residential Mortgages Act of 2011 (H.R. 2413) which would create an explicit government role by merging Fannie and Freddie into a single, government operated mortgage financing entity. Several Republicans, including Representative Scott Garrett (R-NJ), have offered opposing legislation that would reestablish mortgage securitization markets sans government guarantee. Despite this, it would seem unlikely that any of the bills will move this Congress.

## **FTC**

### *FTC Panels Evaluate Mobile Payments:*

In another sign that the US Government is getting serious about dealing with the nascent, yet burgeoning industry of mobile payments, the FTC hosted a series of panels with key stakeholders on April 26<sup>th</sup> to explore the use of mobile payment applications and their impact on consumers and businesses. The opportunities discussed on the first panel for consumers including have access to up-to-date information about account balances and spending habits, as well as access to custom-tailored loyalty rewards programs. The benefits for merchants comes from the ability to accept credit card payments – particularly micro-merchants, collect data on the spending habits of their consumers, and (perhaps in the future) to implement dynamic pricing. Panelists suggested that the industry still needs to convince consumers to trust mobile payment platforms and their security features so as to adopt the services.

The second panel addressed the “Legal Landscape and Dispute Resolution” mechanisms. The representatives agreed that consumers retain the protections otherwise extended to them by credit card companies, their banks, and other institutions when using their mobile phone to make a purchase. Still, some panelists questioned whether consumers would be confused by the additional layers of intermediary companies when seeking to dispute a payment. Other questions centered on the direct (telephone) carrier billing, and its relative lack of transaction oversight. The third panel addressed “Fraud Mitigation and Data Security.” The panelists largely agreed that mobile payment is more secure than conventional forms, with various PIN and other technologies present that are not found when ordinarily swiping a credit card – or storing that card in a leather wallet. Still, the panelists suggested that there is room to improve, as the myriad of start-up companies have not all adopted the best security practices of more established firms. Even so, panelists agreed that the best security system can always be undone by consumers who

enter their secure information into the wrong website or otherwise improperly distribute their secure information.

The fourth panel addressed privacy issues. The panelists disagreed about the privacy approach that should be taken for mobile payment. Some argued fervently for an opt-in provision across all transactions, while others suggested that simple transparency in the use of data would be sufficient. There was consensus that trust is fundamental to the development of the space, but there were again differences into the development of that trust. Some suggested that trust stems from consumers and the businesses having information about one another, while others countered that it is based on a right to anonymity during every transaction. All panelists agreed that data use by unrelated third parties should be restricted.

If you would be interested in a more robust summary of this hearing, please contact me via email.

### UPCOMING HEARINGS

*The House and Senate are in Recess this Week but the House Financial Services Committee has released its schedule for May. Unless otherwise noted, all hearings will take place in 2128 Rayburn House Office Building, and please note that this schedule is tentative and could be subject to change.*

May 7 at 9 a.m.

The Capital Markets and Government Sponsored Enterprises Subcommittee will hold a field hearing in Chicago at 9 a.m. local time to review real-estate-owned properties held by GSEs and the Federal Housing Finance Agency's pilot program to rent these properties. The hearing will take place at the Dirksen Federal Building – Room 1903, 219 South Dearborn Street in Chicago.

May 8 at 10 a.m.

The Domestic Monetary Policy and Technology Subcommittee will examine legislative proposals to reform the Federal Reserve System.

May 9 at 10 a.m.

The Financial Institutions and Consumer Credit Subcommittee will examine the impact Dodd-Frank Act regulations are having on small banks' lending and investment activities.

May 9 at 2 p.m.

The Insurance, Housing and Community Opportunity Subcommittee will examine the Home Equity Conversion Mortgage program, the Federal Housing Administration's reverse mortgage insurance program that allows borrowers 62 or older to convert home equity into a monthly income stream, lump sum payment, or line of credit.

May 10 at 10 a.m.



The International Monetary Policy and Trade Subcommittee will hold a hearing on the consequences of requiring Securities and Exchange Commission (SEC) registrants to provide disclosures about the use of minerals from the Congo region.

May 16 at 10 a.m.

The Financial Institutions and Consumer Credit Subcommittee will examine how the Financial Stability Oversight Council (FSOC) intends to exercise its discretionary authority to designate nonbank financial firms as “Systemically Significant Financial Institutions” (SIFIs).

May 16 at 2 p.m. The International Monetary Policy and Trade Subcommittee will hold a hearing to examine the access U.S. financial services firms have to China’s consumer market and what actions the U.S. can take to support firms seeking to do business in China.

May 16 at 2 p.m.

The Oversight and Investigations Subcommittee will hold a hearing on the FDIC’s Structured Transaction Program, which allows the FDIC to extend subsidies to selected private sector institutions that manage and sell distressed commercial and residential real estate. This hearing will take place in Room 2220 Rayburn House Office Building.

May 17 at 10 a.m.

The Financial Services Committee will hold a hearing to examine the policies of Federal financial regulatory agencies when settling claims against defendants that neither admit nor deny wrongdoing in connection with the settlement.

May 17 at 2 p.m.

The Insurance, Housing and Community Opportunity Subcommittee will examine issues affecting the ability of U.S.-domiciled insurance and reinsurance companies to compete internationally and create jobs.

May 18 at 9:30 a.m.

The Financial Institutions and Consumer Credit Subcommittee will hold a hearing on the Dodd-Frank Act’s Collins amendment regarding bank capital requirements.