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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

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Leading the Past Week

Again, attention and rampant speculation in Washington continues to be focused on the Supercommittee and the details of the President's jobs plan. With less than 9 weeks until the November 23rd deadline, and rumors that the House is going to take the bill up during the week of December 5th, things better start happening soon, even if the Supercommittee has to go behind closed doors to get things done. In non-supercomittee news, Dodd-Frank implementation continued with the FDIC approving final rules for living wills, though the Federal Reserve must issue its own rules before the regs take effect. Speaking of Dodd-Frank, this past week officials at the CFTC, SEC and CFPB provided their insights into their regulatory agenda for the rest of the year and England finally got around to offering its banking reforms – known there as the Vickers Commission. Finally, the week ended with Treasury Secretary Geithner heading to Poland to suggest that the EU engage in a TARP like program to stem the growing financial crisis on the continent.

Supercommittee Update:

Despite being urged to 'go big' when they tackle the national debt, all signs seem to point to the fact that it seems more unlikely than not that the Supercommittee will reach its $1.2 trillion dollar target, let alone a larger figure. A "key lawmaker" who spoke to reporters on the condition of anonymity stressed that it is unrealistic to think that the 12 bipartisan, bicameral lawmakers would be able to agree to a budget deal on the order of $3 to $4 trillion.

This has not prevented some members of the committee from continuing to talk big. At the hearing on September 13th, Senator John Kerry (D-MA) said that they "need to 'go big' and reach savings of more than $1.5 trillion to address long-term deficits." While Kerry may remain optimistic, a lack of consensus on cuts to Medicare payments to doctors, entitlements and defense in addition to heavy GOP resistance to tax increases takes a lot of options for deficit reduction completely off the table. In addition, it remains unclear whether the President will be able to successfully merge his jobs plan (and its deficit reductions) into the supercommittee's recommendation. Co-Chair of the Supercommittee, Representative Jeb Hensarling (R-TX) balked at the prospect of having to come up with savings for the President's jobs plan. Hensarling said "the President is essentially tasking a committee designed to reduce the deficit to pay for yet another round of stimulus."

The White House is not the only one to give an opinion on how the Supercommittee should make its cuts. Minority Leader Mitch McConnell (R-KY) said that the Supercommittee should look for savings which would have "the biggest effect beyond the ten-year budget window." Senator Corker (R-TN), who had originally volunteered to be on the Supercommittee, urged the Committee to come up with at least $3 trillion in savings. Additionally, Senate sources report that Gang of Six members are pressing the Supercommittee to pursue a broad deficit reduction package which includes tax reform. Despite an effort by Senators Mark Warner (D-VA) and Saxby Chambliss (R-GA) to lobby the Supercommittee to pursue tax reform, given that the lawmakers must have a deficit reduction proposal ready in just less than two months, it is unlikely they will tackle the complex tax code.

Notably, House Speaker John Boehner, in a speech at the Economic Club of Washington, DC, urged the Supercommittee to tackle not only tax reform but also entitlement reform. While Boehner admitted that it is "not realistic to think that the Joint Committee could rewrite the tax code by November 23," they could "lay the groundwork" for future tax reform. Despite pushing for tax reform, Boehner's speech make fairly clear that he would not support tax increases of any kind. Boehner also suggested the Supercommittee tackle Social Security, Medicare and other entitlements but did not lay out a plan to do so.

Given the tone of Boehner's speech and the current polarized atmosphere on taxes and cuts, our sense is that is more likely that the final supercommittee recommendation will not include comprehensive tax reform, but a framework that instructs Congress to undertake the issue. Additionally, because it will likely be difficult for the Supercommittee to find the seven votes necessary to avoid sequestration, we believe that the final recommendation will contain language to delay sequestration further.

Legislative Branch

House of Representatives

Garrett Urges SEC to Scrap Uniform Standard - Despite Some Support within Industry: On September 13th, Representative Scott Garrett (R-NJ), Chairman of the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises urged the SEC to stop rulemaking on a uniform fiduciary standard for investment advisors and brokers dealers unless it provides adequate evidence that the rules are justified. By the end of 2011, the SEC is scheduled to propose rules on a uniform fiduciary standard for those who provide personalized investment advice regardless of whether they are investment advisors or broker dealers.

While there was no representative from the SEC present at the hearing, the majority of witnesses supported moving to a uniform fiduciary standard. John Taft, Chairman of the Securities Industry and Financial Markets Association (SIFMA), said that SIFMA has supported a uniform standard since 2009 and writing the uniform standard is the "single most important thing the SEC" can do. One dissenter, Ken Ehinger, speaking on behalf of Association for Advanced Life Underwriting, pressed that the SEC has no data to support the pursuit of a uniform fiduciary standard and that "the broker dealer model is much more robust."

Additionally, in advance of the hearing, on September 9th, a number of representatives from the financial services sector, present at a panel convened to discuss the fiduciary duty, also spoke out in favor of a uniform standard but cautioned that whatever the standard the SEC determines, it should not mirror the duty currently imposed under the 1940 Investment Advisors Act.

House Oversight Committee Explores Crowdfunding as New Avenue for Startup Financing: On September 15th, the House Oversight Committee investigated the use of crowdfunding as a means of providing additional revenue options for small companies and startups. Proponents of crowdfunding assert that the Securities and Exchange Commission's (SEC) regulations inhibit small companies from fundraising. The SEC has already announced the formation of a committee of industry executives to advise the agency on new rules and amended regulations for small and growing companies and Obama, in his jobs speech, spoke about easing regulations to provide additional opportunities to entrepreneurs, and endorsed a GOP plan to exempt small companies who wish to sell public shares from registering with the SEC.

At the hearing, Representative Patrick McHenry (R-NC) introduced the Entrepreneur Access to Capital Act (H.R. 578) which would allow companies to raise up to $5 million dollars from investors who could contribute up to $10,000 or ten percent of their income. In turn, it would exempt such businesses from the SEC regulation capping shareholders at 500 investors before financial reports to the SEC are necessary. Representatives David Schweikert (R-AZ) and Jim Himes (D-CT) also introduced a bill aimed at raising the 500 shareholder cap to a one-thousand shareholders, while also excluding employees from counting towards the total. A third bill mentioned at the hearing would permit companies to use advertisements and direct mail to reach potential investors.

Senate

Senate Subcommittee Approves Financial Services Funding Bill: On September 14th, the Financial Serves Appropriations Subcommittee approved, by a vote of 16 to 14, FY12 funding that provides the SEC with the $1.4 billion funding level requested by President Obama. The legislation also funds the Commodity Futures Trading Commission (CFTC) at $240 million for FY2012, which is $69 million less than the amount sought by the Administration. Despite not receiving the full amount of funding sough by the White House, the CFTC's budget was increased from its FY2011 levels.

Following the Subcommittee's action, House Financial Services Committee Chairman Spencer Bachus appeared to indicate his support for the measure by saying that the SEC needs the additional funding to implement structural reforms recommended by his Committee. However, the Chairman's apparent is not uniformly held by the rest of his committee members, as Representative Randy Neugebauer (R-TX) cautioned against giving the SEC more money without ensuring the existence "regulators that are capable and structured to do their job." In response, SEC Chairman Mary Schapiro said that overhauling the Commission would impede their regulatory responsibilities and the implementation of the Dodd-Frank Act.

Senate Hearing Examines Solutions for Home Mortgage Refinancing: On September 13th, the Banking Subcommittee on Housing, Transportation and Community Development met to examine the failing housing market and examine potential fixes. Experts—including Mark Zandi, chief economist at

Moody's Analytics—forecasted that the 1.25 million vacant or abandoned homes would not be cleared until 2013 or as late as 2016 as more homes are foreclosed on.

One potential solution to the ongoing housing glut was offered by Senators Barbara Boxer (D-CA) and Johnny Isakson (R-GA) who appeared before the Subcommittee to discuss their legislation, the Helping Responsible Homeowners Act of 2011 (S. 170), which would allow loan level price adjustments sans fees, even in cases where borrowers owe more than the current value of their home. The bill aims to stabilize the housing market and would aid over two million homeowners.

The Senators' bill may be made a moot point by the September 9 announcement by the Federal Housing Finance Agency (FHFA) that it will begin to take steps to help underwater homeowners refinance their mortgages. Boxer said she was "heartened" by the FHFA's announcement and, despite saying that changes are long overdue, Zandi said "anything that makes it easier for borrowers to pay their mortgages on time…will reduce agencies' ultimate cost."

Senate Finance Committee Explores Improvements for Retirement Savings: With the possibility that the supercommittee may enact substantive reforms to America's retirement system, this past week the Senate Finance Committee held a hearing on various proposals to increase American retirement savings. Even as Chairman Baucus (D-MT) said that many retirees will find themselves with insufficient savings, he cautioned the Committee from embracing proposals that would lead to higher costs for the federal government. At the same time, Baucus noted that "nearly 30 percent of all Americans in the workforce for 25 or more years had zero retirement savings" and "that fewer than half of all American workers work for an employer that sponsors a retirement plan."

Views were divided among witnesses, with some arguing for modest changes to improve incentives for employers to offer individual retirement plans, and others suggesting that 401(k) plans are poor vehicles for savings. Regarding the current tax incentive model, a representative for the Brookings Institute suggested that direct-to-savings tax credits instead of deductions would benefit more at risk workers in the low to middle-income range. Others cautioned that such a plan may provide an unwelcome incentive for employers to drop retirement benefits altogether. Interestingly, but not surprisingly, Senators Kerry and Bingaman introduced their Auto-IRA bill, although unlike in past years, this time the legislation lacked a Republican cosponsor.

Bipartisan Small Business Bill Aims to Improve Access to Credit: On September 12, Senators Pat Toomey (R-PA) and Jon Tester (D-MT) introduced the Small Company Credit Formation Act, which aims to reduce federal regulations on raising equity. Currently, the SEC limits businesses to sales of up to $5 million in shares before needing to fill out, what the Senators call, burdensome paperwork. This bill would raise the decades old limit to $50 million. Senator Toomey said he believes that by "encouraging small businesses to expand" the bill will allow them to "be competitive, hire new workers, and create badly needed jobs."

Senate Banking Chair Takes Next Step in Ex-Im Reauthorization: On September 13, Senate Banking Committee Chairman Tim Johnson (D-SD) filed the committee bill to reauthorize the US Export-Import Bank. The Bank's authorization expires on September 30 and the bill now awaits scheduling and consideration on the Senate floor. The Export-Import Bank Reauthorization Act of 2011 (S. 1547), which passed the Senate Banking Committee by voice vote, funds the Bank for four years and increases its lending authority to $140 billion by 2015.

<u>Executive Branch</u>

CFPB

CFPB Plans Study of Student Lending Market: On September 15, the Consumer Financial Protection Bureau (CFPB) announced that it will be collaborating with the Department of Education to conduct a study of the private student loan markets and provide recommendations to Congress on findings. Raj Date, Elizabeth Warren's replacement as Special Advisor to the Treasury Department, said the primary goal of the report is to determine the effectiveness of disclosure requirements for private student lenders.

Date, in a speech said the 2008 crisis was, in part, a result of the nation's $20 trillion consumer finance industry overseen by a patchwork of regulations that did not look at systemic health. Date said the CFPB will fill this hole which caused the financial meltdown, and stressed that upcoming final rulemakings will help borrowers get loans they can reasonably expect to repay, develop mortgage servicing standards and level the playing field so that rules apply to mortgage lenders, banks and non-banks equally. Additionally, the CFPB will undertake a study to determine the impact of credit market reforms and assess how to increase transparency in the markets for short-term credit and payday loans. Date combated the assertion that regulations will hinder economic recovery, saying that "sensible, pragmatic rules are a necessary element of the U.S. economy."

FED

Fed Report Finds SIFIs May Exacerbate Complexity, Promote Living Wills as Best Regulatory Fix: On August 31, the Federal Reserve Bank of Cleveland released a report finding that corporate complexity often keeps financial regulators from shutting down large financial firms for fear of consequences to the local and overall economy. In fact, some firms exacerbate the problem of corporate complexity for the sole purpose of increasing the likelihood of government assistance and that it can be another "form of regulatory and tax arbitrage." The report comes as regulators seek to tackle the supervision of systemically important financial institutions (SIFIs).

A possible solution to the problem of complexity is the existence of 'living wills' which are being considered by regulators as a means to unwind the operations of institutions with more than $50 billion in assets in the event of financial troubles or bankruptcy. The report suggests that living wills should be incorporated into a broader supervisory framework and be risk based. Additionally, in the event a resolution plan would not work the report suggests giving regulators power to force changes at large firms—such as simplifying their legal structure.

FDIC Approves Final Living Will Rule: On September 13th, the FDIC Board approved final interagency rules on living wills for SIFIs and for federally insured depository institutions with assets of more than $50 billion. The Fed, which must approve the joint rule before it goes into effect, is likely to act this week. The final rule will affect approximately 124 bank holding companies, many of which are foreign owned. In the future, the final rule will also apply to firms designated systemically significant by the Financial Stability Oversight Council (FSOC).

The final rule directs firms to provide a strategic analysis on how to resolve a failing company. This analysis will include: a description of how it can be resolved under the Bankruptcy Code, its key assumptions and how the plan would be implemented under various stress scenarios. Additionally, if resolution cannot occur under Bankruptcy Code, the living will must include FDIC access to understanding of all of a firm's operations, domestic and foreign. The final rule also directs companies to file additional, more focused plans for resolving non-bank operations if it has less than $100 billion in US nonbank assets and its total insured depository institution assets are 85 percent or more of total assets. Companies must also submit revised plans annually and within 45 days of changes that would affect the resolution plan.

CFTC

CFTC Commissioner Discusses Dodd-Frank Rulemaking Progress, Lay out Priorities: On September 14th, at a conference sponsored by the Futures Industry Association and Options Industry Council, CFTC Commissioner Scott O'Malia laid out the regulatory landscape and outlined what can be expected from the CFTC in coming months. Notably, O'Malia said the CFTC will look at mandatory clearing as soon as the third quarter of 2012 and that at the CFTC's next meeting—slated for October 4—they will consider regulations on clearinghouse rules, commodity derivatives position limits and extraterritoriality and interaffiliate rules. O'Malia added that definitions such as major swap participant and dealer are on the agenda and that the "current definition, especially in the de minimis category, is somewhat arbitrary for those energy companies out there that don't know if they are a swap dealer or not…" and so the Commission intends to provide better clarity into these issues.

SEC

SEC Official Sheds Light on Concept Release to Determine if Additional Derivatives Regulation is Needed: At the end of August, the SEC published a concept release soliciting comment on how mutual funds should use derivatives. On September 9, Eileen Rominger, Director of the SEC's Division of Investment Management, said that this release is merely a "starting point" on managing derivatives risk. Rominger said that "derivatives are not 'bad,' but they are potent and at times full of surprises." Thus, mutual funds must use derivatives responsibly, "consistent with their investors' expectations, and with the backdrop of good risk management systems." Comments being collected on the release will inform the SEC on whether additional derivatives rules are necessary.

MSRB Postpones Rulemaking until SEC Finalizes Definition of Municipal Advisor: In a September 12th release, the Municipal Securities Rulemaking Board (MSRB) announced that it will withdraw its proposals on fiduciary duty, pay-to-play and fair dealing for municipal advisors until the SEC finalizes its definition of municipal advisers. The release said the withdrawal stems from a concern that, without a definition of municipal adviser, some institutions may not be aware they fall within the MSRB's rules—limiting their opportunity to comment in the rulemaking process. The Dodd-Frank Act directs municipal advisors to dually register with the SEC and MSRB and extends a fiduciary responsibility to advisors. In December, the SEC released a proposed definition of municipal advisor; however, the receipt of over 1,000 comments has delayed finalization of the rule.

Industry representatives who have been urging the MSRB to delay rulemakings lauded the announcement. Managing Director of SIFMA, Leslie Norwood said that SIFMA had voiced concerns with the MSRB and that SIFMA "look[s] forward to working with the board on the range of issues affecting municipal advisors once the SEC addresses the questions of what constitutes advice and who is an advisor."

As the SEC continues to struggle finalize their definition, Representative Robert Dold (R-IL) has introduced legislation to clarify the Dodd-Frank Act and limit the scope of municipal advisor provisions. HR 2827 would make sure that already regulated entities—such as brokers, dealers, municipal securities dealers, swaps dealers, banks and other institutions—are not classified as municipal advisors.

SEC Official Lays Out its remaining Dodd-Frank Rulemaking Priorities and Progress: At a conference sponsored by the International Swaps and Derivatives Association, Brian Bussey, SEC Trading and Markets Division Associate Director, said the SEC is "about three-quarters of the way done with proposing [its] rules." Bussey said the SEC is currently working on rules impacting international transactions and securities intermediaries. He added that that the last "major area that [the SEC] still need[s] to complete is in the intermediary area: intermediary registration as well as the financial responsibilities, rules for dealers and for participants." To that end, the SEC will propose tow rules to address Title VII of the Dodd-Frank act—addressing over-the-counter derivatives products and securities products for the first time. The SEC also intends to release a plan "covering implementation of all of the securities-based swap requirements under Title VII."

<u>International</u>

Geithner Warns of Implications of Greek Default; Lagarde Cautions on Global Debt Crisis: On September 15th, Treasury Secretary Tim Geithner warned European leaders that they and the European Central Bank must take prompt action to address the debt crisis which poses "catastrophic risk" to financial markets. Geithner's warning highlights the growing fears that the European debt crisis could cause more problems for the ailing global economy. Despite efforts to shame them into action, Euro area finance ministers delayed a decision on whether to give Greece an eight billion Euro loan so that it may meet its budget obligations. In particular, Geithner was unable to convince Germany of the need to commit taxpayer support to stabilize the Euro zone economy. With the decision to delay action until October, Greece must turn to other EU governments, the International Monetary Fund (IMF) and the ECB for loans before it is unable to pay civil salaries and meet other basic funding obligations.

At the same time that Geithner was in Poland, Christine Lagarde the new Managing Director of the IMF said that while the economy has "entered a dangerous new phase of crisis;" however, she was "reassured" by a statement in support of Greece by German Chancellor Angela Merkel and French President Nicolas Sarkozy. Lagarde said Greece must meet conditions set out in the rescue package and urged all governments to make "credible medium-term plans" to stabilize and cut debt ratios. Largarde also said that she approves of the President's jobs plan but stressed that Congress must identify a "parallel track" for reaching a sustainable US debt path.

UK Commission Releases Recommendations on Reforming Financial Sector: On September 12th, the Independent Commission on Banking (ICB), also known as the "Vickers Commission" released its final report on reforms to improve stability and competition in UK banking. This report, which is the UK's version of Dodd-Frank reforms, made several recommendations, the most controversial of which was that, in order to address the too big to fail issue, the wholesale and investment banking activities of UK banks should be separated by a 'ring-fence.' Ring-fenced banks would completely separate self-standing or subsidiary companies with their own capital. The report also recommended that banks hold more equity capital and loss-absorbing debt than recommended by Basel III. Michael Barnier, European Commissioner, said that the ICB report is "consistent with European laws" but cautioned that implementation of the reports' recommendations must keep in mind EU legislation and the interconnectedness of the Euro zone.

UPCOMING HEARINGS

On Tuesday, September 20th at 10am, in 608 Dirksen, the Senate Budget Committee will hold a hearing on efforts to promote job creation in the United States.

On Tuesday, September 20th at 10am, in 210 Cannon, the Joint Economic Committee will hold a hearing on the debt limit.

On Tuesday, September 20th at 10am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Subcommittee on Housing, Transportation, and Community Development will hold a hearing titled "New Ideas to Address the Glut of Foreclosed Properties."

On Tuesday, September 20th at 10am, in 215 Dirksen, the Senate Finance Committee will hold a series of hearings on options for overhauling the tax system.

On Wednesday, September 21st at 10am, in 210 Cannon, the House Budget Committee will hold a hearing titled "The Broken Budget Process: Perspectives from Former CBO Directors."

On Wednesday, September 21st at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit will hold a hearing on promoting small business capital formation.

On Wednesday, September 21st at 10am, in 1100 Longworth, the House Ways and Means Committee will hold a hearing on the economic models used by the Joint Committee on Taxation (JCT) to analyze and score tax legislation.

On Wednesday, September 21st at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on International Monetary Policy and Trade Panel will hold a hearing on the relationship between the health of the U.S. housing finance system and global financial stability.

On Wednesday, September 21st at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on International Monetary Policy and Trade Panel will hold a hearing on the impact that multi-lateral development banks have on America's national security.

On Thursday, September 22nd at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit will hold a hearing on the availability of credit products for consumers who lack access to services provided by traditional financial institutions.

On Thursday, September 22nd at 10am, in a location TBA, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing on the decision by Standard and Poor's to downgrade the U.S. credit rating.

On Thursday, September 22nd at 10am, in a location TBA, the Joint Select Deficit Reduction Committee will hold a hearing titled "Revenue Options and Reforming the Tax Code."

On Thursday, September 22nd at 10am, the Senate Banking Committee will meet to consider the nominations of Alan Krueger to be a member of the Council of Economic Advisers, David Montoya to be HUD Inspector General, and Cyrus Amir-Mokri to be an Assistant Secretary of the Treasury.

On Thursday, September 22nd at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Oversight and Investigations and the House Oversight and Government Reform Subcommittee on Financial Services and Bailouts of Public and Private Programs will hold a joint hearing titled "Conflict of Interest at the Securities and Exchange Commission: The Becker Case."

On Thursday, September 22nd at 2:30pm, in 538 Dirksen, the Senate Banking Subcommittee on Security and International Trade and Finance will hold a hearing titled : "The European Debt and Financial Crisis: Origins, Options and Implications for the US and Global Economy"