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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

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Leading the Past Week

Members of Congress left town at the end of the week, fleeing the stifling heat of Washington, but not before providing a clear road map for the fall, lame duck and likely, the 2013 agenda. As has been the case for much of the year, legislative paralysis reigned supreme, as neither side could find the votes to advance a farm bill, a cyber security bill or even legislation to help with drought relief. This continued state of stasis appears to be only eventually broken by an aggressive lame duck agenda, though one has to wonder how much runway actually exists to move the plethora of bills being parked for consideration post election. This last week before the long August recess also offered a glimmer of insight into the tax reform that is coming in 2013 as the House advanced a number of tax bills, including one to extend Bush-era tax cuts and another to eventually facilitate comprehensive tax reform and the Senate Finance Committee was able to mark-up and pass on a broad bipartisan basis a tax extenders measure.

Last week also came to a close with better than expected jobs numbers, as the US added 163K jobs in July—stronger than the expected, but the White House was also saddled with an increase of a tenth of a percent in the unemployment, rising to 8.3 percent. Despite the job roll additions the attendant increase in unemployment means that the issue will continue to percolate on the campaign trail. In other news, the Fed delivered a small surprise, announcing that it will continue its current monetary policies and will not engage in any new rounds of quantitative easing in the immediate near future.

With Congress out of session until September 10th, this publication will go on hiatus until they return. In the interim, please sign up to follow us on Twitter, where we post @MLSFInRegUpdate for any news or insights between now and then.

Legislative Branch

Senate

Cybersecurity Bill Fails to Advance in the Senate

On August 2nd, the Senate failed to invoke cloture, or limit the debate, on S. 3414, the Cybersecurity Act of 2012. The bill, which is a comprehensive measure designed to protect the country from a growing cybersecurity threat would, among other things require the SEC to revisit its guidance on cyber-related risks. The bill also would have captured many financial institutions under its broad definition of critical infrastructure, requiring such institutions to share information with the government and adhere to government security mandates. Earlier in the week, nine financial services trade groups [wrote](#) to Senate leadership in opposition to the bill. The letter stresses the groups support for efforts to protect critical infrastructure but urged lawmakers that the “legislation threatens to undermine important cybersecurity protections already in place for our customers and institutions.” Many viewed the letter, along with a similar letter by the Chamber of Commerce as a major factor in the failure of the cloture vote.

Senate Banking Committee Examines Tri-Party Repo Market

On August 2nd, the Senate Banking Committee held a hearing to examine the \$1.8 trillion repurchase, a/k/a the repo market. Matthew Eicher, Deputy Director of the Fed’s Division of Research & Statistics, told lawmakers that there has been significant progress in addressing the shortcomings in the repo market. But he sounded a word of caution, noting that, “not as much progress has been made — or made as quickly — as we believe is warranted given the seriousness of the situation, and certain clear vulnerabilities remain.” Earlier in the month, the Financial Stability Oversight Council (“FSOC”) detailed its concerns with the tri-party repo market in its annual report. Also testifying before the Committee was Karen Peetz, the Vice Chairman of Bank of New York Mellon, who told lawmakers that the bank is committed to working with the Fed to enhance operations and reduce risk. Peetz also told lawmakers the bank is already working to develop technology to create a systematic approach to reforming the unwind process so as to eliminate exposures by the end of 2014. Also testifying were Steven Meier, Executive Vice President of State Street Global Advisors and Thomas Wipf, Managing Director and Global Head of Bank Resource Management with Morgan Stanley.

Senator Floats New Type of Retirement Fund

On July 27th, Senator Tom Harkin (D-IA) announced that he was launching an effort to draw attention to the gap in retirement savings that is threatening many retirees. Harkin, Chairman of the Health, Education, Labor and Pensions Committee, said his new pension fund would combine features of the defined-benefit and defined-contribution plans where employers and employees would be able to contribute to an independent and privately managed fund that would invest their savings and pay annuities. The plans, to be known as Universal, Secure and Adaptable or USA Retirement Funds, and employers' responsibilities would be limited to enrollment, processing payroll contributions and making “modest” contributions. While Harkin has yet to bring his idea before his Republican colleagues, or draft specific language, some advocacy groups—including the Pension Rights Center—have weighed in that there is a “compelling case for a new private retirement system.”

Senate Ag Floats Idea of Futures Insurance Fund; Points to System Failure in Peregrine, MF Global

On August 1st, Chairman of the CFTC Gary Gensler testified before the Senate Agriculture Committee in a hearing examining the recent financial market failures, MF Global and Peregrine. Gensler told lawmakers he is “opened minded” about the idea of creating an insurance-like fund to protect customers of futures commission merchants in the event of a failure but stressed it is more important to ensure rules are strong enough to prevent failures. Gensler continued to say that the feasibility of such an insurance fund would depend on a cost-benefit analysis as “insurance does [come with] a cost.” Also testifying was the MF Global bankruptcy trustee James Giddens who told the Committee that an insurance fund “would have been very beneficial and eliminated a lot of the problems here.” In testimony submitted for the record, Louis Freeh, representing MF Global in the bankruptcy, said he expects MF Global clients will eventually be “made whole.”

In regard to Peregrine, Gensler acknowledged that the “system failed” to protect the firm’s customers and there was ongoing deception on behalf of Peregrine. Similarly, when asked if the CFTC has the ability to oversee the futures self-regulatory organization (SRO) system—given its increased responsibilities under the Dodd-Frank Act—Gensler said the Commission is stretched but “very much focused on the futures markets.” Still, Ranking Member Pat Roberts (R-KN) said the real question is whether the SRO structure “is capable of regulating the industry, or whether it has outgrown its time and needs to be replaced.”

Bill Introduced to Exempt End-Users from Margin Requirements on Uncleared Swaps

On August 1st, a bipartisan group of Senators introduced S. 3480, which would exempt commercial end-users from paying margin on uncleared swaps. Senators Mike Johanns (R-NE), Mike Crapo (R-ID), Pat Toomey (R-PA), Herb Kohl (D-WI), Jon Tester (D-MT) and Kay Hagan (D-NC) introduced the legislation, which comes a few short weeks after the CFTC and SEC finally issued their joint rule defining swaps and end-users. Apparently the rule left things unclear, as the sponsors noted that Dodd-Frank included such an exemption for end-users but there continues to be “debate over how broadly this exemption would apply.” The bill is identical to [H.R. 2682](#), the Business Risk Mitigation and Price Stabilization Act, which was approved by the House in Mark by a 370 to 24 vote.

Bicameral legislation introduced to limit FSOCs powers

On August 2, Sen. David Vitter (R-La.) and Rep. Scott Garrett (R-N.J.) Aug. 2 together introduced legislation that would prohibit the Financial Stability Oversight Council (FSOC) from designating any non-bank financial institution as systemically important. Although the FSOC was established by the Dodd-Frank to monitor the U.S. financial system for economic threats, its potential designation of non-bank financial institutions as a “systemically important financial institution,” or SIFI, which comes with a whole host of attendant regulatory requirements has been one of the most controversial components of Dodd-Frank. To date the FSOC has not named any non-bank financial companies as systemically important, but that has not muted the criticism and concern.

House and Senate Reach Agreement on New Iran Sanctions Bill

On July 30th, Chairman Tim Johnson (D-SD) announced the House and Senate had reached an agreement on an Iran sanctions bill which includes a measure requiring public companies to disclose dealings with Iran to the SEC. According to a Congressional staffer, the bill complements President Obama's [executive order](#) authorizing the Treasury to impose sanctions for Iran-related activities. Two days later the amended measure was cleared by Congress and sent to the President who is expected to sign it. Earlier in the week the SEC Chairman Mary Schapiro has said the agency is working on a rule to require similar Iran disclosures.

House of Representatives

Municipal Adviser Legislation Clears House Financial Services Committee

On July 31st, the House Financial Services Committee advanced [H.R. 2827](#), a bill to clarify the definition of a municipal adviser, was approved in a vote of 21 to 10. The bill would limit the SEC registration requirements found under Section 975 of Dodd-Frank from applying to any advisor already required to register. Lawmakers also approved in an 18 to 15 vote [H.R. 6161](#), the Fostering Innovation Act, which would limit the definition of companies deemed to be "accelerated filers" subject to increased oversight.

FHFA Director Remains Firm Against GSE Principal Reduction to Derision of Congressional Democrats

On July 31st, the head of the Federal Housing Finance Agency ("FHFA") [appeared](#) before the House Financial Services Committee, reaffirming his opposition to any large-scale principal reduction for troubled mortgages backed by GSEs Fannie Mae and Freddie Mac. Acting Director Edward DeMarco has long been under pressure from the Administration and Congressional Democrats to implement a Principal Reduction Alternative ("PRA") under the Home Affordable Modification Program (HAMP) but has opposed the initiative, citing the potential costs and risks to GSEs and the taxpayers of principal reduction. The hearing came as the FHFA completed a new cost-benefit analysis based on a Treasury pledge to triple the financial incentives paid to GSEs.

DeMarco took flak from Committee Democrats for the cost-benefit analysis, which concluded that "HAMP PRA did not clearly improve foreclosure avoidance while reducing costs to taxpayers relative to the approaches in place today." While Republicans, including Chairman Spencer Bachus (R-AL) praised DeMarco for "standing up for the best interests of the American people," Ranking Member Barney Frank (D-MA) led a chorus of Democrats who voiced dissatisfaction with the FHFA's findings. The flack from Democrats was not limited to the House, as Senate Banking Chairman Tim Johnson (D-SD) lambasted DeMarco for a letter sent to the Senate Banking Committee on July 31st. Johnson [wrote](#) to DeMarco chastising him for sharing his correspondence with the media before Johnson had received the letter and insisting the FHFA revisit its economic analysis of principal reduction in light of a July 31 [letter](#) to DeMarco sent by Treasury Secretary Timothy Geithner arguing that principal forgiveness could yield \$3.6 billion in savings to the GSEs.

Small Business Committee Examines CFPB's Impact on Small Businesses

On August 1st, CFPB Director Richard Cordray appeared before the House Small Business Committee to defend the Bureau's efforts to consider regulatory impacts on small businesses. A focus of the hearing was on the Small Business Regulatory Enforcement Fairness Act (SBREFA) review panel process which requires major rulemakings to be scrutinized by panels of small businesses and other affected parties before released. The CFPB, one of three agencies required to conduct such panels, has, despite unleashing a torrent of rulemakings, held three thus far: (1) to consider a proposed rule to streamline Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA) disclosures; (2) to examine a proposed rule on mortgage servicing; and (3) to review the Bureau's proposal on residential mortgage loan origination. Cordray received some criticism from lawmakers, primarily from Representative Allen West (R-FL) who cited concerns from some SBREFA panel members that the process is rushed and does not provide ample time for thoughtful review. In response, Cordray pointed to an aggressive implementation schedule set by the Dodd-Frank Act and reinforced that the CFPB would have preferred more time to draft rules and consider comments.

House Passes Bill Aimed at Expediting Comprehensive Tax Reform

In yet another sign that Congress appears on track to take on comprehensive tax reform in 2013, on August 2nd, the House voted 232 to 189 to pass H.R. 6169 which includes a timeline and expedited process for consideration of a tax reform bill in 2013. To be considered for the expedited process, a tax bill must consolidate individual tax brackets down into two, reduce corporate rates to at least 20 percent, repeal the AMT, maintain revenues at 18 percent to 19 percent, and implement a territorial system. Senator Majority Leader Harry Reid (D-NV) has said the Senate will not consider the legislation. However, during its consideration of the Family and Business Tax Cut Certainty Act of 2012, i.e., the tax extenders bill, the Senate Finance Committee included an amendment by Senator Thune (R-SD) expressing support for comprehensive tax reform.

House Passes Bill to Extend All Bush-Era Tax Cuts

On August 1st, the House voted 256 to 171 to extend Bush-era tax cuts. Lawmakers also voted 170 to 257 to defeat a Democratic proposal, mirroring the Senate-passed bill (S. 3412), that would have extended tax cuts for those earning up to \$200,000 individually and \$250,000 per couple. Despite calls from House Minority Whip Steny Hoyer (D-MD) for Congress to stay in session until the tax issue is resolved, Speaker Boehner (R-OH) said the House will recess and would return to DC is the Senate were to act on the Republican passed bill or choose to consider options to address sequestration.

Executive Branch

Federal Reserve

Fed Maintains Current Monetary Policy in Face of Economic Deceleration

On August 1st, the Federal Reserve announced it would not expand monetary stimulus despite increasingly slow economic growth. The Fed will maintain with its current policies of extending the average maturity of securities already in its portfolio to lower interest rates and maintain the

near-zero target Fed Funds rate. The wide speculation that the Fed would act to provide additional stimulus has now shifted to the next FOMC meeting on September 12th and 13th.

SEC

SEC Report Outlines Ways to Improve Municipal Securities Industry

On July 31st, the SEC released a [report](#) detailing the need for new legislation that would authorize the agency to establish disclosure requirements for municipal securities issuers. The legislation is needed to fill disclosure and regulatory shortfalls and to boost investor protection for the \$3.7 trillion municipal bond market. The report also recommended additional regulatory changes at the SEC and Municipal Securities Rulemaking Board (MSRB) to improve market transparency and structure. Our current regulatory structure, dating to 1975, has yielded concerns over the completeness and timeliness of financial information and disclosures and that the lack of uniform accounting standards makes it difficult to compare securities. Specifically, the report suggests Congress enact laws to allow the SEC to:

- Require municipal issuers to make disclosures about their offerings;
- Name and oversee a private sector body that would set standards for municipal issuers' financial statements;
- Require municipal issuers to have their financial statements audited by an independent or state auditor;
- Prohibit conduit borrowers from taking advantage of municipal securities exemptions in the federal securities laws; and
- Require trustees or others to enforce the terms of municipal issuers continuing disclosure agreements.

The SEC report also outlined several regulatory fixes, including working with the MSRB to enhance transparency, issuing updated guidance on municipal issuer disclosure obligations and finding ways to encourage the use of alternative trading systems or electronic networks that would provide fair access. The SEC report complements a January GAO report which concluded one way in which to improve disclosures for municipal bond investors would be to grant SEC additional authority over the marketplace. In response to the SEC report, market participants urged caution in major overhauls. The Bond Dealers of America asked that any changes be pursued thoughtfully while SIFMA voiced support for the bulk of the report, raising concerns about certain provisions which could add "additional burdens" to the issuer industry.

CFPB

FTC Supports CFPB Efforts to Increase Regulations on General Purpose Reloadable Card Users

On July 30th, the FTC released [staff comments](#) in support of measures being contemplated by the CFPB to extend protections for users of general purpose reloadable (GPR) cards. GPR cards are used to make purchases and payments but do not offer protections the same protections as credit or debit cards. FTC staff noted in their comments that the use of these reloadable cards has expanded in recent years and, while users are protected by the FTC Act, GPR card users do not understand that they are not provided with the same federal laws and protections afforded to credit and debit card users. Specifically, the FTC urged the CFPB to

consider extending protections such as: liability limits for fraud and unauthorized use; disclosure of fees and expiration dates; error resolution procedures; and recurrent payments. The FTC also justified expanding regulations over GPR cards because these cards are most commonly used by underbanked consumers such as students, losses resulting from inadequate protections will have a disproportionately greater impact.

CFPB Solicits Public for Suggestions on Court Cases it Should Weigh in On

On August 2nd, the CFPB published the [nine amicus briefs](#) it has filed in cases dealing with federal consumer financial protections laws and said sought public input for other cases worth filing *amici* in. The CFPB is looking for cases which are considering one or more important legal questions around the application or interpretation of federal consumer financial protection or regulation by the CFPB.

Miscellaneous

Another “Algo” Trade Mishap Roils the Market -- Knight Capital deals with \$440 million loss

It was widely reported that on August 2nd an electronic trading glitch interrupted trading in nearly 150 stocks on Wednesday. The glitch follows an ever growing litany of events from the 2010 flash crash and, more recently, the botched Facebook IPO and Bats Global Markets Inc complications. Regulators have already begun inquiries into the glitch and NYSE canceled trading in six stocks. On Thursday, Knight Capital Group, a broker, announced it had lost \$440 million when selling stocks it accidentally bought due to the glitch—amounting to about \$10 million dollars lost every minute. Knight announced it believes the problems arose due to a new trading software had been installed. The losses at Knight, and other recent stock glitches, have upped the pressure on regulators to show they are able to protect investors in markets that are becoming increasingly computerized and sophisticated. The SEC has already announced the agency is “closely monitoring the situation and in continuous contact with the NYSE and other market participants” and FINRA is also looking into the problem. Despite rumors of Congressional interest, there doesn’t appear to be any concerted efforts on the horizon.

International

Despite Hinting at Interest Rate Manipulation, ECB Maintains Current Target

On August 2nd, the ECB announced that its benchmark interest rate would remain at 0.75 percent—unchanged despite ECB President Mario Draghi raising the possibility of intervening in the euro bond market. The week of July 23rd, Draghi made comments that the ECB will do “whatever it takes” within its mandate to support the euro, including reducing the interest rate. Draghi reiterated on July 26th that the central bank could react against high bond yields by interfering with the interest rate target. Given that it takes time for financial markets to adjust to monetary policy, ECB president governments have been told to “stand ready” to activate the European Financial Stability Facility/European Stability Mechanism “when exceptional financial market circumstances and risks to financial stability exist.” However, analysts have faulted Draghi for failing to provide a detailed plan, saying it would have been better to deliver a “big splash” when there was agreement on when to take action. Meanwhile, Eurozone growth remains weak and Draghi announced expectations that the economy would only recover “very gradually.”

UPCOMING HEARINGS

The House and Senate are in Recess until September 10, 2012