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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

March 19, 2012

Leading the Past Week

The embers of hope for a bipartisan renaissance in Congress, or at least the Senate, continued to glow as Majority Leader Reid appeared to have acquiesced from the calls from Majority Leader Cantor and Minority Leader McConnell, among others, and decided to take up the House passed version of the capital formation bills. Despite the opposition of a small group of Senators who are concerned about the potential evisceration of consumer protections in the legislation, and some Conservative Republicans opposed to the inclusion of an expanded reauthorization for the Export-Import ("Ex-Im") Bank, the Senate is likely to pass the bill by the end of next week. The other major news story of the past week was all of the attention given to the resignation letter from Goldman Sachs that Greg Smith had published in the New York Times. Without judging the contents of his letter or its timing, the more pressing policy question is whether the publicity generated by his letter will galvanize supporters of the Volcker rule, to push back against the continuously mounting opposition.

Legislative Branch

Senate

Senate Looks to Quickly Dispose of House passed "JOBS" Act:

Last week, after passing the Transportation bill by a wide bipartisan margin, the Senate had appeared to turn its attention back to more partisan pursuits (*i.e.,* Judicial nominations) but then suddenly, Leader Reid announced that he had struck a deal with Senator McConnell on the nominations and that the Senate would instead turn to consideration of its version of the capital formation bill (passed in the House as the JOBS Act). After initially indicating that the bill would be open to amendment, the amendment tree was quickly filled, a procedural move to cut off the filing of amendments as both Democrats and Republicans were filings many controversial amendments – since the bill is seen as a must pass measure. Instead, it looks like the Senate is expected to consider the House-passed bill on the Senate floor the week of March

19th, with only a few amendments allowed for debate. Among those considered will be a substitute amendment offered by Senate Democrats to make changes and scale back the House bill. The amendment reflects concerns that emerged throughout the previous week, including rolling back certain regulations to: create an IPO "on ramp" for emerging growth companies; allow crowdfunding; raise shareholder reporting thresholds for all companies and community banks; reinstate general solicitation; and increase the Regulation A offering cap. Notably, the amendment increases checks on crowdfunding with a compromise crowdfunding proposal (S. 2190) put forth by Senators Michael Bennet (D-CO), Scott Brown (R-MA) and Jeff Merkley (D-OR). The amendment also reflects concerns voiced by SEC Chairman Mary Schapiro regarding insufficient investor safeguards, although perhaps not enough to satiate the concerns of Senator Levin (D-MI) and others. On March 13th, Schapiro sent a letter to lawmakers warning that the House-passed JOBS Act needs additional investor protections and urging Senators not to "walk backwards" important safeguards put in place after the 1990s technology bubble.

Senate Banking Examines Housing Market Solutions; Hammers FHFA on Principal Reduction Policies:
On March 15th, the Senate Banking Subcommittee on Housing, Transportation and Community Development held a hearing on methods to strengthen the housing market while minimizing cost to the taxpayer. Democrats on the Subcommittee took the opportunity to pressure the Federal Housing Finance Agency (FHFA) to allow reductions in the principal of home loans backed by federal government-sponsored enterprises (GSEs) Fannie and Freddie. Witnesses also told lawmakers that, in some cases, private mortgage holders have found it helpful to write off the principal of loans faced with foreclosure.

Acting FHFA Director Ed DeMarco was criticized for not accepting the need to reduce the principal due to the potential to deepen losses at the GSEs. "The FHFA seems to be saying there are no GSE borrowers in the entire country for whom principal reductions make sense," charged Chairman Robert Menendez (D-NJ), continuing: "Yet the private sector seems to by saying it does make sense." According to Menendez, approximately 20 percent of private sector mortgages have reduced loan principal along with other loan modifications. In a January analysis, the FHFA asserted that principal forbearance is equally effective as principal reduction—an assertion that was refuted by witnesses. Laurie Goodman, managing director at Amherst Securities Group told lawmakers the FHFA failed to consider several factors including individual loan level data.

Senate Banking Committee Looks Into Prepaid Card Market:
On March 14th, the Senate Banking Subcommittee on Financial Institutions and Consumer Protection held a hearing to examine issues in the prepaid card market. Witnesses included: Lauren Saunders, Managing Director at the National Consumer Law Center; David Rothstein with Policy Matters Ohio; Daniel Henry, CEO of NetSpend Holdings, Inc.; and Jennifer Tescher, President and CEO of the Center for Financial Services Innovation. The hearing was sparsely attended, with only subcommittee Chairman Brown (OH) and ranking member Corker (TN) showing up. The hearing focused mainly on potential statutory and regulatory changes that could be considered, particularly by the CFPB in order to better protection consumers from this growing area of financial transactions. Areas discussed included increased disclosure

requirements and whether other regulatory burdens – traditionally imposed on the banking industry – should be imposed on the prepaid card market.

Executive Branch

Fed

Fed Releases Outcome of Latest Stress Tests; Four Banks Fall Short:

On March 13th, the Federal Reserve announced the results of its annual stress test. The Comprehensive Capital Analysis and Review tests the country's 19 largest banks to see if they are able to withstand a severe recession in the US, including an unemployment rate of up to 13 percent, halved equity prices and a 21 percent decline in home prices. Four of large banks failed the stress tests and would not have had adequate capital ratios under the hypothetical scenario—including Citigroup, Ally Financial, SunTrust and MetLife. Banks that fail to meet the capital requirements of the stress test must raise their capital levels. "It's important to note that the Federal Reserve's stress scenario estimates are the outcome of deliberately stringent and conservative assessments under hypothetical, adverse economic conditions and the results are not forecasts or expected outcomes," said the Fed upon releasing the results. The results were an improvement from the last round.

CFPB

CFPB Releases Proposed Rule to Protect Proprietary Information of Regulated Firms:

On March 12th, the CFPB issued a proposed rule to counter fears that proprietary information provided to the Bureau will not be adequately protected. The rule seeks to address an oversight in the Dodd-Frank Act which failed to extend privacy protections to the information it collects from financial providers and which has been the recent subject of much Congressional consternation. Industry is concerned that without the protections they are afforded at the FDIC and OCC, confidential information given to the CFPB could be made public. Lawmakers from both parties and both chambers—including Chairman Tim Johnson (D-SD) and Ranking Member Richard Shelby (R-AL)— have drafted legislation to protect confidential information, and it is anticipated to be enacted in the near future.

CFPB Extends Comment Period for Regulatory Streamlining Proposal:

In response to the volume and complexity of comments submitted in regard to the CFPB's regulatory streamlining proposal, the Bureau has extended the comment period from April 3rd to June 4th. The streamlining initiative seeks to publically identify inherited regulations, or specific provisions of inherited regulation, that should be given high priority in eliminating, updating or tweaking irrelevant or burdensome regulations.

SEC

Lawmakers Urge SEC to Expedite Pay Ratio Rulemaking:

In a letter sent March 9th, lawmakers urged the SEC to "prioritize" rulemakings to implement the statutory requirement that companies disclose the ratio of CEO pay relative to median annual income of employees. The letter was signed by five Democrat Senators and 20 Democrat House Members and spearheaded by Senator Robert Menendez (D-NJ) and Representative Keith Ellison (D-MN). While the lawmakers bemoaned that CEO pay has "skyrocketed" while employee pay remains 'stagnant,' businesses fear that the requirement would be overly difficult and time-consuming—especially for large, multinational companies. Still, advocates for shareholders and investors have countered that disclosing the ratio would give valuable insight into the overall health of such companies. The SEC has said that the statutory language outlining the rule is constraining; however, they are looking for "creative solutions" to decrease the burden to companies, particularly multinational companies. While there is no statutory deadline for the rule, SEC staff is currently crafting a proposal for commissioners to review in the coming months.

SEC Official Lays Out Priorities for 2012 – Private Fund Advisers and High Frequency Traders Highlighted:
On March 9th, before a conference organized by the Investment Adviser Association, Norman Champ, Deputy Director for the SEC's Office of Compliance Inspections and Examinations (OCIE), spoke on the need to address private fund advisers, high frequency traders and other OCIE priorities. While noting that he spoke for himself and not the SEC, Champ also identified a number of OCIE priorities, including: problematic sales practices; 'retailization' of complex securities' fund governance, registrants' compliance, audit and management; asset safety; and advertising. In addition, the OCIE is currently looking at foreign firms that are registered with the SEC as investment advisers in an effort to understand the non-US companies better. Finally, Champ mentioned that the OCIE will be issue more risk alerts in 2012, following up on the February risk alert warning broker-dealers and investment advisers about inappropriate trading activities.

CFTC

CFTC Plans Expansion of High-Frequency Trader Oversight:
Last week, in an interview, Chairman Gary Gensler said the CFTC is planning to increase day-to-day monitoring of the commodities and futures in order to lessen the impact of high-frequency trading firms. Rather than just monitoring futures trades, the Commission will be watching the buy and sell orders that have begun to increasingly affect the market. By doing so, regulators hope to curb questionable trading which led to the 2010 "flash crash" and to police the high-frequency trading firms that are increasingly issuing computerized buy and sell orders. Gensler said the CFTC expects to soon have the technology to download and monitor all such orders—including those that are ultimately not executed—in real time.

CFTC Sets Date to Consider Clearing Rule:
On March 13th, the CFTC announced it will hold a March 20th meeting to consider a final rule on customer clearing documentation, the timing of acceptance for clearing and clearing member risk management. The rule was proposed in July to facilitate access to clearing and decrease lag time between submission of a trade and a clearinghouse's response. The clearing rule is among the 23 Dodd-Frank proposals that have yet to be finalized by the CFTC, including rules to define swaps products and entities.

<u>Miscellaneous</u>
In Response to Increased Criticism -- Volcker Defends Namesake Rule:

On March 14th, former Fed Chairman Paul Volcker defended regulators' proposed proprietary trading ban that bears his name—asserting that regulations are necessary to rein in excessive risk taking among banks. At a conference sponsored by the Atlantic, Volcker said efforts to simplify the Volcker Rule framework are misguided as they would be picked apart by financial services industry lawyers seeking loopholes. Volcker said while broad principals appear sensible, they go "against the grain of the regulatory philosophy in the United States." Recently, current Fed Chairman Ben Bernanke said regulators will likely miss the July deadline to finalize the proprietary trading ban due to more than 17,000 public comments that must be sifted through. Comments reflect fears that overly restrictive regulation will scare banks from conducting in legitimate activities, harm liquidity and create a competitive disadvantage. In response, Volcker argued that proprietary trading does not play a large enough rile in the banking sector to have such a massive impact and that he hopes the rule will simply rebalance incentives so that banks can focus on "on old-fashioned concerns about lending to small and medium-sized businesses and taking care of deposits."

Disconnect Between Politically Popular Policies and Grave Fiscal Problems:
In its March baseline update, the Congressional Budget Office projected the federal budget deficit to be $1.2 trillion—$93 billion greater than expected in FY 2012. The unexpected jump results mainly from the cost of the payroll tax cut. The new 10 year projections find that the deficit accumulated by 2022 will fall by $186 billion. The new projections reflect the continued choice between deep fiscal cuts and historically popular spending, and will likely be spun by both parties in the fall elections.

UPCOMING HEARINGS

On Monday, March 19th at 9:30am, in Brooklyn, New York, the House Oversight and Government Reform Committee will hold a field hearing titled "Failure to Recover: The State of Housing Markets, Mortgage Servicing Practices, and Foreclosures."

On Tuesday, March 20th at 10am, in 2128 Rayburn, the House Financial Services Committee will hold a hearing to receive the annual testimony of the Secretary of the Treasury on the state of the international financial system.

On Tuesday, March 20th at 10am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Committee will hold a confirmation hearing on pending nominations to the Federal Reserve, Treasury, FDIC and TARP.

On Tuesday, March 20th at 10am, in 215 Dirksen, the Senate Finance Subcommittee on Fiscal Responsibility and Economic Growth on will hold a hearing titled "The Spread of Tax Fraud by Identity Theft."

On Tuesday, March 20th at 10am, in 226 Dirksen, the Senate Judiciary Subcommittee on Administrative Oversight and the Courts will hold a hearing titled "Looming Student Debt

Crisis: Providing Fairness for Struggling Students," that will focus on legislation that would help address the growing student loan debt problem in the United States.

On Wednesday, March 21st at 9:30am, in 538 Dirksen, the Senate Banking, Housing and Urban Affairs Subcommittee on Securities, Insurance, and Investment will hold a hearing titled "Examining Investor Risks in Crowdfunding."

On Wednesday, March 21st at 9:30am, in 2154 Rayburn, the House Oversight and Government Reform Committee will hold a hearing titled "Europe's Sovereign Debt Crisis: Causes, Consequences for the United States and Lessons Learned."

On Wednesday, March 21st at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing on the Swap Data and Clearinghouse Indemnification Correction Act of 2012.

On Thursday, March 22nd at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit will hold a hearing titled "The Future of Money: How Mobile Payments Could Change Financial Services."

On Thursday, March 22nd at 10am, in 428-A Russell, the Senate Small Business and Entrepreneurship Committee will hold a hearing on small business investment companies and their role in the entrepreneurship ecosystem.

On Thursday, March 22nd at 10:00am in 538 Dirksen, the Senate Banking Committee will hold a hearing entitled "International Harmonization of Wall Street Reform: Orderly Liquidation, Derivatives, and the Volcker Rule." The Committee will hear from officials from the Treasury, Federal Reserve, SEC, FDIC, and OCC.