ML Strategies Update

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**MAY 24, 2013**

# Financial Services Legislative and Regulatory Update

Leading the Past Week

The week began with speculation about the fates of two titans of the Financial Services industry, Jamie Dimon and Robert Cordray. While Dimon easily survived a battle to split his CEO and Chairman responsibilities, Cordray will have to wait to learn his fate. The sudden decision by Leader Reid to delay until July, a vote to confirm Robert Cordray as head of the CFPB may have had more to do with immigration reform and the farm bill than the Memorial Day recess, but Senators and their staffs must have been relieved be able to head to the airplanes to return home for the unofficial start of summer.

## Legislative Branch

### Senate

*Cordray Nomination Delayed Until After Recess*

Last week, Senate Majority Leader Harry Reid announced that the Senate would not, as had been previously planned, vote on the nomination of Richard Cordray to head the CFPB. In comments to reporters, Reid said that while he will make sure all nominees receive votes, the Senate needs to finish the farm bill, and the immigration bill, both of which will need Republican support that may have been jeopardized by a major floor fight on Cordray. However, in addition to Cordray, a group of about 15 nominees, including those nominated to lead the Labor Department, EPA and, National Labor Relations Board, may all be grouped together for one big vote in July. Although Reid did not provide any additional details over whether he would seek to change Senate filibuster rules, it is rumored that they are considering using the so-called "nuclear" or "constitutional" option in order to prevent these nominations from being filibustered.

*Bernanke Provides Joint Economic Committee with Outlook for U.S. Economy*

On May 23rd, Chairman of the Federal Reserve Ben Bernanke testified before the Joint Economic Committee to provide an overview of the outlook for the U.S. Economy. In his testimony, Bernanke continued to defend the Fed's accommodative monetary policy, acknowledging that sustained low interest rates can be problematic but refrained from giving a timeline for decreasing stimulus efforts, saying that the Fed will continue to assess the progress made toward economic stability and growth. While Chairman of the Committee Kevin Brady (R-TX) expressed his concern that quantitative easing (QE) "has run out of steam," Bernanke responded that "premature tightening of monetary policy could lead interest rates to rise temporarily but would also carry a substantial risk of slowing or ending the economic recovery and causing inflation to fall further."

Bernanke's comments come as reports emerged that he met privately earlier in the week with House Oversight and Government Reform Chairman Darrell Issa (R-CA) to discuss a potential exit strategy from stimulus efforts. However, according to minutes from the Federal Open Markets Committee released shortly before the JEC hearing, the FOMC is considering revising plans for unwinding its balance sheet in the face of fears that contractionary fiscal policies and Washington budget cuts could slow the economic recovery. Reflecting this possible policy change, Bernanke suggested that Congress consider backing away from the current approach to cutting the deficit, such as through across the board cuts like the sequester, and instead "reduce the federal deficit more gradually in the near term but more substantially in the longer run." Related to Dodd-Frank implementation, Bernanke said he still has concerns about the 'push-out' provisions which would separate banks' derivatives activities from federally insured divisions and that he would support higher capital levels than required by current Dodd-Frank and Basel

*Lew Testifies for First Time as FSOC Chairman, Hearing Focuses on IRS Scandal*
This week Treasury Secretary Jack Lew testified for the first time before Congress in his role as Chairman of the Financial Stability Oversight Council (FSOC), first before the Senate Banking Committee and then the next day before the House Financial Services Committee where he fielded numerous questions about the ongoing IRS scandal. Before Senate Banking, Lew, responding to questions from Senator Bob Corker (R-TN), Ranking Member Mike Crapo (R-ID), and others told the Committee that he and the President were "outraged" at the inspector general's findings and that there "should be no bias in review of applications." While most of the media covered Lew's response to questions about the IRS scandal, Lew did speak to other issues. For example, he told lawmakers that he believes that for Dodd-Frank rulemakings, the emphasis should be on finalizing regulations in a matter of months, not years.

Lew also noted that in the three meetings of the FSOC under his leadership so far, they have made progress, including on moving forward with orderly liquidation and SIFI designation of non-financial firms. The FSOC also recently identified cybersecurity as a growing risk and Lew told lawmakers that it "would be very helpful to get legislation that would make it even more likely that firms would do the kind of cooperative work that is needed to be as vigilant as we can possibly be." Lew did not endorse any legislation but said that any bill should address risks faced by smaller institutions which lack the resources to stave off attacks. Lew also touched on the Brown-Vitter 'too big to fail' legislation, saying that Basel III is working for many countries and he would be wary of doing away with the Basel capital standards. He also noted that there are "a number of regulatory approaches that would considerably raise the costs of being a large bank." He also waded into the debate over cross-border derivatives rules, saying that the SEC and CFTC have made "real progress" but foreign regulators' vocal opposition to U.S. proposals have been hurting negotiations over how to apply over-the-counter derivatives rules to trades that cut across borders. [Coverage of his appearance before the House Financial Services Committee can be found below.]

*Six Senate Democrats Laud CFTC for Cross-Border Proposal While Chastising SEC*
On May 22nd, six Senate Democrats wrote to the CFTC lauding the agency's proposed guidance

for regulating cross-border derivatives contracts. The letter, which was joined by Senators Sherrod Brown (D-OH), Carl Levin (D-MI), Tom Harkin (D-IA), Elizabeth Warren (D-MA), Jeff Merkley (D-OR), and Dianne Feinstein (D-CA), also criticized the SEC's proposal for being insufficient and requested the CFTC push its guidance as a "model framework" for domestic and foreign regulators.

*Treasury Undersecretary Promises EU Trade Negotiations Will Not Impact Financial Reforms*
At a May 23rd Senate Foreign Relations Committee hearing, Treasury Secretary for International Affairs Lael Brainard told lawmakers that the U.S. will "not give our European counterparts any excuse" to slow walk implementation of financial regulatory reform during negotiations of a new EU trade deal. In response to a line of questioning from Senator Bob Corker (R-TN), Brainard said that issues such as derivatives and the Volcker Rule will be "off the table" and negotiated separately. Brainard's comments come as Senator Elizabeth Warren (D-MA) and other stakeholders express concern that negotiations could serve as a "backdoor" to watering down financial reforms. Other witnesses at the hearing, which focused on economic relations with the EU, included Department of State Under Secretary for Economic Growth, Energy, and the Environment Robert Hormats, German Marshall Fund Senior Transatlantic Fellow Jim Kolbe, and Peterson Institute Visiting Fellow Douglas Rediker.

*Senate Finance Releases Options for Dealing with Retirement Reform*
On Thursday evening the Senate Finance Committee released another in its series of options for consideration in comprehensive tax reform. This one was focused tax reform options for retirement and health care. Among other things, with regard to retirement, the paper explored limiting or eliminating tax preferences for retirement savings, replacing deductions for savings with a single refundable credit, and increasing retirement incentives.

*Obama Nominates Two Senate Aides to be SEC Commissioners*
On Thursday, President Obama nominated two Senate aides — Republican Michael Piwowar and Democrat Kara Stein to serve as commissioners at the SEC. Mr. Piwowar, who currently serves as the Republican's chief economist on the Senate Banking Committee would fill the seat held by Commissioner Troy Paredes, whose term expires on June 5th. Ms. Stein, who previously served as the Staff Director for the Senate Banking Committee Subcommittee on Securities, Insurance, and Investment when it was chaired by Senator Jack Reed, and who still serves as Reed's top financial services counsel would replace Commissioner Elisse Walter, whose term expired last year but can continue at the agency through the end of the year.

**House of Representatives**
*Financial Services Subcommittee Explores CFPB's QM Rule*
On May 21st, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit met to examine the CFPB's qualified mortgage (QM) rule which sets standards mortgage lenders must consider regarding borrowers' ability to repay home loans. The hearing reflected lingering concerns that the proposal would not adequately protect access to credit in rural and underserved areas due to a number of exemptions for smaller community banks. Chairman of the Subcommittee Shelley Moore Capito (R-WV) and Ranking Member Gregory Meeks (D-NY) both expressed concerns with the Bureau's QM rule, with Capito saying that "practical implication of this rule could result in the constriction of mortgage credit for consumers" and Meeks saying he wants to make sure the rule would not be "cutting out opportunities for individuals who want to own a home." In addition, several lawmakers noted concern that the definition of "rural" is overly narrow. Witnesses from the CFPB defended the rulemaking; Assistant CFPB Director for Mortgage Markets Peter Carroll saying that the Bureau

has already "significantly expanded" these definitions and made other adjustments "for small creditors to continue making responsible balloon loans." Assistant Director for Regulations Kelly Cochran also told lawmakers that, though it was limited by the January 2013 statutory deadline, the Bureau had proposed a rule which adequately balances the considerations of lenders, borrowers, and market safety. Witness testimonies can be found here.

*House Agriculture Hears from Industry Stakeholders on CFTC Swaps Authority*
On May 21st, the House Agriculture Committee held a hearing to hear industry perspectives on the future of the CFTC. Witnesses included: Terrence Duffy, Executive Chairman and President of CME Group; Jeffrey Sprecher, Chairman and CEO of Intercontinental Exchange; Daniel Roth, President and CEO of the National Futures Association, Walter Lukken, President and CEO of the Futures Industry Association; Stephen O'Connor, Chairman of the International Swaps and Derivatives Association; and William Dunaway, CFO of INTL FCStone, Inc. These industry representatives argued, among other things, that the CFTC must take additional steps to ensure that Dodd-Frank rules are harmonized with those of foreign counterparts. Sprecher told lawmakers that it is crucial the CFTC understand that "substantial differences exist between regulatory regimes" and that these differences will damage market participants. Witnesses also touched on the importance of protecting customer funds in light of the recent failures of Peregrine Financial Group and MF Global. Witness testimonies can be found here.

*House Subcommittee Examines Impact of Dodd-Frank Conflict Minerals Rules*
On May 21st, the House Financial Services Subcommittee on Monetary Policy and Trade met to consider the implications of Dodd-Frank Section 1502, which directs the SEC to draft rules requiring companies to disclose their use of minerals that originated in the Democratic Republic of the Congo (DRC). The conflict minerals provision in the financial reforms was intended to end the use of such minerals in the U.S. supply chain in an effort to dry up demand and decrease the violence between warring factions in the DRC for control of minerals. Witnesses told lawmakers that the de facto embargo has impacted the DRC's economy, proved burdensome to American companies, and increased violence. For the most part, witnesses asserted that the SEC is not the appropriate agency to enforce this law and that Dodd-Frank is not the appropriate venue for human rights battles. Witness testimonies can be viewed here.

*House Subcommittee Grills DOJ on "Too Big to Jail"*
On May 22nd, the House Financial Services Subcommittee on Oversight and Investigations met to hear testimony from the Justice Department (DOJ) on whether large financial institutions are "too big to jail." One key topic of discussion at the hearing was whether the Justice Department relies on outside experts to gauge the consequences of prosecuting financial crimes by large financial institutions. In particular, Ranking Member of the full Committee Maxine Waters (D-CA) criticized DOJ for not jailing bank executives and pressed DOJ Acting Assistant Attorney General for its Criminal Division Mythili Raman on why banks only seem to receive "a slap on the wrist." Raman responded that banks themselves cannot go to jail, only the officers and employees. However, she did point to a number of monetary penalties levied over the years as well as prosecution of "innumerable money laundering cases." Raman also stressed, in response to questions from Chairman of the Subcommittee Patrick McHenry (R-NC), that complexity comes with the size of these institutions, but "complexities do not equal immunity."

*Lew Provides Overview of FSOC Annual Report to House*
On May 22nd, Treasury Secretary Lew reprised his appearance before the Senate Banking Committee earlier in the week, testifying before the House Financial Services Committee on the FSOC's annual report. Lew, repeating his testimony from the Senate panel, outlined for

lawmakers positive signs of growth, including increased bank capital and liquidity and strengthening equity and housing markets, and continued risks to financial stability, such as the need for housing reform, the need for government action to address financial firms internal controls and cyber operations, and LIBOR reforms. Lew also touched on the importance implementing the Volcker Rule in the "right way" and sought to remind lawmakers of their "responsibility" to raise the debt limit. In his opening statement, Chairman Jeb Hensarling set the tone for a hearing which focused largely on recent scandals, saying regulators who failed to stop the financial crisis have been put in charge of stopping the next crisis, and pointing to the IRS as continued evidence of lack of regulatory accountability. In response to harsh questioning around the IRS scandal, Lew reiterated his earlier statements on the controversy, saying he was told of on May 15th that an IG report was being conducted and the findings were "troubling."

*House Financial Services Subcommittee Hears Testimony on Four "Red Tape" Cutting Proposals*

On May 23rd, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises held a hearing to consider legislation that would address the "red tape burden on investors and job creators." Industry witnesses representing the Chamber of Commerce, Small Business Investor Alliance, Center on Executive Compensation, and others provided testimony on four pieces of legislation: H.R. 1135, the Burdensome Data Collection Relief Act; H.R. 1105, Small Business Capital Access and Job Preservation Act; H.R. 1564, Audit Integrity and Job Protection Act; and a discussion draft to amend Section 913 of the Dodd-Frank Act. H.R. 1135 would repeal Section 953 of the Dodd-Frank Act requiring investors to disclose executive compensation, H.R. 1105 exempts private equity advisers from new Dodd-Frank Title IV registration requirements, H.R. 1564 prohibits the Public Company Accounting Oversight Board (PCAOB) from requiring audits be conducted by specific auditors, and the discussion draft would bar the SEC from promulgating rules to extend the fiduciary standard of conduct applicable to investment advisors to broker dealers until it conducts a cost-benefit analysis, among other things

<u>Executive Branch</u>

**Treasury**

*Treasury Outlines Additional Steps to Delay Reaching Debt Ceiling*

On May 17th, Treasury Secretary Lew wrote to Congress outlining additional steps the Treasury Department will take to avoid hitting the debt limit. Beginning on May 16th through August 2nd, the Treasury will not fully invest in the Civil Service Retirement and Disability Fund (CSRDF) and the Postal Service Retiree Health Benefits Fund (PSRHBF). The letter estimates that these efforts will create an additional $19 billion in wiggle room under the debt ceiling. Lew also states that the "CSRDF and PSRHBF will be made whole once the debt limit is increased. Federal retirees and employees will be unaffected by these actions."

**SEC**

*REG SCI Delayed*

Earlier this week the SEC has announced that it was extending the comment period on the proposed Reg SCI by 45 days, making comments now due July 8th instead of May 24th. This proposed regulation is intended to help ensure better market integrity and is viewed as an initial response against some of the adverse impacts of High Frequency Trading. The extension comes in response to requests by Ranking Member of the Senate Banking Committee Mike Crapo (R-ID) and from SIFMA for a 90 day extension because the rule was both significant and complex. Interestingly, the announcement came on the heels of yet another flash crash, this one occurring on May 17th, when shares of Anadarko Petroleum plunged 99 percent in the last minute of trading. The stock dip, which resulted in what had been a $90 dollar stock moments earlier now trading at one penny, was later reversed by NYSE. In comments following the flash crash, SEC Commissioner Elisse Walter said that the SEC should work on the "low-hanging fruit," such as rules governing dark pools, and "move forward first incrementally, and then decide if more holistic change is needed."

**CFTC**

*CFTC IG Releases Report on Response to MF Global Failure*

On May 20th, the CFTC's inspector general issued a report on the Commission's handing of the MF Global failure in 2011. The report, which was requested by Senator Richard Shelby (R-AL), raises concerns about the CFTC's handling of the commodity broker's collapse and Chairman Gary Gensler's recusal from the proceedings. While the IG did not find corruption associated with the use of Chairman Gensler's personal email account, it did site concerns that examiners had no procedures to work off, multiple regulators made duplicative requests for information, and MF Global's regulator CME Group did not formally coordinate with the CFTC. The CFTC declined to comment on the report.

**CFPB**

*Bureau and State Regulators Agree to Coordinated Supervision and Enforcement Framework*

On May 21st, the Conference of State Bank Supervisors (CSBS) and the CFPB announced that they have agreed to a framework establishing a process for coordination on supervision and enforcement matters. The framework is based on a memorandum of understanding (MOU) signed by CFPB and CSBS in 2011 which provided that state regulators and the CFPB would cooperate on standards, procedures and practices of examinations. Specifically, the framework outlines a process for: coordinating exam schedules; developing comprehensive supervisory plans for particular institutions; coordinating information requests; streamlining information sharing; and providing advance notice of corrective actions.

Miscellaneous

*Retailers Oppose Proposed Interchange Fee Settlement*

On May 21st, the National Retail Federation announced it will oppose the $7.25 billion settlement proposal in the federal antitrust lawsuit over Visa and MasterCard swipe fees. NRF urged retailers to consider carefully whether they will join the settlement, thus giving up their right to further legal action. Mallory Duncan, Senior Vice President and General Counsel, said in a statement that no settlement at all would be better than the "one-sided 'agreement' written by card companies." So it was little surprise that on May 23rd, Target, Macy's and a group of other retailers filed a lawsuit alleging that Visa and Master Card violated federal antitrust laws by "exploiting" their market power to "gouge" merchants on interchange fees.

Interestingly, also last week, the Fed released a report which found that community banks which are exempt from the Durbin interchange fee, on average, earn the same amount in fees as they did before the cap. Addressing concerns raised by retailers who asserted that requiring two sets of fees would ultimately affect small banks, the Fed said the "exemption [for banks with less than $10 billion in assets] designed to protect small debit card issuers from interchange fee standards applied to large issuers is working as intended."

Upcoming Hearings

*The Senate and House will be in Recess this Week.*

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