



ML
STRATEGIES

Jason Rosenstock,
JRosenstock@MLStrategies.com
Gregg Gelzinis
GGelzinis@mlstrategies.com

Follow us on Twitter [@MLStrategies](https://twitter.com/MLStrategies) and [@MLSFinRegUpdate](https://twitter.com/MLSFinRegUpdate)

ML Strategies, LLC
701 Pennsylvania Avenue, N.W.
Washington, D.C. 20004 USA
202 434 7300
202 434 7400 fax
www.mlstrategies.com

November 25, 2013

Financial Services Legislative and Regulatory Update

Leading the Past Week

It is a rare moment when we realize we are actually witnesses to history. So it was only fitting that this past week, while the baby boomer generation remembered where they were when they heard the news of the assassination of President Kennedy, Majority Leader Reid decided to execute the so-called “nuclear option.” Like so many things these days in our nation’s Capitol, the decision was simultaneously **hailed** or **demonized**, and while history will be the ultimate judge of things, it is clear that the decision will have a real impact on the remainder of the 113th Congress.

In terms of the procedural maneuver’s impact on the financial services industry, the most immediate effect is that many of the heretofore vacant positions at various regulators will be filled more quickly than under the old system. This includes Mel Watt at FHFA, as well as others, such as Janet Yellen who certainly appeared able to be confirmed under the 60 vote threshold. Though, the regulator that benefits the most from this change is the CFTC, which will dwindle to only two commissioners sometime shortly after the start of 2014 and likely would have been crippled for many months. Instead, the Senate should be able to confirm a new Chairman and two additional commissioners more quickly, though it is worth noting that the stakeholders interested in the majority of the CFTC’s work tend to break along regional, rather than partisan lines, so that an expedited process isn’t guaranteed.

In other news, Senate Finance Chairman Max Baucus **released** the first of his draft proposals for comprehensive tax reform. Each document focuses on a relatively narrow area to reform, with last week’s documents focusing on international taxation, tax administration, and cost and recovery. The release of these drafts, coupled with news that the Budget Conference might be able to produce a “**small deal**” rekindled the belief amongst some in Washington, that Congress was on the path to recovery and some type of major tax reform could be accomplished in 2014. Whether this is now possible as the Senate sifts through its “**nuclear winter**” is unclear. On one hand the decision could shut down and already **broken institution**, though on the other it could galvanize Congress to work together to operate as a coequal branch of the government, now that the President is no longer

handcuffed in making appointments, and thus is incentivized to pass appropriation bills, as well as other legislation.

Legislative Branch

Senate

Senate Banking Committee Votes on Yellen

On November 21st, the Senate Banking Committee, on a 14-8 vote approved the nomination of Janet Yellen to serve as Chairwoman of the Federal Reserve. Republican Senators Corker (R-TN), Kirk (R-IL), and Coburn (R-OK), along with 11 Democrats, voted in favor of Yellen. The only Democrat on the committee to vote against Yellen's nomination was Senator Manchin (D-WV), who indicated that his vote was based on concerns that Yellen wasn't committed enough to ending the Fed's QE program. A vote by the full Senate has not yet been scheduled, and while it appeared that she had at least 60 votes, the procedural changes in the Senate could ensure that Ms. Yellen is confirmed before the end of the year, but almost certainly before current Fed Chairman Ben Bernanke's term ends on January 31, 2014.

Senate Committees Weigh Threats and Promises of Virtual Currency

Last week, two Senate Committees separately held hearings to examine the growing prevalence of virtual currencies. First, on November 18th, the Senate Homeland Security and Government Affairs Committee's hearing focused on how virtual currencies, such as Bitcoin, have been used to launder money and facilitate other illegal activities. The first panel was comprised of representatives from Treasury, Justice, and Homeland Security, and all three agencies stressed that while virtual currencies are not inherently illegal and many have legitimate uses, they do contain features that make them particularly appealing to criminals. In addition to hearing from law enforcement, the Committee also heard from the private sector representatives on how industry has approached virtual currencies.

The next day, two Senate Banking Subcommittees, the Subcommittee on Economic Policy and the Subcommittee on National Security and International Trade and Finance held their own hearing on virtual currencies. Senators on these subcommittees appeared interested in how regulators are interacting with virtual currencies in order to mitigate risk of illicit activities. In response, Ms. Jennifer Shasky Calvery, Director of the Financial Crimes Enforcement Network (FinCEN) testified that FinCEN requires institutions that accept virtual currencies to register with FinCEN and abide by all of FinCEN's Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) standards. She explained that illicit actors may choose to utilize virtual currency because it may have low fees, it provides anonymity, it is accessible globally, and there are no transaction limits. Mr. Cotney, Commissioner of Banks in Massachusetts, argued that moving forward, federal-state communication and cooperation is vital. Also at the hearing, industry stakeholders testified that while virtual currencies have great promise, there are consumer protection issues that need to be addressed. Ms. Mercedes Kelley Tunstall, a partner at Ballard Spahr LLP, argued that Bitcoin has caused some of its own problems because it is designed somewhat like a commodity. Other virtual currencies are designed to avoid boom and bust cycles.

Generally, both of these hearings were seen as the first step in a coming out party for BitCoin in Washington, DC, and so it was not surprising that following the hearings the value of BitCoin rose to an all-time high. Incidentally, this past week, the FEC failed to adopt formal rules on the use of Bitcoin in federal elections, due to a 3-3 vote. (One commissioner recused himself and FEC rules require that at least 4 Commissioners approve an advisory opinion). Despite failing to grant an advisory opinion on

this issue, it seems clear that “we have not seen the last of Bitcoin at the FEC,” as FEC Chairwoman Weintraub noted.

Senate Banking Committee Continues Examination of Housing Finance Reform

On Friday, November 22nd, the Senate Banking Committee held another hearing on Housing Finance Reform, this one focused on how to ensure a smooth transition from the status quo to the new system. The Committee heard from four witnesses and the general consensus was that Congress needs to provide the greatest amount of flexibility possible as the market transitions from the current model, with GSEs serving as the ultimate backstop, to the framework imagined by the Corker Warner bill, which creates a new federal entity to serve as a backstop but only after private investors have absorbed 10% of the losses. For example, Mark Zandi, Chief Economist for Moody’s noted that the current system is effectively capitalized at a 2.5 percent loss rate, whereas moving to the 10% threshold envisioned under Corker Warner would add about 40 basis points to mortgage rates. Instead of a straight line transition, Zandi proposed a system based on benchmarks and hitting targets to minimize the amount of systemic risk. This sentiment was echoed by other witnesses, including James Millstein, chairman and chief executive officer of Millstein & Co. and a former Treasury official responsible for restructuring during the financial crisis, who said that there must be a proven path toward accumulating the substantial layer of private first-loss capital on which the new system will depend, since “you can't issue a new guarantee unless you have your first-loss capital in place, and there will be no guarantees in the absence of that capital being there.”

Democratic Lawmakers Ask for Foreclosure Review Details

On November 15th, Senator Elizabeth Warren (D-MA) and Reps. Maxine Waters (D-CA) and Elijah Cummings (D-MD) sent a [letter](#) to Federal Reserve Chairman Ben Bernanke and Comptroller of the Currency Thomas Curry asking them to release information regarding past reviews of bank foreclosure files. In April of 2011, past abuses by 16 mortgage servicers were discovered which led to the agreement that the mortgage servicers would be reviewed by independent consultants. Earlier this year, regulators agreed to settlements with 15 out of the 16 mortgage servicers. Senator Warren and Reps. Waters and Cummings would like a report on relief being given to borrowers under the terms of the settlements. The lawmakers requested the information by the end of this year.

Senate Finance Committee Holds Confirmation Hearing for Deputy Treasury Secretary Nominee – Indicate Work on Tax Reform to continue in 2014

At the confirmation hearing of Sarah Bloom Raskin to serve as Deputy Treasury Secretary, Chairman Baucus (D-MT) and Ranking Member Hatch (R-UT) both made it clear to Ms. Raskin that she would need to make tax policy a top priority if confirmed and that the Finance Committee expects a high level of cooperation from the Treasury Department as the committee continues to engage in tax reform. Interestingly, Chairman Baucus also said that Ms. Raskin will have to work to regain the public’s trust in the IRS after the Tea-Party targeting controversy last May. With Ranking Member Hatch publicly stating his support for Ms. Raskin’s confirmation, it may have indicated smooth sailing. However, in light of the “nuclear winter” in the Senate, that issue is moot as Ms. Raskin only needs a simple majority to win confirmation, meaning the only issue is when the Senate will take up the vote.

Trio of Senators Write to Regulators on Leverage Ratios

On Friday, a bipartisan group of Senators Sherrod Brown, Senator David Vitter and Senator Carl Levin [wrote to the banking regulators](#), including the FDIC, the Fed, and the OCC urging the regulators to impose a stricter leverage ratio than was proposed in July. The letter praised the regulators for their

work to date, it urged them to go further than the July proposal, which incidentally was tougher than the international standard set forth by the Basel III agreement, in order to ensure that big banks do not become “too big to fail.”

House of Representatives

House Financial Services Examines Disparate Impact Theory

On November 19th, the House Financial Services Committee held a hearing to examine the use of disparate impact theory in fair lending cases. As was expected, Democrats voiced support for the concept, while Republicans cautiously expressed their concerns about the application of Disparate Impact in enforcement or judicial actions. Many of the CFPB's actions of late include disparate impact analysis, and there are reports that lenders are concerned that they may encounter disparate impact cases after the CFPB's QM rule goes into effect in January. The hearing came one week after settlement was reached in a case that was heading to the Supreme Court.

House Financial Services Holds Hearing on Flood Insurance Implementation

Last week, the House Financial Services Committee held a hearing to analyze the implementation of the Biggert-Waters Flood Insurance Reform Act of 2012. Many Representatives expressed their concerns that the anticipated premium spikes in flood insurance will force constituents out of their homes and potentially destroy coastal economies. The Biggert-Waters reform was designed to make the federal flood insurance program financially solvent and to remove taxpayer subsidies. At the start of 2013, the flood insurance program was \$20 billion in debt. Representative Maxine Waters (D-CA), one of the architects of the reform bill, stated that the massive premium increases were unintended. FEMA Director Craig Fugate cautioned the committee against delaying implementation of the flood insurance reform bill. Chairman Hensarling (R-TX), in a pre-hearing statement, emphasized the importance of implementing the new flood insurance program in order to prevent taxpayers from having to bail out the flood insurance program.

Luetkemeyer Writes to CFPB Contesting Auto Lending

On November 15th, Representative Blaine Luetkemeyer (R-MO) joined a growing chorus of lawmakers writing to CFPB Director Cordray to note his concerns with the Bureau's actions in the auto lending sector. The core of Luetkemeyer's letter focuses on a controversial bulletin that the CFPB released in March, which among other things outlined the Bureau's intent to ensure that automobile finance sources were not engaging in discriminatory practices under a disparate impact theory analysis. Luetkemeyer argues that, though discrimination has no place in lending, the Equal Credit Opportunity act (ECOA), which is the foundation of the law for the CFPB's guidance, does not actually contain a disparate impact theory of discrimination and therefore the Bureau's use of this theory is an "entirely new dimension of public policy surrounding fair lending."

Neugebauer Planning TRIA Markup for Next Year

The week after holding a legislative hearing on the Terrorism Risk Insurance Act (TRIA) program, Chairman of the House Financial Services Subcommittee on Housing and Insurance Randy Neugebauer (R-TX) announced that he expects the subcommittee to mark up legislation to reauthorize the program in February or March 2014.

House Financial Services Committee Approves CFPB Related Bills

On November 21st, the [House Financial Services Committee reported out six bills dealing with the structure of the CFPB](#). Among the bills voted on included legislation to subject the CFPB to the annual congressional authorization and appropriations process, a bill that would take CFPB employees off the Federal Reserve pay scale and put them on the GS compensation scale, as well as legislation that would eliminate the current Director based leadership of the CFPB and replace it with a bipartisan five-

member commission nominated by the president and confirmed by the Senate. Other bills voted out of Committee would require the CFPB to take into consideration the impact of a rule on the safety and soundness of an insured depository institution, as well as a bill that would enable the FSOC to set aside any CFPB issued regulation by a majority vote instead of the currently required 2/3rds vote. Finally, the Committee also passed [HR 3183](#), which would provide consumers with an annual report on the information that the CFPB collects on them., as well as [HR 2571](#), which would require the CFPB to obtain permission from consumers prior to collecting their personal data. All votes passed on a straight party line vote, indicating that there is little chance they will be considered in the Senate.

Executive Branch

CFPB

The CFPB Releases Streamlined Mortgage Forms

This week, the CFPB released the final version of their new streamlined mortgage disclosure forms, after a process that was more than two years in the making. Under this rule, lenders are required to use the two new CFPB forms, the loan estimate form and the closing disclosure form. The [loan estimate form](#) provides consumers with a snapshot of a loan's key terms and estimated costs. This form is given to borrowers after they submit their mortgage application and replaces RESPA's Good Faith Estimate Form along with the early TILA form. [The disclosure form](#) provides the consumer with an in depth overview of the transaction. This form will be given to the consumer three days before closing, instead of at the time of closing, to provide the consumer with more time to review the terms of the agreement. Lenders are required to start issuing the new mortgage disclosure forms in August 2015.

CFPB Takes Enforcement Action Against Payday Lender

On November 20th, the CFPB took its first enforcement action against a payday lender after discovering violations during an examination of the company back in mid-2012. As a result of the CFPB's actions, a Texas based company, Cash America, will pay \$14 million in customer refunds for lending law violations and \$5 million in fines for destroying records after the CFPB began its investigation.

Bureau Report Finds Spending on Marketing Far Outpaces Spending on Education

On November 18th, the CFPB released a [report](#) comparing spending on financial education and financial marketing. The report finds that for every dollar spent educating consumers on financial decisions, \$25 is spent marketing financial products to them. The report found that financial institutions spend roughly \$17 billion a year on marketing, while only \$670 million is spent on financial education. Non-profits account for the most spending on financial education (\$472 million), followed by the government (\$130 million), and financial institutions (\$31 million). The report posits that this disparity makes it difficult for consumers to find objective information about financial products and decisions. Announcing the report, Director Cordray said the study "further reinforces the dire need for more and better financial education in this country."

CFTC

Draft Volcker Rule Shared with Commission

On November 19th, Chairman Gary Gensler presented a draft of the "final" Volcker Rule to his fellow CFTC Commissioners, though the SEC, which also must vote on the rule, apparently had circulated its draft several days prior. While all signs point to an interest by the respective leaders of the many agencies involved in finishing this rule before the end of the year, and the end of Gensler's term, there are clearly bumps in the road ahead. First, CFTC Commissioner Bart Chilton announced his

opposition to the current draft of the Volcker Rule because he is concerned that it would allow banks to place speculative bets under the guise of hedging. Then, SEC Commissioner [Kara Stein](#) indicated that she might not be willing to support this draft, thus likely dooming its passage at the SEC, because it isn't tough enough.

Although the change in Senate rules could [expedite replacements](#), the Volcker Rule is clearly at a critical stage, especially at the CFTC, where Chilton has announced his plans to step down at an undisclosed time. If the Commission cannot vote on the Rule before the end of the year, it would be hard to see how the CFTC votes on it afterwards, as the Commission will dwindle to two members, one Democrat and one Republican, on January 1st. Furthermore, Senate Agriculture Committee Chairwoman Debbie Stabenow has made it clear that she does not expect to vote on the new CFTC nominees, including Treasury official Timothy Massad, who has been nominated to be the Chair, or Christopher Giancarlo to fill a vacant Republican seat. Other rumored nominees include Sharon Bowen, who is considered a leading contender to replace Commissioner Chilton.

European Union Expresses Concerns about CFTC Cross Border Staff Advisory

This week it was reported that foreign regulators, particularly those in the EU, were critical of the CFTC's cross-border plans, which they viewed as a dramatic over reach by the CFTC. For example, a spokeswoman for EU financial services commissioner Michel Barnier said that EU officials were "very surprised" by the CFTC's announcement last week, which held that trades booked by foreign banks could fall under rules from the 2010 Dodd-Frank law if an employee in the U.S. is involved with arranging the deal. Interestingly, some EU regulators saw the CFTC's move as another example for why financial regulation should be within the scope of trans-Atlantic trade talks, which is something that, to date, U.S. negotiators have resisted including in talks on the deal.

Judge Orders MF Global to Pay Fine, Restitution

On November 18th, the CFTC [announced](#) that the agency has obtained a federal court consent order against MF Global requiring it to pay \$1.212 billion in restitution to customers harmed by the losses sustained by the firm in 2011. U.S. District Judge Victor Marrero also ordered the failed financial firm to pay a \$100 million penalty as part of a settlement with the CFTC. Despite the order, a civil case against former CEO Jon Corzine and former Assistant Treasurer Edith O'Brien is still pending.

CFTC Publishes Weekly Report on Derivatives Market

On November 20th, the CFTC published the inaugural edition of a weekly swaps [report](#) that will provide the public data collected on the derivatives market. The current plan is to publish the report on Wednesdays using 12-day-old data, in order to provide more transparency to the derivatives market. The report also contains data on interest rate and credit asset classes that make up 90% of the market, as well as estimates on equities, foreign exchange, and commodities.

SEC

Advisory Committee Votes to Recommend Imposing a Fiduciary Duty on Brokers

On Friday, the SEC's Investor Advisory Committee, a 21 person panel chaired by Joseph Dear, Chief Investment Officer of the California Public Employees Retirement System, and includes members such as Joseph Grundfest, a Stanford Professor and former SEC Commissioner, and Barbara Roper of the Consumer Federation of America, voted to recommend the SEC impose a fiduciary duty on brokers who provide personalized investment advice. Although not a binding imposition on the SEC, the move is clearly a strong "nudge" for the Commission. SEC Chairwoman White has said that the

fiduciary duty issue is “a major focus” at the SEC and that there is “real traction” on the issue but as of yet has refrained from offering a timetable for drafting any rules. The Department of Labor is also pressing ahead with its own rules to re-define the definition of fiduciary.

FDIC

FDIC Issues Final Guidance on Direct Deposit Advance Loans

On November 21st, the FDIC, along with the OCC issued [final guidance](#) on Direct Deposit Advance Loans. Consumer advocates have pushed for the elimination of these loans claiming the loans are predatory in nature and that the loans pose financial and reputational risk to the banks that issue them. The FDIC advised banks to continue to meet the small dollar needs of its consumers but warned of the credit, reputational, operational, and compliance risks associated with Direct Deposit Advance Loans. Furthermore, the FDIC noted out that many banks do not check a borrower’s creditworthiness before issuing the loans, which leaves the institution open to safety and soundness risk. The guidance also criticizes the way institutions advertise the loans, claiming that many institutions do not advertise lower cost alternatives that are available to the consumer. Finally, the FDIC made clear that the Direct Deposit Advance Loans may raise issues under the FTC Act, the Electronic Fund Transfer Act, and the Truth In Savings Act. Industry response to this guidance attempted to point out that these rules may drive customers away from well regulated banking institutions to the darker corners of the financial system, especially for those customers who live pay-check to pay-check and often rely on these loans to bridge cash flow issues.

Federal Reserve

The Fed Continues to Weigh Removal of Bank Executives

After her confirmation hearing, Federal Reserve Vice Chairwoman Janet Yellen sent a [letter](#) responding to Senator Elizabeth Warren’s (D-MA) written questions in which she explained that the Fed is continuing to investigate whether removal of bank executives involved in foreclosure abuses is warranted. Yellen said that in order to justify removal, there must be evidence of “personal dishonesty or reckless or willful disregard for safety and soundness”. The Fed has worked with the Department of Justice in their efforts to determine whether filing criminal charges against bank executives is appropriate. Senator Warren has repeatedly pushed regulators to bring more cases against bank executives.

Fed Approves Green Dot to Becoming Issuing Bank

On Friday, the Fed blessed an application by Green Dot, a leading prepaid card provider, to become the issuing bank for the cards, if the company goes ahead with its planned acquisition of GE Capital Retail Bank. If that deal goes through, Green Dot will become the issuing bank for Wal Mart’s branded prepaid cards and more than double its deposits from around \$183 million to almost \$500 million. If that deal goes through, it will be the first time that the same entity is both the issuing bank and the program manager. The move could be finalized as the CFPB ramps up its examination of the industry, as it is understood that the Bureau will act on its pending ANPRM sometime in Q1 or Q2 of 2014.

USTR

U.S. Trade Representative Froman Cautions Against Linking Currency Provisions to Trade Agreements

On November 19th, at an event hosted by the Wall Street Journal, U.S. Trade Representative Michael Froman took a cautious posture on the issue, saying, “We have to be careful, I think how we talk about currency and how we link it to trade rules because we certainly don't want to put ourselves in a defensive position as well.” The comments came in response to pressure from members of the House

and Senate are advocating for the inclusion of currency rules within the Trans-Pacific Partnership agreement (TPP). Froman left the door open to currency provisions in the TPP and said that trade officials are continuing to consult with Congress and other stakeholders regarding the TPP.

MISCELLANEOUS

Banking Groups Press for FACTA Compliance Extension

Earlier this week, four major Financial Services lobbying groups requested the Obama administration to issue a six-month delay for the FACTA law which is scheduled to begin on July 1, 2014. The groups asked for the delay due to the fact that banks and other financial institutions need additional time to bring themselves in compliance with the parameters of FACTA. The Obama Administration has not yet responded to the request, but it is worth noting that FACTA's effective date has already been postponed twice. The law requires foreign banks, insurers and investment funds to send the Internal Revenue Service information about Americans' offshore accounts worth more than \$50,000 and the institutions asking for the delay argue that foreign businesses that do not comply might be effectively frozen out of U.S. capital markets because of a 30 percent withholding tax on their income from the United States.

Upcoming Hearings

The Senate and House will be in Recess.