



## ML Strategies Update

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## Financial Services Legislative and Regulatory Update

### Leading the Past Week

*And the beat goes on...* Another week with the White House dealing with another issue, this time news that the national security apparatus is collecting and combing through telephone record metadata. The widespread revelation about a data mining program that would make any hedge fund quant jealous drowned out more positive news of the week, including that the U.S. recovery continues its sluggish, yet positive pace with 175,000 jobs added in May.

And in an interesting comparison, as noted by the extraordinary team at [Davis Polk](#), while the agencies were silent during the Month of May, and did not announce any new implementations of the Dodd-Frank Act, last week, three major implications of the implementation were announced. First, the SEC publicly released its much anticipated and long awaited money market mutual fund rules. Second, the Fed announced an almost equally anticipate interim final “push out” rule that provided significant relief to foreign-based banks with operations in the United States. Finally, the FSOC made its first round of non-bank systemically important financial institutions (“SIFIs”) designations.

### Legislative Branch

#### **Senate**

*As Administration Announces New Iran Sanctions, Senate Banking Members Skeptical of their Effectiveness*

On June 4<sup>th</sup>, the Senate Banking Committee held a hearing to review sanctions against Iran. Witnesses and lawmakers were split regarding the efficacy of the sanctions, some arguing that their effectiveness has been proved by Iran’s continued inability to fund nuclear enrichment and other arguing that the sanctions have not had the desired result of fundamentally changing the governance of the country. Specifically, Ranking Member Mike Crapo (R-ID) and Senators Bob Corker (R-TN), Bob Menendez (D-NJ), and Chuck Schumer (D-NY) all expressed concerns that the sanctions have not measurably changed Iran’s behavior. Witnesses included: David Cohen, Under Secretary for Terrorism and Financial Intelligence for the Treasury; Wendy Sherman, Under Secretary for Political Affairs with the Department of State; and Eric Hirschhorn, Under Secretary for Industry and Security with the Department of Commerce. The hearing comes as

the Administration announced a new set of sanctions against the country. An [Executive Order](#) released June 3<sup>rd</sup> takes aim at Iran's currency and auto sector in addition to expanding sanctions against private business supporting the government of Iran.

#### *Senate Finance Committee Releases Income and Business Entities Tax Reform Working Paper*

On June 6<sup>th</sup>, the Senate Finance Committee [released the latest](#) in a series of options papers outlining tax reform options for individual and business income taxes and payroll taxes. The proposal outlines three options for tackling the integration of individual and corporate taxes, such as making the corporate tax a withholding tax on dividends and adjusting capital gains taxes for businesses to match the individual Code. In addition, the paper discusses ways in which to reach a long-term solution for taxing derivatives.

#### *Senate Banking Approves Nomination to Ex-Im Bank*

On June 6<sup>th</sup>, the Senate Banking Committee voted 20 to 2 in favor of Fred Hochberg to continue to head the Export-Import Bank. Senator Tom Coburn (R-OK) and Senator Patrick Toomey (R-PA) both voted against the nomination. Hochberg's nomination now moves to the full Senate where, though he is expected to be confirmed, he must be approved before July 20<sup>th</sup> or else the bank would lose its quorum for voting on items. During the same executive session, the Committee approved by voice vote the National Association of Registered Agents and Brokers Reform Act of 2013 (S. 534) which would make it easier for insurance agents to sell state-regulated insurance in multiple states.

#### *Senator Brown Calls on CFPB to Target Debt Collectors*

On June 4<sup>th</sup>, Senator Sherrod Brown (D-OH) [wrote](#) to the CFPB, urging the Bureau to enact rules to curb customer abuses by debt collectors. In a statement accompanying the letter, Brown, Chairman of the Senate Banking Subcommittee on Financial Institutions and Consumer Protection, said he intends to hold a hearing in the next month which will shine a light on bad practices and consumer abuses in the industry. The Dodd-Frank Act gives the CFPB authority to enforce and enact rules under the Fair Debt Collection Practices Act (FDCPA). Brown's letter urged Director Cordray to pursue debt collectors as soon as possible, as the Bureau would lose its oversight authority in this space should Cordray's nomination expire and a director not be in place.

#### *Senate Banking Committee To Consider Flood Insurance As Soon As July*

In remarks made on June 6<sup>th</sup>, Chairman of the Banking Committee Tim Johnson (D-SD) said the panel will hold hearings as soon as July to consider national flood insurance affordability. The announcement comes as a number of lawmakers express concerns that rate increases in the 2012 reauthorization are not affordable.

#### *Senate Banking Subcommittee Looks into the State of the Middle Class*

On June 6<sup>th</sup>, the Senate Banking Subcommittee on Economic Policy held a hearing titled "The State of the American Dream: Economic Policy and the Future of the Middle Class." It was Senator Jeff Merkley's first hearing as Chair of the Subcommittee, he said he wanted to feature witnesses whose voices were not normally heard in committee hearings and public policy debates. The witnesses included: Ms. Diedre Melson; Mr. John Cox; and Ms. Pamela Thatcher, who were subjects of the documentary movie *American Winter*; Dr. Atif Mian, Professor of Economics and Public Policy at Princeton University; Ms. Amy Traub, Senior Policy Analyst for Demos; Mr. Nick Hanauer with Second Avenue Partners; and Mr. Steve Hill, Executive Director of Nevada Governor's Office of Economic Development.

## **House of Representatives**

### *House to Consider Multiple Financial Services Bills Next Week*

Next week the House is set to consider and vote on four separate bills dealing with the Financial Industry. Three of these bills, The Business Risk Mitigation and Price Stabilization Act (H.R. 634), The Reverse Mortgage Stabilization Act (H.R. 2167), the Swap Data Repository and Clearing House Indemnification Correction Act (H.R. 742) will be brought up on the suspension calendar, which is generally used for non-controversial measures. The other bill, the Swap Jurisdiction Certainty Act ([H.R. 1256](#)) will be brought forward under a rule, which may allow for amendments to the bill that directs the SEC and CFTC to issue joint rules on swaps and security-based international swaps. All are expected to pass the House.

### *Financial Services Subcommittee Examines Role of Proxy Advisory Firms*

On June 5<sup>th</sup>, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises met to examine the growing reliance on proxy advisory firms in proxy solicitations and corporate governance. Specifically, the Subcommittee sought to investigate the effect proxy advisory firms have on corporate governance standards, the market power of these firms, potential conflicts of interest, and SEC proposals seeking to modernize corporate governance standards. During the hearing Subcommittee Chairman Scott Garrett (R-NJ) voiced concern that institutions are overly reliant on proxy advisory firms in determining how to cast shareholder votes and questioned whether conflicts of interest and voting recommendations based on one-size-fits all policies affect shareholder value.

Witnesses at the hearing included: former SEC Chairman Harvey Pitt, Timothy Bartl, President of the Center on Executive Compensation, Niels Holch, Executive Director of Shareholder Communications Coalition, Michael McCauley, Senior Offices for Investment Programs and Governance of the Florida State Board of Administration, Jeffrey Morgan, President and CEO of the National Investor Relations Institute, Darla Stuckey, Senior Vice President of the Society of Corporate Secretaries & Governance Professionals, and Lynn Turner, Managing Director of LitiNomics. The hearing comes as SEC Commission Daniel Gallagher recognized that lawmakers and regulators need to re-examine the role of advisory firms in the corporate governance matters as “no one should be able to outsource their fiduciary duties.”

### *Lawmakers Introduce Legislation Targeting Foreign Cyber Criminals*

On June 6<sup>th</sup>, House Intelligence Committee Chairman Mike Rogers (R-MI) along with Representative Tim Ryan (D-OH) and Senator Ron Johnson (D-WI) [introduced](#) legislation that would impose visa and financial penalties on foreign cyber criminals who target American businesses. Specifically, the measure would deny foreign agents engaged in cybercrime from apply for visas or, if they reside in the U.S., would revoke visas and freeze financial assets. The bill also calls for the Department of Justice to bring more economic espionage criminal cases against offending foreign actors.

### *Online Gambling Legislation Introduced*

On June 6<sup>th</sup>, Representative Peter King (R-NY) introduced legislation to create broad federal Internet gambling regulations and allow all online gambling with the exception of betting on sports and where Indian tribes opt not to participate. The legislation would also establish an office of Internet gaming housed within the Treasury. Following a 2011 ruling by the Justice Department that the 1961 Wire Act does not ban online gambling, several states, including Delaware, New Jersey, and Nevada, have moved forward with creating intra-state online gaming operations. The movement at the state level has taken some of the momentum out of federal legalization efforts.

### Executive Branch

## **Treasury**

### *FSOC Selects First Group of Non-Banks to be SIFIs*

On June 3<sup>rd</sup>, the Financial Stability Oversight Council (FSOC) voted on the preliminary list of systemically important financial institutions (SIFIs) which will be subject to additional regulation by the Fed. This additional regulation will include new stress tests to monitor stability, additional capital requirements, and the need to create living wills in the event of resolution. While the Council did not release the names or the number of non-banks that have been selected, several firms have announced that they have received notice from the FSOC regarding their designation, including GE Capital, Prudential Financial, and AIG. Now that designations have been made, companies selected will have 30 days to request a hearing to contest the designation. While Secretary Jack Lew called the designations an “important step forward,” Chairman of the House Financial Services Committee Jeb Hensarling criticized the move, saying perpetuating non-banks as “too big to fail” will only put taxpayers on the hook for another bailout.

## **Federal Reserve**

### *Fed Approves Final Rule Clarifying Treatment of Foreign Banks Under Push-Out Rule*

On June 5<sup>th</sup>, the Fed [approved](#) an [interim final rule](#) clarifying the treatment of uninsured U.S. branches of foreign banks under the Dodd-Frank Act swaps push-out measure. Dodd-Frank calls for banks to separate certain swap trading activities from divisions that are backed by federal deposit insurance or which have access to the Fed discount window. Under the clarification, the Fed states uninsured U.S. branches of foreign banks will be treated as insured depository institutions and that entities covered by the rule, including U.S. branches of foreign banks, can apply for a transition period of up to 24 months to comply with the push out provisions. The interim final rule also states that state member banks and uninsured state branches of foreign banks may apply for the transition period. The Institute of International Bankers, which represents international banks operating in the U.S., praised the Fed for offering clarity on a “widely acknowledged drafting error in the original legislation.”

### *Fed Vice Chairman Appears to Support Stronger Capital Rules for Large Banks*

Speaking in Shanghai last week, Fed Vice Chairman Janet Yellen said that it may be necessary for regulators to impose capital requirements even higher than those set forth in the Basel III agreement. Agreeing with Fed Governors Daniel Tarullo and Jeremy Stein, Yellen said “fully offsetting any remaining “too big to fail” subsidies and forcing full internalization of the social costs of a SIFI failure may require either a steeper capital surcharge curve or some other mechanism for requiring that additional capital be held by firms that potentially pose the greatest risks to financial stability.” To that end, Yellen noted that the Fed and FDIC are “considering the merits” of requiring systemically significant firms to hold minimum levels of long-term unsecured debt to absorb losses and support orderly liquidation. Yellen who, is seen by many as the frontrunner for Fed Chairman following Bernanke’s term, is starting to generate a lot more attention as we come closer to the end of Bernanke’s reign. However, she is not the only member of the Fed espousing this policy. In a [speech](#) later in the week, Philadelphia Fed President Charles Plosser echoed Yellen’s sentiments, saying Dodd-Frank and other efforts to end “too big to fail” may not be “sufficient.” Plosser argued that current capital requirements should be made more stringent but also simpler by relying on a leverage ratio rather than the current practice of risk weighting.

## **SEC**

### *SEC Proposes Long-Anticipated Money Market Mutual Fund Overhaul*

On June 5<sup>th</sup>, the SEC released a [proposal](#) which would change the way the \$2.6 trillion money market mutual fund industry is regulated. After months of internal disagreement within the SEC, the Commission voted unanimously to propose the plan. The goal of the proposal is to avoid

future runs on the market, like that which occurred during the financial crisis, in tandem with ensuring that the industry still function as a viable investment vehicle. The Commission's proposal sets out two alternative options for reform which could be enacted alone or in combination. The first would require institutional prime money market funds to operate with a floating net asset value (NAV). Notably, retail and government funds would still be allowed to operate with a fixed-NAV. The second alternative would require nongovernment funds whose liquid assets fell below 15 percent of total assets to impose a 2 percent liquidity fee on all redemptions. If this were to occur, a money market fund's board would be permitted to suspend redemptions for up to 30 days. The proposal also calls for prompt public disclosure if a fund dips below the 15 percent weekly liquid asset threshold.

#### *Coalition of Investment and Consumer Interests Call for Strong Uniform Fiduciary Standard*

In a [letter](#) sent to the SEC on June 4<sup>th</sup>, a coalition of investment and consumer groups called on the Commission to enact a uniform fiduciary standard that would require broker-dealers and investment advisers to act in consumers' best interest. The letter, signed by organizations such as AARP, the Consumer Federation of America, and the Investment Adviser Association, is in response to an SEC request for information (RFI) requesting input on regarding the possible extension of a fiduciary duty to broker-dealers. The groups assert that, the fiduciary standard set forth in the RFI is weak compared to current law and "seems to contemplate little more than the existing suitability standard supplemented by some conflict of interest disclosures."

#### *District Court Hears Challenge to SEC Critical Minerals Rule*

On June 7<sup>th</sup>, the Court of Appeals for the D.C. Circuit heard a challenge brought on behalf of the American Petroleum Institute, the Chamber of Commerce, and others to the SEC's critical minerals rule which requires companies to disclose payments made to foreign governments. Industry argues that the rule is overly burdensome and could result in proprietary information being shared with competitors. However, supporters of the rule, including Oxfam America, assert that the measure will increase transparency and help combat human rights abuses.

## **FDIC**

#### *FDIC Approves Non-Bank Resolution Final Rule*

On June 4<sup>th</sup>, the FDIC approved a final rule establishing the criteria which will be used to determine which non-bank financial firms will be required to comply with the FDIC's authority to liquidate large failing companies. The rule, which lays out factors used to determine if a company is "predominately engaged in financial activity," requires companies where at least 85 percent of revenues are classified as financial in nature by the Bank Holding Company Act to comply. The FDIC's rule closely resembles a [final proposal](#) by the Fed which established criteria for non-banks to be flagged for additional supervision under Dodd-Frank.

## **CFPB**

#### *CFPB Finalizes Ability-to-Repay Rule Amendments*

On May 29<sup>th</sup>, the CFPB [finalized rules](#) designed to increase access to credit through exemptions and modifications to the Bureau's ability-to-repay rule. The ability-to-repay rule, which was finalized in January 2013, requires that new mortgages comply with basic consumer protection requirements that are meant to ensure consumers do not take out loans they cannot pay back through Qualified Mortgages (QMs). In response to public and Congressional concerns about the scope of the rule, the Bureau's finalized rules exempt certain nonprofit creditors and community-based lenders who service low- and moderate-income borrowers, facilitate lending by small creditors, banks and credit unions with less than \$2 billion in assets and which make 500 or fewer mortgages loans per year, and establish how to calculate loan origination compensation. In announcing the amendments, the CFPB also [delayed the effective date](#) of

provisions prohibiting creditors from financing certain credit insurance premiums in connection with certain mortgage loans. Currently, the effective date is January 10, 2014; however, the Bureau plans to solicit comment on an appropriate effective date for proposed credit insurance clarifications.

#### *Bureau Issues Mortgage Rule Exam Guidelines*

On June 4<sup>th</sup>, the CFPB issued an update to its exam procedures based on the new Truth in Lending Act (TILA) and the Equal Credit Opportunity Act (ECOA) mortgage regulations finalized in January. The guidance addresses questions about how mortgage companies will be examined such as for: setting qualification and screening standards for loan originators; prohibiting steering incentives; prohibiting “dual compensation,” protecting borrowers of higher-priced loans; prohibiting the waiver of consumer rights; prohibiting mandatory arbitration; requiring lenders to provide appraisal reports and valuations; and prohibiting single premium credit insurance.

#### *CFPB Announced Further Study on Pre-Dispute Arbitration in Financial Products*

In a [notice and request for comment](#) published on June 7<sup>th</sup>, the CFPB announced it will conduct phone surveys of credit card holders as part of its study of mandatory pre-dispute arbitration agreements. While Dodd-Frank gave the CFPB authority to ban the use of arbitration in mortgages, Section 1028(a) of the Dodd-Frank Act requires the Bureau to conduct a study before taking additional action to limit arbitration in other financial products. According to the notice, the survey will investigate “the extent of consumer awareness of dispute resolution provisions in their agreements with credit card providers” and consumers’ assessments of these tools.

#### International

##### *IMF Working Paper Calls for Taxes on Large Banks to Level Playing Field, End “Too Big to Fail”*

In a [working paper](#) published at the end of May, the International Monetary Fund (IMF), suggesting that large banks in advanced economies have more incentive to take risks due to cheaper funding sources, proposed taxing large banks to “extract their unfair competitive advantage.” The authors of the paper argue that such a tax would level the playing field from the perspective of competitive policy and reduce excess incentives of banks to grow, reducing the problem of “too big to fail” and increasing financial stability. Specifically, the paper found that the implicit guarantee that “too big to fail” banks will be bailed out in the event of failure or crisis can lead to a funding advantage of up to 0.8 percent a year. In related news, On June 5<sup>th</sup>, Representative Michael Capuano (D-MA) introduced legislation (H.R. 2266) which would require certain systemically important institutions to account for the financial benefit they receive as a result of the expectations on the part of shareholders, creditors, and counterparties that the government will bail them out in the event of failure.

#### Upcoming Hearings

On Wednesday, June 12<sup>th</sup> at 10am, in 1100 Longworth, the Trade Subcommittee of House Ways and Means Committee will hold a hearing titled “U.S.-Brazil Trade and Investment Relationship: Opportunities and Challenges.”

On Wednesday, June 12<sup>th</sup> at 10am, in 2128 Rayburn, the House Financial Services Committee will hold a hearing titled “Beyond GSEs: Examples of Successful Housing Finance Models without Explicit Government Guarantees.”

On Wednesday, June 12<sup>th</sup> at 2pm, in 2128 Rayburn, the Capital Markets and Government

Sponsored Enterprises Subcommittee of House Financial Services Committee will hold a hearing on proposals intended to support capital formation.

On Thursday, June 13<sup>th</sup> at 10am, in 538 Dirksen, the Senate Banking, Housing, and Urban Affairs Committee will hold a hearing titled “Lessons Learned From the Financial Crisis Regarding Community Banks.”

On Thursday, June 13<sup>th</sup> at 10am, in 2128 Rayburn, the Monetary Policy and Trade Subcommittee of House Financial Services Committee will hold a hearing on changes to the Export-Import Bank.

On Thursday, June 13<sup>th</sup> at 1pm, in 2128 Rayburn, the Housing and Insurance Subcommittee of House Financial Services Committee will hold a hearing on international insurance issues.

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