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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

June 18, 2012

Leading the Past Week

The theme of this past week once again, was crisis. First, in Europe, where the results of the Greek elections on Sunday were met with mixed results – relief that Greek voters approved the *status quo*, but apprehension that ultimately the country may still have to pull out of the Euro in order to save its economy. Of course, while the world’s economic future may hinge on what happens in Europe, according to the Atlantic Monthly the global financial leaders simply need to listen to the latest American [earworm](#) to solve the continent’s problems. In the United States, dueling appearances in Ohio by the President Mitt Romney provided insight into how their respective campaigns intend to frame America’s economy. Romney spoke for 18 minutes outlining the need to end big government while President Obama spoke for close to an hour on the need to leverage strengthening the middle class into an economic recovery—taking the opportunity to call out Romney 13 times. Interestingly, this occurred in the same week that the New York Fed announced it had received, and made profit on, the final payment of liabilities from the fund established to facilitate the sale of Bear Stearns & Co and provide assistance to AIG., potentially closing the books on the first chapter of America’s financial crisis.

Legislative Branch

Senate

Jamie Dimon Testifies Before the Senate Banking Committee and Comes out Relatively Unscathed

This past Wednesday, the Senate Banking Committee heard from Jamie Dimon, CEO of JP Morgan, who expressed contrition for the recent \$2 billion or more synthetic credit portfolio trading loss while simultaneously underscored the continued strength and responsibility of his bank. The hearing focused largely on reviewing the events surrounding the trade and how things may or may not have been different if Dodd-Frank were fully implemented. Speaking on the Volcker Rule, Dimon told Senator Michael Crapo (R-ID) that it will be “very hard to make a bright line distinction between proprietary trading and hedging.”

And while it did not come up during the hearing, Senator Bernie Sanders (I-VT) released a GAO [list](#) of all regional Fed directors—underscoring the fact that many, including Mr. Dimon are also prominent bank executives. Sanders has introduced [S. 3219](#), a bill which would bar bank executives from filling any seats on the Fed Board by prohibiting employment of anyone who works for or invests in any firm eligible for Fed assistance. Representative Barney Frank (D-MA) has introduced a similar proposal in the House, [H.R. 1512](#), which would put the 12 regional Fed presidents under the White House appointment process, however, despite the media attention surrounding JP Morgan, it is unlikely that this legislation will be enacted this year.

While Dimon emerged from the Senate hearing relatively unscathed, he is scheduled to testify before the House Financial Services Committee on June 19th and there are some who think he may receive less amiable treatment, if only because the members don't wish to see a repeat of the news stories, which implied a "too close" relationship between the bank and the Senators.

Senate Appropriations Bill Would Fund Financial Services Agencies at President's Recommendation

On June 14th, the Senate Appropriations Committee favorably approved, along party lines, a draft FY 2013 appropriations bill that would provide \$23.2 billion in discretionary funding for the Treasury Department and other various regulatory agencies, including the SEC and CFTC. The Senate bill provides \$308 million for the CFTC, matching President Obama's request and doubling current funding levels while providing approximately \$2 billion more than the proposal approved by the House subcommittee last week. The Senate also provided about \$200 million more than the House for the SEC, approving a mark that would give the regulator \$1.566 billion. Obviously these figures will need to be reconciled, and we anticipate a good fight as House Republicans are committed to reducing the funds for both agencies.

House of Representatives

Although the House was in recess this past week, it didn't stop a bipartisan group of eleven Congressmen from sending a letter on June 15th to Treasury Secretary Geithner urging him to refrain from labeling asset managers as being systemically significant to the financial system until after the completion of an already commenced study on the industry.

The Financial Stability Oversight Council (FSOC) and Treasury's Office of Financial Research (OFR) are currently analyzing to what extent asset management firms might pose a systemic risk, and the letter urged that the study of asset managers should be broadly construed to include managers of pension fund and mutual fund assets and that the analysis should be carried out in a thorough and transparent manner.

Executive Branch

FDIC

FDIC Approves Measures to Implement Basel Recommendations and Increase Bank Capital

On June 12th, the FDIC approved a [proposal](#) that would raise capital requirements for banks. The FDIC's approval follows the Fed's June 7th release of three "notices of proposed rulemakings" implementing global Basel capital standards. Under one of the NPRMs U.S. banks

will be required to meet new minimum common equity Tier I capital ratio requirements equal to 4.5 percent of risk-weighted assets. While Acting Chairman Martin Gruenberg said that approximately 96 percent of all banks already hold capital meeting or exceeding these requirements, Thomas Hoenig expressed fears that the “rules continue to focus on risk-based capital ratios” which seem to him “overly complex and opaque.”

Federal Reserve Board

Community Banks Push Back Against New Capital Standards

Following last week’s release of joint rules to implement new capital standards in the U.S., community banks expressed their concerns about being ensnared by these new standards, which, they argue, are meant for much larger institutions. In a [press statement](#), the Independent Community Bankers of America (ICBA), said Basel III was intended to apply to only the largest, internationally active lenders and complained that regulators’ proposed rules would subject community banks to the same regulatory standards as large, complex firms.

Tarullo Urges More Regulatory Scrutiny of the Shadow Banking System – Offers Insight into Future Possible Regulations on Money Markets, Repo Markets among others

In remarks June 12th before a global finance conference Fed Governor Daniel Tarullo said regulators must act to spur greater transparency in the shadow banking system in order to reduce systemic risk. The shadow banking system generally performs the same activities as banks but do not rely on federally backed deposits, allowing them to thus far avoid the brunt of federal oversight. Citing the \$2.6 trillion money market mutual fund industry, Tarullo argued against the conventional wisdom that money market funds are completely liquid with no risk is a serious problem. The SEC has been exploring ways in which to strengthen the market; however, Tarullo said there are “second-best alternatives” if the SEC does not act—such as placing “new limits on banks’ reliance on funding provided by money market funds.”

Tarullo also highlighted risks in the securities lending market, or institutional investors such as insurance companies, pension funds and investment funds dealing in loan securities to banks and broker-dealers against the collateral of cash or securities. Tarullo called for more reforms in the repo market in which securities are sold with repurchase agreements given the risks associated with large amounts of intraday credit.

SEC

SEC Outlines Plan to Phase In Swaps Requirements

On June 11th, the SEC released a [statement of general policy](#) detailing how it expects new rules governing swaps markets will be phased in. While the policy statement did not estimate when the rules would be finalized, it created a framework for when market participants will be required to comply. Security based swap rules have been categorized into five buckets:

- rules defining market participants and products and rules regulating cross-border swap transactions and non-U.S. market participants;
- rules for the mandatory clearing process of swap transactions, including the end-user exception from mandatory clearing;

- rules for the registration and regulation of swap data repositories;
- rules for the registration and regulation of swap dealers and major swap participants; and
- rules for the mandatory trading of swap transactions.

Definitional rules will be adopted first before the SEC requires compliance with other rules and cross-border rules will be dealt with before those with cross-border implications are finalized. Compliance dates will be consistent for rules within the same category. Industry has generally lauded the policy statement but expressed impatience with the overall progress regulators are making on implementation of regulations governing the over-the-counter derivatives market. Comments on the policy statement are being accepted for 60 days following publication in the Federal Register.

Investment Advisers Get Reprieve from Pay-to-Play Rule

On June 13th, the SEC published an [extension](#) of the compliance date of a ban on third-party solicitation in rule 206(4)-5 of the Investment Advisers Act of 1940. The compliance date is now set at nine months following the approval of a final rule. Known as the ‘pay-to-play’ rule, it would require SEC registered investment advisers and certain executives and employees from directly or indirectly paying a third party for the solicitation of advisory business from any government entity unless the solicitor is a SEC registered entity. The rule would also make the third party solicitors subject to pay-to-play restrictions in order to be a member of FINRA or the Municipal Securities Rulemaking Board (MSRB). Meanwhile, on June 12th, the Division of Investment Management [announced](#) that under the Dodd-Frank Act approximately 3,990 investment advisers managing one or more private funds have registered with the SEC. The financial reforms required hedge advisers and other private funds to register with the agency by March 30th.

New Investment Advisor Committee Stresses Dodd-Frank as Priority

On June 12th, the SEC’s new Investor Advisory Committee met for the first time. Discussions at the Committee’s first meeting signal that initial priorities will focus on investor education, JOBS Act implications for investor protection and market structure issues. Another priority, and a focus of Tuesday’s meeting, was the implementation of the Dodd-Frank Act. Members of the Committee generally agreed that SEC cannot neglect its responsibility of implementing and enforcing the Dodd-Frank reforms—especially the new capital formations statute. In response to comments on the SEC Dodd-Frank implementation from member—who include representatives from the AFL-CIO, Consumer Federation of America and the California Public Employees’ Retirement System—Thomas Kim, of the Commission’s Division of Corporation Finance, said the agency is “hard at work” on all Dodd-Frank tasks.

CFTC

Industry Presses CFTC Seek Statutory Fix on Indemnification

As the CFTC moves forward with a regulatory solution to deal with concerns about the swap data repository (SDR) industry continues to press the agency to join the SEC and members of the House Financial Services Committee in seeking a legislative solution. Further evidence came

to light last week via comment letters sent separately on June 6th, the Depository Trust & Clearing Corp. and the Financial Services Roundtable, both of which echoed a June 5th letter from the European Securities and Markets Authority asking for legislation due to “concerns with respect to the legal nature of the CFTC interpretative statements and on its application in a US court of law.”

The issue stems from the fact that the Dodd-Frank Act directed the SEC and CFTC to write rules requiring most regulators to indemnify SDRs when requesting collected swaps trading data. The goal of the provision was to ensure that SDRs would be able to protect themselves from potential litigation if sensitive or proprietary data were mishandled by a regulator. However, the requirement has been the subject of much complaint from numerous fronts. Foreign regulators have noted that cross-border complications would prevent them from indemnifying SDRs, restricting their access to data. The CFTC, SEC and Congress have all echoed these concerns and the SEC and members of the House Financial Services Committee are seeking a legislative fix.

Despite broad industry support for a legislative fix, the CFTC appears committed to addressing the issue through regulation. In May, the Commission released an [interpretive statement](#) on the issue that seeks to exempt foreign regulators for the requirement. Under the interpretive statement, SDRs “registered, recognized or otherwise authorized in a foreign jurisdiction” would be exempt.

CFTC Schedules Vote on Cross-Border Extension of Dodd-Frank Swaps Rules

Bloomberg reported that on June 21st, the CFTC will meet to consider proposed rules on the regulation of swaps outside of the U.S, which may look very similar to the basic principles that Chairman Gary Gensler set out in a June 14th speech before the Institute of International Bankers. If so, then the proposed guidance would require foreign entities to register under existing CFTC swap dealer rules, if they engage in more than a de minimis level of swaps activity. Other requirements, such as capital and risk management standards would also be imposed if the non-U.S. actors meet “substituted compliance” standards of their jurisdiction’s regulator. Clearing and margins would also be imposed on transactions with counterparties operating or incorporated in the U.S. and overseas branches.

CFTC Technology Advisory Committee Meets June 20th

A notice in the Federal Register on June 11th, indicated that the CFTC’s Technology Advisory Committee has scheduled an all-day meeting for June 20th, in which it will focus on high-speed trading and liquidity aggregation as they relate to designated contract markets and swap execution facilities.

CFPB

CFPB Seeking Information on Student Loan Data and Complaints

On June 13th, the CFPB [published](#) a notice and request for information seeking data on private student loan complaints from state regulators, attorneys general, colleges, universities, lenders and consumer groups. In conjunction with the notice, the CFPB also [wrote](#) to state attorneys

general and higher education officials requesting their participation in the data collection. Section 1035 of the Dodd-Frank Act established a private student loan ombudsman be housed within the CFPB who will collect and analyze borrower complaints. As part of this analysis, the ombudsman is required to submit an annual report to Congress and made oversight recommendations to the Bureau Director, Treasury Secretary and Education Secretary.

International

Greek Votes for Status Quo – But Europe Cant's Seem to Escape its Financial Quagmire

On Sunday as the results of Greece's election, and the approval of the ruling party and their attendant support for continuation of the austerity measures became clear, the situation in Europe continued to get murkier. There was a renewed sense of desperation this past week, as European leaders scrambled to reach agreement on proposals to avoid sinking deeper into financial crisis. Watching things from across the pond, on June 13th Treasury Secretary Tim Geithner said eurozone countries need to urgently lay out the latest proposals to reinforce the strength of their monetary union. Calling for a stronger growth agenda, a more integrated banking sector and firewalls against increasing rates in indebted countries, Geithner said it would be ideal for European leaders to unveil plans to the G-20 during their June 18th and 19th meetings.

Complicating matters is the apparent lack of synergy between the ideas being put forward by central powers and the individual countries. For example, earlier this week the European Parliament approved in a 471 to 97 vote to establish a 'redemption fund' to ring-fence the \$3 trillion in public debt held by eurozone countries and provide a joint liability plan for reducing borrowing costs and reducing sovereign debt. The plan emphasizes the importance of economic growth and thus allows certain expenditures—such as in health care, education and infrastructure—to be exempted from deficit cutting calculations. In many ways the plan presents a strong approach to the sovereign debt crisis; however, it is unclear whether EU member states will approve of the proposal. Specifically, it is expected that Germany will oppose the notion of ring-fencing sovereign debt with public debt through a joint guarantee. Another provision that will prove controversial is one which would isolate countries facing default, providing time to negotiate with creditors without excessive market speculation.

In addition to the plan approved by Parliament, France is calling for the EU to adopt a financial stability package to further bolster expectations following the less than enthusiastic market reaction to the Spanish bank bailout. France's proposal would recapitalize banks directly with a new €500 billion rescue fund run out of the European Central Bank. The proposal exemplifies the new French government's approach to the crisis—one that is very different from Germany's calls for closer political ties and fiscal union.

Separately, Britain released plans on June 14th to inject its banks with billions of dollars in capital in an effort to create an additional buffer against turmoil from the eurozone. The goal of flooding British banks with cheap funds is to reinvigorate lending and further insulate the country from shocks emanating from the continent.

Merkel Remains Strong Supporter of Financial Transactions Tax

In a June 11th cabinet news briefing, a spokesman for Angela Merkel said the German Chancellor plans to strongly push for a financial transactions tax when the heads of Italy, Spain and France convene on June 22nd. The German Cabinet is supportive of a transaction tax and feels it is appropriate to ask the financial markets to contribute to the costs associated with overcoming the crisis. While some countries appear reluctant to support the proposal, it is assumed that the recently elected French President Francois Hollande will be in favor.

Basel Committee Considering Nationally Systemic Bank Controls

Even as tougher capital controls decided on by the Basel Committee begin to roll out, the Committee has turned its attention to draft rules governing systemic lenders not captured by last year's plans requiring global banks deemed systemically significant to hold additional capital. The Committee does not intend to publish a list of nationally systemic banks; however the draft plans will feature guidance for regulators on how to identify and regulate the large institutions in an effort to "accommodate the needs for national regulators to reflect their own jurisdictional peculiarities in their risk assessment."

Miscellaneous

S&P Warns of Impending Refinance Crisis

On June 14th, Standard & Poor's warned that U.S. financial institutions and junk-rated borrowers may find it difficult to refinance the estimated \$3 trillion in debt that is estimated to be realized at the end of 2016. While S&P said these fears would likely not begin to arise until after 2013, "fears of European Economic and Monetary Union [eurozone] contagion, a harder than expected landing in China's economy and a potential economic slowdown in the US, consistent investor demand for risky assets" may hasten a refinancing reckoning. The future ability of low rated companies to refinance will largely depend on the financial health of the US economy and how risk adverse investors are in the coming years.

UPCOMING HEARINGS

On Tuesday, June 19th at 10am, in 2128 Rayburn, the House Financial Services Committee will examine the public policy implications of JPMorgan Chase's recent multi-billion dollar trading loss.

On Tuesday, June 19th at 10am, in 215 Dirksen, the Senate Finance Committee will hold a hearing titled "Confronting The Looming Fiscal Crisis."

On Wednesday, June 20th at 9:00am, in 2128 Rayburn, the House Financial Services Capital Markets and Government Sponsored Enterprises Subcommittee will hold a hearing focused on U.S. equity market structure.

On Wednesday, June 20th at 9:30am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Subcommittee on Securities, Insurance, and Investment will hold a hearing titled "Examining the IPO Process: Is It Working for Ordinary Investors?"

On Wednesday, June 20th at 10am, in 2359 Rayburn, the House Committee on Appropriations will meet to markup the Financial Services Appropriations Bill, FY 2013.

On Wednesday, June 20th at 1:30pm, in 2128 Rayburn, the House Financial Services Insurance, Housing, and Community Opportunity Subcommittee will examine recent efforts by the Consumer Financial Protection Bureau (CFPB) to change mortgage loan disclosures required at closing.

On Thursday, June 21st at 9:30am, in 2128 Rayburn, the House Financial Services Financial Institutions and Consumer Credit Subcommittee will meet for a hearing to discuss issues surrounding the provision of retail banking services to money service businesses.

On Thursday, June 21st at 10am, in 538 Dirksen, the Senate Banking, Housing, and Urban Affairs Committee will hold a hearing titled “Perspectives on Money Market Mutual Fund Reforms.”

On Thursday, June 21st at 10am, in 215 Dirksen, the Senate Finance Committee will hold hearing titled “Russia’s World Trade Organization Accession: Administration’s Views on the Implications for the United States.”

On Thursday, June 21st at 10am, in 2360 Rayburn, the House Small Business Subcommittee on Investigations, Oversight and Regulations will hold a hearing on the management of financial assistance programs by the Small Business Administration and the regulatory burdens associated with lending to small businesses.