ML Strategies Update

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Financial Services Legislative and Regulatory Update

Leading the Past Week

With January officially in the record books, it is worth noting that as of February 1st, 279 Dodd-Frank rulemaking requirement deadlines have passed. Of the passed deadlines, 63 percent have been missed and 37 percent have been met with final rules. While the implementation continues to plod along, the heads of the regulatory agencies will be brought before the Senate Banking Committee this week, as the first hearing 113th Congress will focus on the FSOC and the implementation of Dodd-Frank. Last week, the House Financial Services Committee met for the first time, and although there were behind the scene efforts to increase the comity of the committee – with many of the members meeting for an impromptu dinner – it remains unclear if such efforts will be successful as less than an hour into the hearing Ranking Members Waters and Chairman Hensarling appeared to engage in a sharp exchange.

Attention this week will be focused on the State of the Union on Tuesday night, which appears to be focused on the economy.

Legislative Branch

Senate

Senate Banking Finalizes Subcommittee Leadership

Last week the Senate Banking Committee officially announced its subcommittee chairmen and ranking members, with the only major changes occurring due to the fact that Senator Jack Reed (D-RI) was forced to give up his position as top Democrat on the Securities, Insurance and Investment Subcommittee to comply with a caucus rule barring lawmakers from chairing three subcommittees. The Securities Subcommittee will now be chaired by Senator John Tester (D-MT) with Senator Mike Johanns (R-NE) serving as Ranking Member. The remaining subcommittee assignments include:

- Housing, Transportation, and Community Development – Chair Robert Menendez (D-NJ), Ranking Member Jerry Moran (R-KS)
- Financial Institutions and Consumer Protection – Chair Sherrod Brown (D-OH),

Ranking Member Patrick Toomey (R-PA)

- National Security and International Trade and Finance – Chair Mark Warner (D-VA), Ranking Member Mark Kirk (R-IL)
- Economic Policy – Chair Jeff Merkley (D-OR), Ranking Member Dean Heller (R-NV)

Rand Paul Continues Father's Bid to Audit Fed
Last week, Senator Rand Paul (R-KY) resubmitted legislation to audit the Federal Reserve. The legislation, a long-time goal of Paul's now-retired father Representative Ron Paul (R-TX), was introduced in the House by Representative Paul Broun (R-GA). In the 112th Congress, Representative Paul's legislation passed the House 327 to 98 but never came to a vote in the Senate.

House of Representatives
House Financial Services Committee Hears Testimony on Role of FHA
On February 6th, the House Financial Services Committee met for the first time in the 113th Congress to consider ways in which to bolster the finances of the FHA and the government's role in the mortgage finance system. Lawmakers heard testimony from, among others, Julia Gordon, director for housing finance policy at Center for American Progress, who argued that the FHA has so far been successful in covering its costs and avoiding a subsidy or increased premiums. Gordon asked the Committee to give the agency more time "to see the results of the significant improvements made by the FHA before adding still more changes to the mix. The FHA currently insures 1.2 million mortgages, supporting 15 percent of all home loans, and has a projected $16.3 billion shortfall in its insurance fund.

Waters Calls on Chairman to Hold Hearing on Foreclosure Settlement Review
On February 5th, Ranking Member of the House Financial Services Committee Maxine Waters (D-CA) called on Chairman Jeb Hensarling to hold a hearing on the recent settlement between banking regulators and U.S. banks faced with foreclosure abuse charges. Waters said that she wants bank regulators to explain what went wrong during a case-by-case review of foreclosed homes that ended "abruptly" in January, why a cash settlement with the mortgage industry was reached instead, and what the deal means for struggling homeowners. Representatives Carolyn Maloney (D-NY) and Elijah Cummings (D-MD) and Senator Warren (D-MA) have also called on regulators to turn over the results of the performance reviews by the independent contractors hired to examine the loan files, as well as detailed information about the reviews' preliminary results, to determine the extent of the harm to the 500,000 people who had applied to the Independent Foreclosure Review program.

House Democrats Urge White House to Replace FHFA Director
On February 7th, 45 House Democrats wrote President Obama urging him to replace Federal Housing Finance Agency (FHFA) Acting Director Edward DeMarco with a permanent replacement. Director DeMarco has been in the interim position for three and a half years. The FHFA Director oversees Fannie Mae and Freddie Mac and is able to minimize foreclosures through an ability to modify mortgage loans. The letter indicates frustration that DeMarco has not fully executed these duties and that he failed to implement a pilot program to reduce taxpayer costs and home foreclosures.

Terrorism Risk Insurance Program Reauthorization Introduced
On February 6th, Representatives Michael Grimm (R-NY) and Carolyn Maloney (D-NY) introduced legislation to extend for five years the Terrorism Risk Insurance Program (TRIA).

The bill is also cosponsored by Representatives Pete Sessions (R-TX), André Carson (D-IN), Peter King (R-NY), Gregory Meeks (D-NY), Dennis Ross (R-FL), Timothy Bishop (D-NY), and Carolyn McCarthy (D-NY). Absent Congressional action, TRIA is set to expire on December 31, 2014, but the Committee is expected to begin working on the issue this year.

Bipartisan Homeowner Catastrophe Protection Act Introduced
On February 6th, bipartisan lawmakers introduced the Homeowner Catastrophe Protection Act, a bill which would create tax incentives for insurance companies and homeowners in the event of natural disasters. Representatives Bill Pascrell (D-NJ), Michael G. Grimm (R-NY), Thomas Rooney (R-FL), and Theodore Deutch (D-FL) introduced the measure, which combines the Policyholder Disaster Protection Act, the Catastrophe Savings Accounts Act, and the Natural Disaster Mitigation Act.

<u>Executive Branch</u>

DOJ

DOJ Brings Charges Against S&P for Role in Financial Crisis
On February 4th, the Justice Department filed suit against Standard & Poor's, alleging the ratings agency gave improperly high ratings to securities that failed, triggering the financial crisis. According to DOJ, the lawsuit will examine the AAA ratings given to collateralized debt obligations that were tied to subprime mortgages. S&P has called the suit, which is being brought under the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA), unjustified as the company was assessing securities based on the same data that other ratings agencies and government officials used. In the past credit ratings agencies have made a First Amendment argument in attempting to rebuff challenges to ratings, and are expected to raise similar arguments here, having retained legendary constitutional defense attorney Floyd Abrams.

Following the announcement, Representative Maxine Waters (D-CA) lauded DOJ for filing "long overdue" civil charges against S&P. She urged Federal and state prosecutors to pursue possible bad actors, saying "given the power and influence credit ratings agencies have on the market and investor confidence, they should be held to a higher standard of accountability." In the past, Waters has supported the California Attorney General in efforts to crack down on ratings agencies. Notably, New York Attorney General Eric Schneiderman is not participating in the DOJ suit, but is expected to pursue his own investigation.

White House

White House Sees Carried Interest as Priority
In a February 3rd interview before the Super Bowl, President Obama said that he plans to include in his annual budget proposal a plan to change the tax treatment of carried interest—the investment gains that fund managers retain for themselves as compensation. The taxation of carried interest has been a recurring battle in Congress and is currently taxed as capital gains. In 2010, Democrats tried to tax the profits from investments made by fund managers without success due to opposition from a variety of Senators, including Patty Murray (D-WA), Robert Casey (D-PA), Mark Warner (D-VA), and Jeanne Shaheen (D-NH). Finance Committee Chairman Max Baucus' (D-MT) last attempt to compromise on carried interest included a proposal to allow 75 percent of carried interest income to be taxed at ordinary rates while the remainder would be taxed at the capital gains rates, with an exemption for long term investments. However this proposal was defeated in Committee and despite the President's recent push, or the fact that it may be included in Senator Levin's proposal to delay the impact of sequester, it is unclear if there is any appetite in Congress for reform.

Federal Reserve

Fed Governor Duke Advises Community Banks to be Vocal on Burdensome Regulations

In a speech on February 5th, Governor Elizabeth Duke called for community banks to identify new regulations that would be particularly onerous to their business and continue to engage with regulators on alternatives. Duke said, so far, community banks have been successful in making themselves heard and arguing against 'one-size-fits-all' regulations—pointing to the CFPB's ability-to-repay rule as a recent example of an exemption for small banks. Duke also assured small banks that, in considering final capital rules, the Fed "will do everything possible to address the concerns that have been expressed by community bankers."

CBO Predicts Expansionary Monetary Policy Will Begin to Wind Down in 2016

CBO Director Douglas Elmendorf said on February 5th that the Fed will likely begin to raise the federal funds rate in 2016 and begin to sell off the bonds it bought to stimulate the economy. The low fed funds rate and bond buys have both been a part of an effort to provide easy and inexpensive access to credit to spur economic recovery.

SEC

SEC Offers Guidance on JOBS Act

On February 5th, the SEC Division of Trading and Markets released a frequently asked question, or FAQ guidance on the registration exemption for broker-dealers under the JOBS Act, which among other things requires the SEC to raise its ban on general solicitation and advertising of private offering. The guidance issued last week clarifies that the registration exemption is only available when securities are offered or sold under Rule 506 and that the exclusion does not mean the person is exempted from the definition of "broker" or "dealer."

SEC Extends Relief for Certain Swap Deals

Based on a request from SIFMA, the SEC announced on February 7th that it was extending, the current temporary relief exempting market participants from compliance with certain 1 security-based swaps for another year. The protections were set to expire on February 11th, but an extension was deemed necessary by the Commission in order to avoid a potential unnecessary disruption to the security-based swap market while continuing to allow the SEC to consider the potential impact of the revision of the Exchange Act definition of security "in light of recent Commission rulemaking efforts under Title VII of the Dodd-Frank Act."

FDIC

FDIC Board Member Pushing for Leverage Ration Based Capital Framework

In a speech on February 6th, Jeremiah Norton, member of the FDIC board, speaking on Basel III capital standards, said that a leverage ratio based on total assets may be a more appropriate measure of bank stress than a risk-based capital ratio. The FDIC, OCC and FED proposed a rule in June to implement the capital rules; however, in response to widespread criticism, such as was expressed by members of both parties at a late November hearing, regulators released guidance delaying the effective date. Norton recommended that regulators consider setting higher leverage ratio requirements based on higher quality tangible capital relative to banks' total assets.

Treasury

CBO Finds TARP Sales Decrease FY 2013 Deficit

According to the CBO's budget outlook which it released on February 5th, the sale of the

Treasury's remaining stock in AIG will further reduce the deficit by $13 billion in FY 2013. The purchase of AIG shares cost the taxpayer $25 billion, but, as the Treasury was able to sell the shares at much higher prices than anticipated. The final AIG stock holdings were sold in December for $32.50 per share, recovering al of the $182.3 billion invested by the Treasury and Fed plus an additional $22.7 billion.

FHFA

Fannie and Freddie Seeking to Incentivize Use of HARP

Under new rules, which were sent to mortgage lenders last week, beginning May 1st the government-sponsored entities Fannie Mae and Freddie Mac will allow lender to pay up to $2,000 of a loan owned by the GSEs in order to incentivize use of the Home Affordable Refinance Program. The FHFA has thus far been skeptical of allowing GSEs to reduce the principal on loans they own, concerned that principal reduction could ultimately cost the taxpayer.

DOL

Re-Proposed Fiduciary Rule Coming in July – Expected to Address Difference Between Education and Advice

At a February 7th meeting of employee benefit practitioners, the Department of Labor said it intends to propose a bright-line test for differentiating between investment education, investment advice and fiduciary liability when it re-issues a proposed regulation on the definition of a fiduciary. The re-proposed fiduciary rule, which DOL is expected to release in early July, could also include a prohibited transaction exemption for revenue-sharing and other indirect compensation practices.

International

European Commission Readying Transaction Tax

According to a recent proposal by the European Commission, some of the larger Eurozone economies could raise €30 to €35 billion from the plan to levy a tax on financial transactions. The proposal, which has been revised and strengthened over earlier drafts, is the beginning of an agreement on the final terms of the so-called "Tobin tax" on equity, bond, and derivative transactions. The blueprint for the tax, which is due to be published soon, is reported to add additional anti-avoidance measures to the levy so businesses cannot flee to safe havens. Specifically, the plan levies a 0.1 percent tax on stock and bond trades and .01 on derivatives transactions involving more than one financial institution located in the Eurozone tax area.

Miscellaneous

Report Finds Cuts to Government Subsidy of Retirement Savings Highly Unpopular

Recent finding show that 85 percent of households surveyed from November to January did not support removing tax incentives for defined-contribution retirement plans. The survey, conducted by the Investment Company Institute, also shows that 89 percent of those surveyed disapprove of removing incentives for other retirement accounts, such as 401(k)s. However, a recent paper published by Harvard University calls into question the effectiveness of these tax incentives for increasing retirement savings. The report finds, using data from Denmark, that for every dollar of government subsidy spending, retirement savings rise by only one cent. Still, the Employee Benefit Research Institute has since refuted these claims, saying the Harvard study explored only the impact of tax incentives on work place retirement plans.

Upcoming Hearings

On Tuesday, February 12th at 10:30am, in 608 Dirksen, the Senate Budget Committee will hold a hearing on the budget and economic outlook prepared by the Congressional Budget Office.

On Wednesday, February 13th at 10am, in 215 Dirksen, the Senate Finance Committee will meet to Consider the Nomination of Jacob J. Lew to be Secretary of the Treasury.

On Wednesday, February 13th at 10am, in 2128 Rayburn, the House Financial Services Committee will hold a hearing titled "FHA November 2012 Actuarial Report and Potential for Taxpayer Bailout."

On Wednesday, February 13th at 10am, in 215 Dirksen, the Senate Banking, Housing and Urban Affairs Committee will hold a hearing titled "Wall Street Reform: Oversight of Financial Stability and Consumer and Investor Protections."

On Wednesday, February 13th at 10:30am, in 608 Dirksen, the Senate Budget Committee will hold a hearing on the impact of budget decisions on families and communities.

On Thursday, February 14th at 9:30am, in 1100 Longworth, the House Ways and Means Committee will hold a hearing on the itemized deduction for charitable contributions and on previous proposals to modify the deduction and its value.

On Thursday, February 14th at 2pm, in 2247 Rayburn, the House Oversight and Government Reform Subcommittee on Economic Growth, Job Creation and Regulatory Affairs will hold a hearing titled "Unintended Consequences: Is Government Effectively Addressing the Unemployment Crisis?"

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