ML Strategies Update

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Financial Services Legislative and Regulatory Update

Leading the Past Week

Congress returned from a two-week recess and the President finally released his FY14 Budget, which was immediately attacked by friend and foe alike. Some view this bipartisan attack as a sign that the President made a real effort to offer a framework for serious negotiation. Later in the week the President met with fifteen CEOs from some of the largest financial institutions, including: JP Morgan CEO Jamie Dimon, Goldman Sachs CEO Lloyd Blankfein, AIG CEO Bob Benmosche, Citigroup CEO Michael Corbat, MetLife CEO Steve Kandarian, Bank of America CEO Brian Moynihan, in a meeting generally described as positive. Although there weren't any detailed press accounts of the meeting, other than that it included discussion of immigration, cybersecurity, the stability of the financial system, and the nation's long-term fiscal health, one wonders whether the CEOs shared their thoughts about a leaked draft of legislation being pushed by Senators Brown and Vitter that would effectively break up many of their institutions.

The other major story of the past week isn't financial services specific, and it still may be premature, but there is a growing sense that long-standing partisan gridlock may be easing – especially in the Senate, as it a series of major legislative deals, including on how to move forward on gun control and immigration, were either announced or imminently close. If this new paradigm holds, it offers a glimmer of hope for the possibility of dealing with other, heretofore intractable issues such as the nation's fiscal health and comprehensive tax reform.

Budget Summary

On April 10th, the White House released its $3.77 trillion FY2014 Budget proposal. The Treasury also released its Greenbook, which provides further details about how the Administration intends to collect the $580 billion in new revenues that were included in the budget. These revenues would, in part, be reached by limiting tax deductions to 28 percent for top earners and instituting the Buffet rule. A number of the proposed tax initiatives have appeared in previous years' budgets such as child care tax credits, tax cuts to encourage infrastructure investment, and proposals to close "unfair tax loopholes." In addition, the budget once again proposes closing the carried-interest loophole but also comes up with a new revenue raiser by limiting the size of individual retirement accounts to $3 million.

The Budget requests $1.6 billion for the SEC, which would be $350 million more than the agency's current funding level. The request would support 5,180 positions and 4,638 full-time equivalents (FTE), in addition to 676 new employees to help the agency meet key priorities including enhancing its oversight capabilities, and implementing both the Dodd-Frank Act and the JOBS Act.

The CFTC's Budget request, at $315 million, is approximately $100 million more than the agency's current funding level, $73 million of which would go to improving technology. The proposed large boost in the agency's budget mirrors requests from previous years, and the fact that CFTC Chairman Gary Gensler has warned, without more funding, that the regulator will be unable to meet its Dodd-Frank obligations.

The Budget also estimates that, despite recent efforts to bolster its insurance reserves, the FHA will likely require $943 million from the Treasury to backstop losses on mortgages. While the President's budget acknowledges that recent improvements in the housing sector and increased insurance premiums have strengthened the FHA's capital reserves, it makes clear that despite these positive developments, it anticipates that the FHA will need additional funding for the first time since it was created in 1934. Reform of the FHA is an issue that could have traction in the 113th Congress, and in fact the House Financial Services Committee met on April 10th to discuss legislative reforms to reduce the agency's risk exposure. Similarly, GSE Reform is also an issue that will receive significant attention this year, and it is worth noting that the Treasury Department included estimates of $183.3 billion in payments from Fannie Mae and Freddie Mac between 2013 and 2023.

The White House budget proposal also would implement a 2010 agreement with the IMF which would increase the U.S.'s IMF quota by $63 billion. IMF is largely financed through these quotas, which also determine member country's voting power in the international body. In addition, the proposal would decrease the U.S.'s commitment to the IMF's New Agreements to Borrow, which are borrowing arrangements with 38 IMF members used to bolster IMF resources and address global financial crises.

Following the release of the President's Budget, the CFPB announced its Strategic Plan for FY 2013-2017 and its Annual Performance Plan and Report for FY 2013 and Budget for FY 2013 and FY 2014. The FY 2013 CFPB budget is $541 million, an 81 percent increase from FY 2012 to support ongoing operations and new investments in human capital, technology and facilities, as well as consumer research and financial education activities in order to achieve four strategic goals: Prevent financial harm to consumers while promoting good practices that benefit them; Empower consumers to live better financial lives; Inform the public, policy makers, and the CFPB's own policy-making with data-driven analysis of consumer finance markets and consumer behavior; and Advance the CFPB's performance by maximizing resource productivity and enhancing impact outlined in this plan. The FY 2014 Budget estimates a need for $497 million, 66 percent above FY 2012 levels, but down from FY13. Funding for the CFPB is outside the normal appropriations process, and is primarily received through transfers from the Federal Reserve.

Legislative Branch

Senate

Banking Subcommittee Examines Role of Independent Consultants as part of Independent Foreclosure Review
On April 11th, the Senate Banking Subcommittee on Financial Institutions and Consumer Protection met to consider testimony on the role of independent consultants in bank examination and regulation. The hearing primarily sought to shed light on the use of independent consultants by the OCC and Fed in the Independent Foreclosure Review (IFR). Though the hearing was sparsely attended, both Chairman of the Subcommittee Sherrod Brown (D-OH) and Senator Elizabeth Warren (D-MA) grilled regulators and industry representatives on the foreclosure review process and regulators refusal to share information. Brown told regulators that with such "little information about the consultants and who they report to, it is impossible for Congress and the public to hold them accountable" and that regulators failed to ensure that poor performance of a consulting company in the review was corrected. Similarly, Warren criticized regulators for failing to answer Congressional requests for information and for ending the foreclosure review process without definitive answers as to the extent of illegal foreclosures. Once again, Senator Warren showed why so many in the industry were concerned about having her on the committee as one of her lines of questioning exposed significant flaws in the process.

While the hearing was going on, Ranking Member of the House Financial Services Committee Maxine Waters (D-CA) introduced the Stop Outsourcing Banking Enforcement and Examination Act. This legislation, similar to a bill introduced last year, would impose additional transparency measures on banking enforcement by requiring that consent orders between regulators and companies be made public whenever outside consultants are involved. The legislation is intended to resolve an issue that received significant attention during the Senate Banking Committee hearing, namely how independent consultants are often paid by the same institutions that they are hired to investigate. It is unclear at this time whether similar legislation will be introduced in the Senate, or whether House Republicans intend to support Ms. Waters' bill.

Politico leaks copy of Brown-Vitter Capital Requirement Legislation
Last week, draft legislation, written by Senators Sherrod Brown and David Vitter (R-LA), focusing on dealing with the "too big to fail" issue by requiring large banks to raise more than $1 trillion in additional capital was leaked. The legislation calls for all banks to meet a 10 percent capital ratio, with banks larger than $400 billion in assets required to meet a 15 percent capital ratio. The draft would more than double the requirements under Basel III and would pull the U.S. from the Basel accords. In addition, the legislation would ensure banks do not structure themselves or their activities to skirt the capital requirements and prohibit the government from assisting non-banks.

While many in Congress are looking into how to confront the problem of 'too big to fail,' the leadership of the Senate Banking Committee signaled the draft is unlikely to go anywhere in the Senate. Chairman Tim Johnson (D-SD) said he disagrees with the proposal to eliminate the implementation of the Basel III capital standards and Ranking Member Mike Crapo (R-ID) said capital standards should be set by regulators, not legislators. While many Members of the Banking Committee are withholding judgment of the draft, Senator Bernie Sanders (I-VT), who has been pushing for measures to break up large banks, said he did not believe capital standards alone would be enough to resolve 'too big to fail.' Still, Wall Street has treated the draft with caution. Goldman Sachs is urging its investors not to dismiss the plan because, though the likelihood of passage is low, "even a 'watered-down' version could have an outsized negative impact on the industry."

Warner, Toomey Introduce Municipal Advisors Legislation
On April 11th, Senators Mark Warner (D-VA) and Patrick Toomey (R-PA) introduced S. 710, legislation to provide exemptions for commercial banks and savings and loan associations from the municipal advisor regulations put in place by the Dodd-Frank Act.

House of Representatives
Housing and Insurance Subcommittee Explores FHA Reform Options
On April 10th, the House Financial Services Housing and Insurance Subcommittee held a hearing to explore reforms for the Federal Housing Administration (FHA). Subcommittee Chairman Randy Neugebauer (R-TX) offered a number of reforms including FHA stabilization, a clarification of the FHA's mission, shifting risk to the private sector, and implementing risk management procedures in the FHA Mutual Mortgage Insurance Fund. The hearing included testimony from Adolfo Marzol of Essent US Holding, David Stevens of the Mortgage Bankers Association, Gary Thomas of the National Association of Realtors, Kevin Kelly of the National Association of Home Builders, Sarah Rosen Wartell of the Urban Institute, and Dr. Clifford Rossi from the University of Maryland. Mr. Stevens said the FHA has never played a more important role in the housing market, and he suggested that the subcommittee work to lower loan limits and address risk sharing.

House Financial Services Subcommittee Examine Bills to Tweak Dodd-Frank Derivatives Provisions
On April 11th, Members of the House Financial Services Capital Markets Subcommittee offered support for a series of bills to amend the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. During a subcommittee hearing, bills addressing end-user margin requirements, inter-affiliate swaps, and swap data repository indemnification were discussed. The Subcommittee also debated Dodd-Frank's "push-out" clause, the treatment of cross-border swaps transactions, and harmonization of international derivatives reform rules. The bills have broad bipartisan support, but Representative Maxine Waters (D-CA) expressed concern that Dodd-Frank has not been fully implemented.

The hearing included testimony Kenneth Bentsen of the Securities Industry and Financial Markets Association, Christopher Childs of the Depository Trust & Clearing Corp. Data Repository, Thomas Deas of the Coalition of Derivatives End-Users, and Dr. John Parsons of the MIT Sloan School of Management. Dr. Parsons said he supports Dodd-Frank but that the bills addressed in the hearing would go in an opposite direction.

Financial Services Subcommittee Examines Dodd-Frank Impact on Credit Unions
On April 10th, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit met to discuss potential regulatory burdens placed on Credit Unions by Dodd-Frank. Witnesses included Mr. Robert Burrow, President and CEO of the Bayer Heritage Federal Credit Union; Ms. Pamela Stephens, President and CEO of Security One Federal Credit Union; and Mr. Mitchell Reiver, General Counsel of Melrose Credit Union.

Witnesses testified that, as compliance costs do not vary by size of financial institution, these costs are a much greater burden for small credit unions than for larger banks. Lawmakers supported bringing some form of regulatory relief to credit unions, with Representative Gary Miller (R-CA) announcing he would introduce a regulatory relief legislation. Miller's proposal would enable the National Credit Union Administration (NCUA) to: modify a CFPB rule (so long as the modified rule still meets the CFPB objective); authorize a risk-based capital system for credit unions; review cost-benefit analyses after three years to ensure regulators have a true sense of cost of compliance; and review the Credit Union Central Liquidity Facility.

House Judiciary Advances Regulatory Oversight Legislation
On April 11th, the House Judiciary Committee voted in a 20 to 9 party line vote to advance Regulations From the Executive in Need of Scrutiny Act of 2013 (H.R. 367). The bill would require prior Congressional approval of major regulations which would cost more than $100 million or adversely impact the economy. Specifically, the bill would prohibit agencies from enforcing major rules unless Congress adopts a joint resolution within 70 days of the rulemaking. The Committee voted down several Democratic amendments to limit the scope of the legislation, including an amendment by Representative Watt (D-NC) which would exempt regulations required by the Dodd-Frank Act and any issued by the CFPB. The House passed similar legislation in 2011.

Financial Services Democrats Hold Panel on GSE Reform
On April 12th Ranking Member of the Financial Services Committee Maxine Waters held a policy panel on GSE and housing finance reform. In her opening remarks, Ranking Member Waters expressed hope that the Financial Services Committee will tackle not just FHA reform, but also work to overhaul the GSEs. In general, the conversation provided a high-level look at some of the proposals which have been put forward to address housing finance and Fannie Mae and Freddie Mac. Panelists included: Nela Richardson, Senior Economic Analyst, Bloomberg Government; Jim Millstein, Chairman and Chief Executive Officer of Millstein & Co; Robert Rozen, Commissioner at the Bipartisan Policy Center; Ellen Seidman, Advisor, Urban Institute, Former Director of the Office of Thrift Supervision; and Julia Gordon, Director of Housing Finance Policy, Center for American Progress.

Panelists all stressed that any deal to overhaul the federal housing finance sector should seek to preserve American's access to the 30-year fixed rate mortgage. Other proposal included ensuring that small financial institutions will have equal participation in the housing market, recapitalizing and privatizing Fannie Mae and Freddie Mac (similar to what was done with AIG), and ensuring that borrowers are able to access quality capital. In addition to the panelists, several Democratic Members of the Committee attended, including: Representatives Velazquez (D-NY), Watt (D-NC), Capuano (D-MA), Hinojosa (D-TX), Clay (D-MO), Green (D-TX), Delaney (D-MD), Carney (D-DE) and Denny Heck (D-WA).

<u>Executive Branch</u>

Federal Reserve

Fed Accidently Releases March FOMC Minutes Early, Showing Possible Easing of QE3
On April 10th, the Fed announced the minutes of the March 19th and 20th meeting of the Federal Open Market Committee (FOMC) were being released early because they were inadvertently sent to individuals, including Congressional staffers and trade association employees, who receive the minutes by email "shortly after their normal release time." The minutes, which were distributed on April 9th, signal that the FOMC has begun to consider slowing down quantitative easing "at some point over the next year" as a result of improvements in the labor market. Only a handful of the participants at the March meeting felt the economy would be weak enough to continue QE at the current pace through the end of the year. However, with recent job growth estimates weaker than usual, the Bureau of Labor Statistics finding the U.S. only added 88,000 jobs in March, the debate to end QE may already be moot. Upcoming FOMC meetings are in April, mid-June, late-July, and mid-September.

Fed Focused on High-Frequency Trading Controls
Speaking on a panel of regulators at an SEC conference, Michael Gibson, Federal Reserve Division of Banking Supervisions and Regulation Director, said that the Fed is working to supervise high-frequency trading (HFT) at banks it oversees. Gibson said the Fed is focusing on "risk management, oversight and controls" at firms engaged in HFT, rather than pursuing how HFT affects markets. Stressing the importance of "multiple layers of control, so if one control fails," there are back up plans, Gibson said the SEC and CFTC are also working on policies to respond to the prevalence of HFT.

Fed President Says Living Wills Best Option for Ending Too Big to Fail
In an April 9th speech, President of the Richmond Federal Reserve Bank Jeffrey Lacker said that the most promising plan for ending "too big to fail" is to require banks to come up with detailed plans and living wills for how they would be liquidated in the bankruptcy process. While the Dodd-Frank Act attempts to resolve too big to fail through the FDIC's Orderly Liquidation Authority, there remains considerable regulatory discretion in how a firm is wound down. According to Lacker, this opens the door for creditors to believe regulators could deviate from living wills, seeking funds from the Treasury, and therefore "pay less attention to risk than they should." Lacker joins several Fed officials to enter into the too big to fail debate, after Fed President Richard Fischer, Fed Governors Jerome Powell and Daniel Tarullo, and Chairman Ben Bernanke have already addressed the issue.

SEC
White Confirmed by the Senate, Begins Work as Head of SEC
On April 10th, Mary Jo White was sworn in as the 31st Chairman of the SEC following confirmation by unanimous consent of the Senate on April 8th. White's confirmation was unsurprising, having cleared the Senate Banking Committee by a wide margin of 21 to 1. In a statement upon her swearing in, White said she was honored to lead the SEC and that the U.S. markets are the envy of the world because "of the SEC's work effectively regulating the markets, requiring comprehensive disclosure, and vigorously enforcing the securities laws." Departing acting-Chairman Elisse Walter, speaking to reporters on the SEC's priorities under White, said that rulemaking to require public companies to disclose political spending is "not high on [the] agenda for obvious reasons," such as Dodd-Frank rulemakings and the JOBS Act. White presided over her first open commission meeting the same day she was sworn in. In the Commission's first public vote under White, the SEC voted unanimously to adopt rules requiring broker-dealers, mutual funds, investment advisers, and certain other entities regulated by the agency to adopt programs to detect red flags and prevent identity theft.

SEC Proposes Reg SCI Rule
On March 25th, the SEC published its proposed Regulation Systems Compliance and Integrity (Reg SCI) rule directing exchanges to strengthen technology and instructing firms to participate in tests to ensure they can sustain operations after disruptions. The proposed rule covers testing, disaster preparedness, and software development, which the SEC expects will affect 44 firms, including 17 exchanges, clearinghouses, 15 alternative trading platforms, 10 dark pools, systems that provide public quote and trade data, FINRA, MSRB, and others. The rule requires these firms to have formal, written policies and procedures, including a yearly review, in place to ensure that systems supporting trading, clearing, order-routing can remain available to users.

Reg SCI will update and replace the Commission's Automation Review Policy Guidelines which were developed after the 1987 market crash, Black Monday. While the rule codifies many voluntary guidelines, there is an estimated one-time compliance cost of $61.6 million and $176 million with annual costs between $48.7 million and $125 million for affected firms. Firms and other market participants may find themselves spending up to $66 million a year to just participate in the business-disruption tests required by the regulation. In addition, Reg SCI attempts to begin treating exchanges and private or alternative trading systems more similarly. For example, dark pools trading 5 percent of their daily volume in a single stock and 0.25 percent of total exchange listed equities, or 1 percent of the average daily dollar volume across equities, will be subject to Reg SCI. Recognizing the breadth and potential impact of the proposed rule, the SEC posed more than 850 questions to industry in the proposed rule. The comment period ends on May 24th.

SEC To Propose New Money Market Reforms in Coming Months
On April 11th, SEC Commissioner Gallagher said that the SEC will likely propose a new set of reforms to money market mutual funds by early June. While Gallagher said he does not know where Chairman Mary Jo White "stands" on this issue, but assumes she agrees with "the logic of the proposal" which they have worked on with staff, and they will have a proposal in an open meeting "between now and two months out."

White Signals HFT Is a Priority for the SEC
After pledging that she will give a "sense of urgency" to understanding high-frequency trading (HFT) market structure issues, Chairwoman White was reported to be considering Chris Concannon, Executive Vice President at Virtu Financial, to lead HFT efforts at the SEC. However, as soon as this news was leaked, it seemed like Mr. Concannon was equally vocal in letting folks know that he was unlikely to join the public sector. Other rumored candidates include, Joseph Lombard, a former advisor to SEC Chairman Arthur Levitt, who is currently a trading and markets attorney at Murphy and McGonigle.

CFTC

CFTC Extends End User Reporting Requirement Deadlines
On April 9th, the CFTC issued a no-action letter providing swap counterparties that are not swap dealers or major swap participants with relief from certain derivatives reporting requirements. Specifically, non-financial firms would have until July 1st to begin public and regulatory disclosure of interest rate and credit swaps and until August 19th for equity, foreign exchange, and commodity swaps. Non-dealer financial firms, deemed to be more advanced in reporting methods, will still be required to begin reporting on interest rate and credit swaps on April 10th but will have until May 29th to begin reporting on other swaps. Speaking on the extension, CFTC Commissioner Scott O'Malia said the no-action letter "fails to deliver on the request by end users for delay" as "the Commission has declined to provide relief for the time period requested by end users to allow them to bring their IT infrastructure up to proper specification."

Upcoming Hearings

On Tuesday, April 16th at 9am, in 2128 Rayburn, the House Financial Services Subcommittee on Oversight and Investigations will hold a hearing on the role of the Financial Stability Oversight Council and its role in determining which institutions are "too big to fail."

On Tuesday, April 16th at 10am, in 215 Dirksen, the Senate Finance Committee will hold a hearing titled "Tax Fraud and Tax ID Theft: Moving Forward with Solutions."

On Tuesday, April 16th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit will hold a hearing on how federal regulations affect small financial institutions.

On Tuesday, April 16th at 10am, in 210 Cannon, the House Budget Committee will hold a series of hearings on the fiscal 2014 budget.

On Tuesday, April 16th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Oversight and Investigations will hold a hearing titled "Who is Too Big to Fail: Does Dodd-Frank Authorize the Government to Break Up Financial Institutions?"

On Tuesday, April 16th at 2pm, in 1100 Longworth, the House Ways and Means Subcommittee on Human Resources will hold a hearing to review the implementation of the Middle Class Tax Relief and Job Creation Act of 2012, PL 112-96.

On Tuesday, April 16th at 3pm, in 608 Dirksen, the Senate Budget Committee will hold a hearing on President Barack Obama's proposed fiscal 2014 budget.

On Wednesday, April 17th at 10am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Subcommittee on Housing, Transportation, and Community Development will hold a hearing titled "Helping Homeowners Harmed by Foreclosures: Ensuring Accountability and Transparency in Foreclosure Reviews."

On Wednesday, April 17th at 10am, in 2128 Rayburn, the House Financial Services Committee will hold a hearing on the obstacles to private capital in the housing finance system.

On Wednesday, April 17th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Oversight and Investigations will hold a hearing on the status of rulemaking required by the Jumpstart Our Business Startups Act

On Wednesday, April 24th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing on the privatization of Sallie Mae.

On Wednesday, April 24th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Monetary Policy and Trade will hold a hearing on the role of the United States in the International Monetary Fund.

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