



ML Strategies Update

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Financial Services Legislative and Regulatory Update

Leading the Past Week

Although there were several hearings and major implementations of Dodd-Frank rules, the leading story from the past week had to be Majority Leader Harry Reid (D-NV) filing cloture on seven Administration nominees, including Richard Cordray to continue as head of the Consumer Financial Protection Bureau (CFPB). This is the start of a process that could end up with Leader Reid going for the “[nuclear option](#)” of changing the Senate rules dealing with the filibuster of certain nominations. Based on [some reports](#), it appears that Reid has the votes and that Cordray may be the sticking point in the negotiations. Interestingly, late last week Chairman Tim Johnson (D-SD) and the eleven other Democratic Members of the Banking Committee, wrote Minority Leader Mitch McConnell (R-KY) to end the Republican filibuster of Cordray’s nomination, requesting “an up-or-down vote on the nominee’s merits.”

While it remains to be seen how the filibuster cold war will resolve itself, last week the Congressional Budget Office (CBO) announced that the government achieved a surplus of \$116.5 billion in June, the largest in five years. This surplus, due in part to \$66.3 billion in dividend payments from the GSEs, only solidified that this fall will see yet another convergence of a debt ceiling / government funding fight as both the debt limit and end of the federal fiscal year appear to be aligned to come due at the same time.

We also saw several important steps forward in the implementation of the Dodd-Frank Act, including a proposed leverage ratio rule, approval of a final rule implementing capital requirements in excess of those required by Basel III, the designation of two nonbanks as SIFIs, and the long awaited announcement of the Commodity and Futures Trade Commission’s (CFTC) cross-border derivatives rulemaking.

Legislative Branch

Senate

Senate Banking Hearing Discusses Dodd-Frank Progress, Risk Mitigation

On July 11th, the Senate Banking Committee met to discuss Dodd-Frank implementation progress and whether financial reforms have succeeded in mitigating systematic risk from large financial institutions. Witnesses included Treasury Under Secretary for Domestic Finance Mary Miller, Fed Governor Daniel Tarullo, Federal Deposit Insurance Commission (FDIC) Chairman Martin Gruenberg, and Office of the Comptroller of the Currency (OCC) head Thomas Curry. In their testimony, regulators said that they expect almost all remaining Dodd-Frank rules, including capital surcharges for systematically important banks, the Volcker Rule, and liquidity rules to be finalized by the end of the year. Regulators also expressed confidence that the recently finalized Basel III rules, when combined with proposed stricter leverage requirements, will be an effective means of ensuring that banks carry enough capital. Notwithstanding the assertion of the regulators that the implementation of Dodd-Frank was nearing a close, Ranking Member Crapo remarked in his opening statement that there is a growing bipartisan consensus that some parts of Dodd-Frank need to be reformed. In particular, he mentioned the burden of regulations on community banks, short-term wholesale funding, debt to equity ratios for large banks, and the perceived continuation of “too big to fail” as areas that require address.

Democratic Senators Request CFPB, DOL Look Into Prepaid Payroll Cards

Following a front page story in the New York Times, on July 11th, sixteen Senate Democrats [wrote](#) to the CFPB and Department of Labor (DOL) requesting that the agencies investigate fees and practices associated with pre-paid payroll cards. The letter was particularly strong, including the assertion “that mandating the use of a particular payroll card, with no available alternative, seems clearly to violate federal law,” the lawmakers requested that CFPB Director Cordray clarify whether employers provide sufficient alternatives for payment. The letter was signed by Senators Richard Blumenthal (D-CT), Chuck Schumer (D-NY), Joe Manchin (D-WV), Tom Harkin (D-IA), Barbara Boxer (D-CA), Dick Durbin (D-IL), Debbie Stabenow (D-MI), Bob Menendez (D-NJ), Ben Cardin (D-MD), Robert Casey (D-PA), Jeffrey Merkley (D-OR), Brian Schatz (D-HI), Martin Heinrich (D-NM), Elizabeth Warren (D-MA), Mark Warner (D-VA), and Al Franken (D-MN). It is unclear whether this letter will spur the CFPB to re-engage on its broader general purpose reloadable card ANPRM that is still pending with the agency.

Bipartisan Group of Senators Introduce the 21st Century Glass-Steagall Act

On July 11th, Senators Elizabeth Warren (D-MA), John McCain (R-AZ), Maria Cantwell (D-WA), and Angus King (I-ME) introduced [legislation](#) that would reinstate the Glass-Steagall Act by separating FDIC insured depository divisions from riskier banking activities such as investment banking, insurance, swaps dealing, and hedge fund and private equity activities. By curbing those activities at federally insured institutions, the bill aims to eliminate the concept of “too big to fail” by making institutions smaller and thus decreasing the need, either real or perceived for a government bailout if the institution were to fail.

Senate Banking Leaders to Introduce FHA Reform Bill

Last week, Senate Banking Committee Chairman and Ranking Member Tim Johnson (D-SD) and Mike Crapo (R-ID) announced they will introduce legislation this week to provide the Federal Housing Administration (FHA) with additional authority, including the ability to charge higher premiums, to “get back on stable footing.” The FHA currently has a \$943 million short fall in its insurance fund and a Treasury bailout is expected without additional Congressional action. The House has already passed a measure this year which would allow the agency to make changes to the Home Equity Conversion Mortgage program.

House of Representatives

House Approves FSOC, PCAOB Bills

On July 8th, the House passed two bills, the first to require the Financial Stability Oversight

Council (FSOC) to study the effects of derivatives-related capital exemptions, and the second to bar the Public Accounting Oversight Board (PCAOB) from requiring public companies to regularly change auditors. The Financial Competitive Act of 2013 ([H.R. 1341](#)) passed the House by a 353 to 24 vote and directs the FSOC to study and report to Congress on an exemption for EU banks from the credit valuation adjustment (CVA) capital charge which was part of the Basel III agreements. The Audit Integrity and Job Protection Act ([H.R. 1564](#)) passed the House by a 321 to 62 vote and would do away with mandatory audit-firm rotations currently required by the agency. Ranking Member of the House Financial Services Committee Maxine Waters (D-CA) expressed concern that the bill would result in “diminished information” and increased costs. The legislation also directs the Government Accountability Office to update a 2003 study on the Potential Effects of Mandatory Audit Firm Rotation.

House Republicans Unveil Housing Finance Reform Legislation

On July 11th, Chairman of the Financial Services Committee Jeb Hensarling (R-TX), [unveiled](#) the Protecting American Taxpayers and Homeowners (PATH) Act which would reform the US housing finance system by phasing out Fannie Mae and Freddie Mac and moving to a largely private system. The legislation would continue to wind down the GSEs’ portfolios while establishing new rules for private covered bonds and mortgage bonds. The legislation would also reign in the FHA and its ability to insure loans for only low income borrowers, reducing how much of a loan the FHA can insure. Notably, the proposal would also repeal the Dodd-Frank Act’s risk-retention rule and place a two year hold on Basel III capital rules. Also worth noting is that [despite earlier hopes](#) that Hensarling and Ranking Member Maxine Waters (D-CA) might be able to find some common ground housing reform, Ms. Waters said she was “strongly disappointed” by Hensarling’s proposal. The Committee would hold a hearing on July 18th to examine the legislation.

House Financial Services Subcommittee Grills CFPB Over Data Collection

On July 9th, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit held a hearing to examine how the CFPB collects and uses consumer data and personal information. CFPB Acting Deputy Director Steven Antonakes received heavy criticism from Committee Republicans for being unable to provide exact numbers on how many Americans the Bureau has collected information. Republican lawmakers also criticized many of the data collection practices of the agency, citing concerns that the collection infringes on citizens’ right to privacy and attempting to draw analogies to the current NSA and IRS scandals. Still, Antonakes and to some extent, Committee Democrats insisted that the CFPB is a data-driven agency, that the data being collected is, except when the result of a consumer contact, anonymized and that the CFPB takes very seriously its obligation to protect its data as it is vital to the Bureau’s work.

House Financial Services Subcommittee Explores Constitutionality of Dodd-Frank

On July 9th, the House Financial Services Subcommittee on Oversight and Investigations held a hearing to consider potential legal uncertainties in the Dodd-Frank Act. The hearing featured testimony from three constitutional scholars, each of whom expressed concern that certain provisions of the law may be unconstitutional. Professor Thomas Merrill, of Columbia Law School, argued that there are large constitutional concerns surrounding the orderly liquidation provision and the government’s power to seize control of an institution. While the provision is likely legal, he said, it would undoubtedly be litigated the first time it is invoked. In addition, Boyden Gray, testified that Dodd-Frank violates separation of power by giving too much power to regulators, while Timothy McTaggart, a partner at Pepper Hamilton LLP, argued that Dodd-Frank ultimately does not violate separation of powers or the due process clause.

House Financial Services Subcommittee Explores Small Business Capital Formation

On July 10th, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises held the second in a series of hearings exploring existing barriers to capital formation. In his opening statement, Chairman Scott Garrett (R-NJ) made it clear that the sponsors of last year's JOBS Act are not satisfied with the bill's implementation and are looking for new ideas to help small businesses build capital. Additional proposals could include increasing tick sizes, creating special exchanges for the stock of small companies, and changing filing rules for small business financial statements. Witnesses expressed additional concerns; Kenneth Moch, CEO of Chimerix, noting the cost of compliance with internal controls associated with Sarbanes-Oxley, and Christopher Nagy, President of Kor Trading, calling for patent litigation reform.

House Appropriations Subcommittee Marks Up FY 2014 Financial Services Spending Bill

On July 10th, the House Appropriations Subcommittee on Financial Services and General Government met to consider the \$17 billion [FY2014 Financial Services and General Government spending bill](#), approving the legislation by voice vote. The bill funds a variety of agencies, including the Securities and Exchange Commission (SEC), Treasury, Internal Revenue Service (IRS), and others. The legislation boosts the SEC's budget by \$50 million to \$1.4 billion, a figure that is still over \$300 million dollars short of the President's budget request. In addition, the bill would bring the CFPB into the normal appropriations process beginning in 2015, something which Republicans have sought to do since the standing up of the Bureau. Despite serving as one of the main sticking points against Director Cordray's confirmation, the bid to move the Bureau's funding out from the control of the Federal Reserve is unlikely to be successful.

Executive Branch

CFTC

CFTC Finalizes Cross-Border Derivatives Rule, Including Effective Date Delay

Following several weeks of rampant speculation over the fate of the CFTC's proposal to regulate cross-border swaps trades, the CFTC [voted](#) 3 to 1 on July 12th phase in [guidance](#) governing how U.S. derivatives laws apply to foreign banks. The CFTC also approved an "exemptive order" extending the effective date for the new requirements to 75 days after the guidance is published in the Federal Register. In addition, by December 21st, the Commission hopes to approve additional "substituted compliance" requests that will enable market participants to meet the requirements put out by other countries, including the EU, Japan, Hong Kong, Australia, Canada, and Switzerland.

The CFTC's vote follows the news that the Commission reached an [agreement](#) with EU regulators on how the two regulatory zones would oversee cross-border derivatives deals. The agreement will allow uncleared transactions that are deemed to fall under certain "essentially identical" US and EU rules to be governed by just the EU. In addition, the agreement allows US market participants to directly trade on a foreign board of trade and addresses US fears over loopholes for firms engaged in high-risk overseas operations, among other things. The CFTC also [released](#) four "no-action letters" on July 11th which implement the agreement with the EU.

Federal Reserve

Federal Reserve Releases Minutes of June FOMC Meeting

On July 10th, the Fed released the [minutes](#) of the June 18th and 19th meeting of the Federal Open Markets Committee. Following market disruptions after Chairman Bernanke's statements after the June meeting, the FOMC minutes shed light on how the Fed plans to proceed in winding down its quantitative easing program by stressing that continuation of the monthly billion dollar

asset purchases will largely depend on continued economic growth. Regardless of the exact timing, it appears a tapering of the highly accommodative monetary policy will occur in the near-to mid-term, as the minutes state: “several members judged that a reduction in asset purchases would likely soon be warranted, in light of the cumulative decline in unemployment since the September meeting and ongoing increases in private payrolls, which had increased their confidence in the outlook for sustained improvement in labor market conditions.”

Regulators Propose Exempting Certain Mortgages from Appraisal Requirements

On June 10th, six regulatory agencies issued a proposed rule exempting certain subsets of high-priced mortgages from Dodd-Frank appraisal requirements. The exempted mortgages include loans of \$25,000 or less, certain “streamlined” refinancings, and some loans for manufactured homes. The new rule is meant to lower cost hurdles for borrowers and improve mortgage lending practices. The proposal was released jointly by the Fed, CFPB, FDIC, OCC, Federal Housing Finance Administration (FHFA), and the National Credit Union Administration (NCUA).

FDIC

Regulators Propose Leverage Ratio Rule; Finalize Rule Implementing Basel III Agreement

On July 9th, the Fed, FDIC, and OCC released a [new proposal](#) which would require federally insured banks with more than \$700 billion in assets to meet a 6 percent leverage ratio, double the 3 percent ratio agreed to under the Basel III. The proposed rule would currently capture eight US banks, including: JPMorgan Chase, Bank of America, Bank of New York Mellon, State Street, Citigroup, Goldman Sachs, Wells Fargo, and Morgan Stanley. The holding companies of these institutions would be required to meet a 5 percent leverage threshold, the Basel III 3 percent minimum plus a 2 percent buffer. The same day the FDIC and OCC finalized an [interim final rule](#) to implement the Basel III international bank capital agreement, which the Federal Reserve adopted [unanimously](#) the previous week.

Treasury

FSOC Releases Final AIG, GE SIFI Designations

On July 9th, the Financial Stability Oversight Council (FSOC) [voted](#) to designate American International Group (AIG) and GE Capital as the first two nonbank financial companies required to meet additional regulatory and supervisory requirements associated with being systemically important financial institutions (SIFIs). As such, these companies will be subject to supervision by the Fed’s Board of Governors and to enhanced prudential standards. In deciding to designate these two nonbanks, the FSOC noted AIG’s “size and interconnectedness” and GE’s role as a “significant participant in the global economy and financial markets.” Remarking on the designations, Treasury Secretary Jack Lew said that they will help “protect the financial system and broader economy” and that the Council will “continue to review additional companies in the designations process.”

CFPB

Bureau Updates 2013 Rulemaking Schedule

On July 8th, the OIRA released an [updated list](#) of rulemakings and their status at the CFPB. The list included a variety of items, at different stages of the rulemaking process.

CFPB Warns it Will Closely Scrutinize Debt Collection

On July 0th, the CFPB [announced](#) that it will be heavily examining the practices used to collect debt from borrowers. The CFBP also said that it will be looking into the activities of both third-party collection agencies, which are subject to regulations under the Fair Debt Collection Practices Act (FDCPA), in addition to lenders trying to collect directly from borrowers who are

not covered by FDCPA. As part of this effort, the Bureau has published two bulletins outlining illegal and deceptive debt collection practices. The [first bulletin](#) outlines that any creditor subject to CFPB supervision can be held accountable for any unfair, deceptive, or abusive practices in collecting a consumer's debts. The first bulletin also warns against threatening actions, falsely representing the debt, and failing to post payments. The [second bulletin](#) cautions companies about statements they make about how paying a debt will affect a consumer's credit score, credit report, or creditworthiness. As part of this crackdown, the CFPB will also begin accepting debt collection complaints from consumers.

SEC

Commission Finalizes JOBS Act General Solicitation Rule

On July 10th, the SEC [adopted](#) in a 4 to 1 vote a [final rule](#) to lift the ban on general solicitation and general advertising for certain private securities offerings. Commissioner Luis Aguilar was the sole no vote, saying that the rule puts investors at risk. In [remarks](#) delivered the same day, Aguilar said that the rule does not contain sufficient investor protections as is, and it is not enough to rely on "speculative future actions to implement common sense improvements" to ensure investor safety. In conjunction with this vote, the agency proposed for comment a [separate rule](#) which will increase the amount of disclosures which issuers must provide on public offerings, such as providing the SEC with 15 days advance notice of the sale of unregistered securities, and provide for other new safeguards. Commissioners Dan Gallagher and Troy Paredes both opposed the new disclosure requirements, citing concerns that they would "undermine the JOBS Act goal of spurring our economy and job creation." The SEC also approved in a 5 to zero vote a [rule](#) which would prohibit felons and other "bad actors" from participating in offerings.

Lawmakers on both sides of the aisle had strong opinions about the final general solicitation rule. Democratic lawmakers, though somewhat assuaged by the additional disclosure safeguards, echoed Commissioner Aguilar's sentiments regarding investor safety. In particular, Senator Carl Levin (D-MI) said in a statement that he was disappointed in Chairman Mary Jo White for advancing a rule with too few investor protections. On the other hand, Representative Patrick McHenry (R-NC) accused the SEC of flaunting Congressional intent by moving forward with the additional filing and disclosure requirements, saying the requirements will "unjustifiably burden American entrepreneurs" and "neutralize congressional intent."

SEC Delays Rules on Retail Forex Transactions

On June 11th, the SEC agreed to delay rulemaking on restrictions to retail foreign exchange (forex) trading by up to three years. The SEC said that it would use the additional time to assess the market for off-exchange foreign currency contracts and determine if more targeted regulations are necessary. While the vote for the extension was private, Commissioner Aguilar publically criticized the delay, saying that the transactions, while profitable, pose unnecessary risks to small investors in the economy.

OCC

Martin Pfinsgraff to be OCC Senior Deputy Comptroller for Large-Bank Supervision

On July 11th, US Comptroller of the Currency Thomas Curry named Martin Pfinsgraff Senior Deputy Comptroller for Large-Bank Supervision. Pfinsgraff has filled the role on an acting basis since January 30th, and has worked in the OCC since 2011. Previously, he served as Chief Operating Officer for iJet International, a risk management company, and Treasurer for Prudential Insurance. In this position, he will continue to supervise 19 of the nation's biggest banks with over \$8 trillion in combined assets.

International

Basel Committee Considering Simplified Capital Regime

On July 8th, the Basel Committee on Banking Supervision released a [paper](#) positing alternative proposals to reform the international capital regime in ways which would be simpler and easier to compare global capital levels. Specifically, the Committee proposed reforms such as enhanced disclosures, additional metrics, strategies to ensure effective leverage ratios, and reigning in national discretion as potential options for simplifying the framework. The paper reiterated that risk-based procedures will remain at the heart of the Basel capital framework but these will be complemented by liquidity and leverage ratio metrics.

Upcoming Hearings

On Tuesday, July 16th at 10am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Committee will meet in executive session to vote on pending nominations. Immediately following votes on nominees, the Committee will hold a hearing titled “Oversight of the Defense Production Act: Issues and Opportunities for Reauthorization.”

On Wednesday, July 17th at 10am, in 538 Dirksen, the Financial Institutions and Consumer Protection Subcommittee of Senate Banking, Housing and Urban Affairs Committee will hold a hearing on the consumer debt industry.

On Wednesday, July 17th at 10am, in 2128 Rayburn, the House Financial Services Committee will hold a hearing to receive the Semi-Annual Monetary Policy Report to Congress.

On Wednesday, July 17th at 2:30pm, in 216 Hart, the Senate Agriculture, Nutrition and Forestry Committee will hold a hearing on the Commodity Futures Trading Commission Reauthorization.

On Thursday, July 18th at 10:30am, the Senate Banking, Housing and Urban Affairs Committee will hold a hearing on the Federal Reserve’s Semiannual Monetary Policy Report to the Congress.

On Thursday, July 18th at 1pm, in 2154 Rayburn, the Economic Growth, Job Creation and Regulatory Affairs Subcommittee of House Oversight and Government Reform Committee will hold a hearing titled “Regulatory Burdens: The Impact of Dodd-Frank on Community Banking.”

On Thursday, July 18th at 1pm in 2128 Rayburn, the House Financial Services Committee will hold a hearing titled “A Legislative Proposal to Protect Americas Taxpayers and Homeowners by Creating a Sustainable Housing Finance System.”

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