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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

September 26, 2011

Leading the Past Week

Having apparently learned nothing from their dance to the precipice during the debt ceiling debate, Congress is again careening towards another reminder that bipartisan deal making is as anachronistic as cassette mix tapes. Late last week, on its second attempt, the House of Representatives passed its version of the a continuing resolution to fund the government, only to see that very measure defeated in the Senate by a vote of 59-36. With Congress supposed to be in recess this week, and FEMA announcing that they will run out of funding for disaster relief by Tuesday, the stage is set for either a dramatic last minute deal, or images of people trying to recover from the recent spate of natural disasters with big "closed" signs outside of FEMA, which should only further erode the public's confidence in Congress. In other news, in what must be billed as a great win for many in the industry, the DOL's Employee Benefits Security Administration (EBSA) announced that they will be re-proposing a rule defining fiduciary in the face of criticism over the original definition, a decision that will likely delay the impact of this change on many in the asset management and retirement savings industry. Finally, as was somewhat expected, the Fed announced a new policy (that is really based on an old policy) dubbed "the twist" that is intended to provide additional stimulus to the economy.

Supercommittee Update:

With each passing week there is a growing concern that the Supercommittee is not going to be able to produce a recommendation that meets its full deficit reduction targets. This past week perfectly encapsulated why these fears exists, as the Supercommittee met to consider "Revenue Options and Reforming the Tax Code" and immediately the Co-Chairs Jeb Hensarling (R-TX) and Patty Murray (D-WA) disagreed on the role taxes should play in meeting the Committee's mandate. Hensarling stressed that the Committee should consider broader tax reform with the end goal of reducing rates across the board. However, Murray said she expects the group's end proposal to include a mix of tax increases and spending cuts. The hearing also exposed some of the strains that the supercommittee as this hearing, unlike previous ones, had more sniping across partisan lines.

Many members of the Supercommittee focused on the possibility of reforming tax expenditures as a money saving tactic. Senator John Kerry (D-MA) said that "eighty percent of all the money the federal government raises goes right back out to tax expenditures." Despite lawmakers' fixation on reforming tax expenditures, Tom Barthod, Chief of Staff of the Joint Committee on Taxation, cautioned that tax expenditures are complex and that it is unclear "what it means to eliminate tax expenditures and make a clean slate."

In addition to another public meeting to discuss taxes, the Supercommittee met for its first closed-door discussion last week. Following the meeting, it is clear that there are growing concerns over the Committee's ability to make any large, substantive cuts given the items that are already off the table. Congressional Republican, led by Speaker John Boehner (R-OH) have pledged to reject any and all tax increases, President Obama has declared Medicare sacred unless Republicans consider a tax increase for the rich and the Defense community has expressed concern about preserving Pentagon funding. With so many big dollar programs already off table the Supercommittee is looking at "only about 18 percent of federal spending" open to discussion.

Despite a shrinking pool from which to cut, House Majority Leader Eric Cantor (R-VA) has called for talks to begin from where discussions left off with the Biden Group. Cantor—who was major cause in the breakdown of Biden Group negotiations when he walked out of discussions—said talks broke down over questions of tax rate increases. He stressed that the Supercommittee should follow the Biden Group's model "without getting into the areas of strong disagreement" such as tax increases.

All of this leads us to believe that the Supercommittee's recommendation will include a broad, unspecific requirement that Congress take up tax reform but will not have any major tax code modifications itself.

<u>Legislative Branch</u>

Senate

Despite Approval of Three Data Breach Bills, Outlook in Senate Remains Murky: On September 22, the Senate Judiciary Committee approved three bills to address data breach security. The Committee approved the Senator Patrick Leahy's (D-VT) "Personal Data Privacy and Security Act of 2011 (S 1151), Senator Richard Blumenthal's (D-CT) "Personal Data Protection and Breach Accountability Act" (S 1535) and Senator Dianne Feinstein's (D-CA) "Data Breach Notification Act" (S. 1408).

This week's markup is the fourth time that Senator Leahy's bill has been considered by the Judiciary Committee and the outlook in the Senate for data breach legislation remains murky. A Commerce Committee aide told reporters that the failure to pass data breach security legislation results from "a battle between Commerce and Judiciary over who gets primacy over data security." Some Senators—such as Ranking Member of the Judiciary Committee Chuck Grassley (R-IA) — question the need to move forward with data breach notification at all, as Leahy and Majority Leader Reid have been working to incorporate breach notification into a broader cyber security bill.

Democrats Introduce Legislation to Limit Commodity Speculation: On September 21st, Democratic members in the House and the Senate introduced companion bills designed to "drastically limit" speculators from driving up prices of commodities. The Anti-Excessive Speculation Act (S. 1598) was introduced in the

Senate by Senators Bill nelson (D-FL), John Rockefeller (D-WV), Bernard Sanders (I-VT) and Richard Blumenthal (D-CT) and in the House by Representatives Peter Welch (D-VT) and Rosa DeLauro (D-CT). Lawmakers say their bill will cut speculation in half by imposing position limits in oil to 5 percent of the market.

Meanwhile, the CFTC, despite indicating that final position limit rules are ready for a vote, have not set a date to consider the rules. CFTC Chairman Gary Gensler declined to comment when asked if the rules would be considered at the Commission's October 4th meeting.

Senate Banking Republicans Back Bill to Impose Additional Cost-Benefit Analysis on Financial Regulators: On September 22, Republicans on the Senate Banking Committee introduced legislation seeking to capitalize on a recent court ruling that many in the industry see as game changer. The bill—introduced by Ranking Member of the Committee Richard Shelby (R-AL)—would require regulators to justify all new regulations and disclose the economic impact of proposed rulemaking. Additionally, the legislation would ban regulators from pursuing any rules if the costs of the rule were determined to outweigh the benefits. The legislation creates a new "chief economist council" position at each federal agency which would be required to submit annual reports to Congress on regulations.

Shelby said the legislation is necessary to ensure that the Dodd-Frank Act does not cause any additional unemployment. Shelby charged that "regulators are about to subject those who had nothing to do with the financial crisis to hundreds of new rules" without a thought to the costs. In addition to support from Shelby and other Committee Republicans, the measure is backed by the US Chamber of Commerce which lauded the bill for addressing the problem of "inadequate cost-benefit analysis."

Similar legislation has been introduced in the House. In June, Representative Scott Garrett (R-NJ), Chairman of the House Financial Services Subcommittee on Capital Markets, introduced the "SEC Regulatory Accountability Act" (HR 2308). This bill, like Shelby's, would direct SEC's Office of the Chief Economists to analyze the costs and benefits of all potential regulations. The legislation also requires the SEC to outline the costs and benefits of alternative regulations—"including the alternative of not regulating."

Senate Banking Subcommittee Examines Solutions to the "Glut" of Foreclosed Properties: On September 20th, the Senate Banking Subcommittee on Housing, Transportation and Community Development met to hear recommendations on how to address the "glut" of foreclosed properties. Chairman of the Subcommittee, Senator Robert Menendez (D-NJ) floated several proposals to help resolve the foreclosure issue; however, in advance of the hearing Douglass Elliot, a fellow at the Brookings Institution, warned that any legislative fix will do little to solve the problem as the "backlog of foreclosures will continue to thwart any progress of a growth strategy."

Following the hearing, Senators Menendez and Mike Enzi (R-WY) introduced bipartisan legislation to "spark" the US commercial real estate market. The legislation would increase the amount of shared foreign investors may hold in public companies before owning taxes under the Foreign Investment in Real Property Tax Act (FIRPTA). Business groups support the effort and claim that the measure will address "the looming crisis in the commercial real estate market."

House of Representatives

House Subcommittee Grills SEC Over Possible Conflicts of Interest in Madoff Investigation: On September 22nd, the House Oversight and Government Reform Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs held a hearing on conflicts of interest at the SEC, specifically the 'Becker Case.' At the hearing, former SEC General Counsel David Becker defended himself against allegations contained in the SEC Inspector General's report regarding his involvement in the investigation of Bernie Madoff and a potential conflict of interest that Becker had in the case. The IG's report found that Becker—whose late mother had invested in Madoff and left Becker some of her estate—played a large role in determining how to calculate 'net equity' for clawbacks and recommended the case move to the Justice Department for criminal investigation.

Subcommittee members also grilled SEC Chairman Mary Schapiro over IG's report finding that senior SEC officials had knowledge of a possible conflict. In response to lawmakers' concerns of her knowledge of the conflict, Schapiro said, at that time, the SEC was not focusing on "people whose accounts had been closed years ago," as Becker's mother's had been. Schapiro also stressed that the SEC has already made progress in overhauling the Ethics Office and she "we will take immediate steps to implement the report's recommendations."

Meanwhile, at the same time, fifty-two securities attorneys, regulators past and present and noted academics sent a letter to key House lawmakers in support of Becker. The signers of the letter included former SEC Enforcement Division Director Stanley Sporkin, Financial Industry Regulatory Authority (FINRA) Chairman Richard Ketchum, and former SEC Chairman Hervey Pitt, who stressed that Becker "has consistently shown himself to be one of the highest moral and ethical fiber and a strong advocate for justice and the public interest. Another signatory, in a separate interview, said that Becker is a dedicated and talented public servant and "whatever issues people may have, it is now time to move on."

Liberal Democrats continue to rally around the ghost of Glass-Steagall: On September 23rd, Representative Marcy Kaptur (D-OH) held a press conference to announce additional support for her bill, the "Return to Prudent Banking Act" (HR 1498). The bill would reinstate the Glass-Steagall Act which separates the consumer and investment arms of banking. Among the organization in support of Kaptur's legislation are the AFL-CIO and Public Citizen. Despite the support from these stalwart liberal organizations, there is little chance that Congress will vote to re-impose Glass-Steagall anytime, if ever.

Executive Branch

Treasury

President's Budget Proposal Includes Bank Tax: As part of the White House's 'American Jobs Act" the President has proposed a Financial Crisis Responsibility Fee to be imposed on the large financial institutions which accepted taxpayer support through the Troubled Asset Relief Program (TARP) and other government assistance programs. The fee would be imposed on firms with assets over $50 billion until all TARP costs are fully repaid. The fee is expected to reduce the deficit by $30 billion over the next 10 years.

CFPB

CFPB Sheds Light on Timeline for Qualified Mortgage Rule: On September 20, Raj Date, Special Advisor to the White House for the Consumer Financial Protection Bureau (CFPB) announced that the Bureau is working on finalizing a rule to implement the qualified mortgage provision of the Dodd-Frank Act by early 2012. Date said that the CFPB is building on a proposal issued by the Fed and is planning to issue a final rule soon "in order to provide clarity to the market." The proposed rule lays out underwriting standards for qualified mortgages (QM) and states that lenders must make "a reasonable and good-faith determination" on borrowers' ability to meet the terms of the loan. If mortgages do not meet the criteria laid out in the rule, they will be more costly for lender and be more susceptible to litigation.

In addition to the qualified mortgage rule, Date said that the CFPB will be working with fellow regulators to create national mortgage servicing standards. Date said current mortgage servicing puts consumers at a disadvantage because there is no "incentive for servicers to treat borrowers properly." Other speakers at the mortgage conference cautioned industry that the "mortgage industry is the reason why we have this Bureau" and that the CFPB currently has the authority to regulate under current consumer laws such as QM standards. Another speaker noted that the Dodd-Frank Act allows for an "unprecedented amount" of information sharing between the CFPB and state regulators.

DOL

EBSA Announces They Will Re-Propose Rule Defining Fiduciary: On September 19th, the Department of Labor's (DOL) Employees Benefits Security Administration (EBSA) announced that they will re-propose their rule defining a 'fiduciary.' The new proposed rule will likely be issued in early 2012 after giving additional time to "inform judgments, ensure an open exchange of views and protect consumers while avoiding unjustified costs and burdens."

The DOL release announcing the re-proposal cited public comments—including comments from members of Congress—as one reason the agency has decided to re-propose the rule. Industry had long been a vocal critic of this proposal and certain lawmakers had long expressed concerns over the DOL's fiduciary rule—in particular the possibility that the SEC and DOL will propose conflicting definitions. However, the definitive action may have been Barney Frank's letter to the DOL, sent just days before EBSA's decision, that may have been the sign to the administration that industry had won this battle.

In announcing the re-proposal, EBSA indicated that they anticipate the new fiduciary rule will clarify "that fiduciary advice is limited to individualized advice directed to specific parties, responding to concerns about the application of the regulation to routine appraisals and clarifying the limits of the rule's application to arm's length commercial transactions, such as swap transactions." The agency also expects they will address concerns over the impact of the definition on current fee practices of brokers and advisors through adding new of amended exemptions.

FED

Fed Announces Yet Another Round of Monetary Policy: Operation Twist: On September 21st, the Fed announced that, between now and June 2012, they will be purchasing $400 billion in long-term Treasury securities offset by the sale of Treasury securities with maturities of three years of less. The program, which resurrects a policy from the 1960's, is, and was known, "Operation Twist," since the action, which intends to "put downward pressure on longer-term interest rates and help make broader financial conditions more accommodative" resembled the popular dance at the time. In announcing

the program, the Fed cited concerns over slow growth, continuing weakness in the labor market and the unemployment rate as the reasoning for the twist and reaffirmed that it will keep interest rates low through "mid-2013."

In a nearly unprecedented move, prior to the Fed's announcement, Republican Congressional leaders urging the central bank to reject engaging in any action that was intended to create additional stimulus. The letter, which was signed by House Speaker John Boehner (R-OH), Majority Leader Eric Cantor (R-VA), Senate Minority Leader Mitch McConnell (R-KY) and Minority Whip Jon Kyl (R-AZ) told the Fed that it should "resist further extraordinary intervention in the US economy." This action was viewed my many as a clear sign that Republicans are hoping to capitalize politically on a weak economy and that there tea party base, with its 'anti-Fed' attitude, would not object to this nearly unprecedented action. Given that the Fed clearly ignored the last minute missive, at the very least the letter offered Speaker Boehner the ability to claim true "conservative" credentials and will likely be used by Republican Presidential candidates as another example of why the Federal Government cannot stimulate the economy.

International

As Europe appears to be dragging down global markets, G-20 Officials Develop Plan to Aid European Markets: On September 22nd, G-20 ministers issued a statement indicating that the central banks of the world's twenty most developed economies are prepared to provide liquidity to their financial systems if Europe shows additional signs of instability. A senior US Treasury official said that finance ministers feared the European economy has entered a "dangerous phase" and that policymakers agreed a strategy for financial backstop was necessary. The same Treasury official said that discussion "focused on the European Strategy entirely" and a sense of urgency has arisen from perceived "heightened" risks to the economic system such as sovereign debt, system fragility, high unemployment and other market disruptions.

International Financial Services Regulators Discuss Future of Large Financial Institutions: On September 22nd, banking regulators from the US and the UK, at a conference sponsored by Georgetown University, warned that large financial firms will confront major challenges in years to come. Regulators predicted that large firms will have to compete based on the safety of their operations. Thomas Huertas, Director of the UK Financial Services Authority said that "if banks cannot be made safe to fail, society will change what banks can do and limit it." Speakers at the conference stressed that large institutions are increasingly seen as a risk to the global economy and will face new mandates from regulators. Gregory Baer, managing director at JP Morgan Chase said that large banks will have to make an effort to explain how their size adds value to the consumer in the future.

Miscellaneous

Insurance Industry Advised to Brace itself for Upcoming Regulation: On September 19th, at a Practicing Law Institute Conference, stakeholders and former insurance regulators advised that the US insurance industry must change the way it thinks about the regulatory regime. In the past, insurers have been regulated by state agencies; however, as the Dodd-Frank Act begins to take effect, the new Federal Insurance Office (FIO) will begin considering options for federal and international regulatory bodies. While FIO's operations have been "muted" thus far – as a director was not confirmed until March 2011—regulations will likely experience an uptick in coming months as the FIO completes a report on

ways in which to improve regulation of domestic insurance and consider uniformity in the regulation of the insurance industry.

While many argue that insurance companies were not at the heart of the financial crisis—and thus the government should be cautious before labeling insurance providers systemically important financial institutions (SIFIs)—an imminent Dodd-Frank rulemaking to designate SIFIs has the potential to designate insurance firms as systemically important. The insurance industry is staunch in its opposition to being considered a SIFI; however, proponents of the designation argue that some insurers did seek TARP funding. Further adding to the confusion is the misperception that AIG's insurance business received a bailout—however; AIG's subsidiary insurance business was not the source of the company's disintegration.

The insurance industry also awaits Senate action on the confirmation of S. Roy Woodall to be the voice of the industry on the Financial Stability Oversight Council (FSOC). Despite having cleared the Senate Banking Committee on September 8th, it is unclear when the full Senate will vote on the sole insurance industry representative to the FSOC.

Moody's Downgrades Several Large Banks, Citing Dodd-Frank as Motive: On September 21st, Moody's Analytics downgraded three major US banks, Bank of America, Wells Fargo and Citigroup. Moody's said that the downgrades are based on the belief that the federal government is far less likely to bail out a failing bank in a post-Dodd-Frank environment and thus the burden of future crises of bank losses are shifting back to banks and away from taxpayers.

Reacting to the announcement, Barney Frank (D-MA) said that while he would not comment on the merit of Moody's ratings he was "pleased that the rating agency recognizes that such large institutions are not 'too big to fail'" and that the downgrades are confirmation that the Dodd-Frank Act "got it right."

UPCOMING HEARINGS

The House and Senate were originally scheduled to be in recess until October 3 – though the uncertainty of the schedule due to the need to pass a CR before September 30th may complicate that, at this time the schedule of relevant hearings is as follows:

On Tuesday, October 4th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Domestic Monetary Policy and Technology will hold a hearing to assess transparency at the Federal Reserve.

On Tuesday, October 4th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing on the Securities Investor Protection Corporation.

On Tuesday, October 4th at 10am, in 216 Hart, the Joint Economic Committee will hold a hearing on the current economic outlook.

On Wednesday, October 5th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will mark up draft legislative proposals relating to small business capital formation and job creation.

On Thursday, October 6th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Insurance, Housing and Community Opportunity will hold a hearing on the administration's responses to the housing finance crisis.

On Thursday, October 6th at 2pm, in 2128 Rayburn, the House Financial Services Committee will hold a hearing on the first annual report from the Financial Stability Oversight Council.

On Wednesday, October 12th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit will hold a hearing on regulatory impediments to job growth.

On Wednesday, October 12th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Insurance, Housing and Community Opportunity will hold a hearing on the housing choice voucher program, also known as the Section 8 program.

On Thursday, October 13th at 10am, in 2128 Rayburn, the House Financial Services 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 Thursday, October 13th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing on proposals that would amend provisions contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act.