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FINANCIAL SERVICES REGULATORY REFORM UPDATE

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Although the House of Representatives was in recess this week, a draft of the Financial Services Majority staff's oversight strategy was leaked and widely circulated. Based on that report, which is expected to be ratified this week, the Republicans intend to scrutinize nearly every piece of legislation that stands to create more and potentially unnecessary regulation by the federal government, and will hold multiple hearings overseeing the implementation of Dodd-Frank. Notably, the plan does not call for outright repeal of Dodd-Frank.

The U.S. debt ceiling was also a major topic of discussion this week, with members of both parties, administration officials, and others all weighing in on when the ceiling will be reached and how to avoid a default on U.S. debt. While most of the major players seem to be in agreement that something must be done in the near future, there is no consensus on how to move forward. Potentially complicating matters, arch conservatives like Senator Toomey (R-PA) believe that no action is necessary at all, as evident by the dueling statements he issued with Treasury Secretary Geithner this week on the need to expand the ceiling.

Finally, we saw the beginnings of the debate on whether the States should be allowed to seek protection under the federal bankruptcy law. With many municipalities teetering on the verge of bankruptcy, and growing concerns about whether some States are soon to follow, there is small group of Congressmen (led by Rep. Patrick McHenry (R-NC)) who wish to allow States to be eligible for bankruptcy. This debate, which we anticipate to go on for most of this year, could have a major impact on the bond market.

TREASURY DELAYS DEBT CEILING DEADLINE

Although the Treasury had previously estimated that the U.S. government would reach the federal debt ceiling between March 31st and May 16th, the Treasury has modified its estimates to sometime between April 5th and May 31st. This has significant effects on Congress's efforts to curb spending because the continuing resolution (the "CR"), which is a temporary government funding bill, is set to expire on March 4th, well before the debt ceiling would begin to affect the Treasury. The CR is slated for consideration on the House floor the week of February 14th, which would theoretically provide enough time for subsequent consideration by the Senate. However, because Senate Appropriations Chairman Inouye has vociferously criticized the spending cuts likely to be found in the House bill, the conventional wisdom is that Congress will pass another short-term funding proposal before the serious negotiations commence on a new budget plan.

TOOMEY AND TREASURY TRADE BARBS ON DEBT CEILING

Last month, Sen. Patrick Toomey (R-PA) proposed legislation that would require the Treasury to prioritize payments to U.S. bondholders before paying other government bills, in the hopes of avoiding a default in case the government exceeds the debt limit. Similar legislation was also introduced in the House by Rep. Tom McClintock (R-CA). In response, Treasury officials have strongly opposed both bills, stating that they would be ineffective at forestalling a debt crisis. Earlier this week, Toomey rebutted the argument in a letter to Treasury Secretary Timothy Geithner, asserting that comments made by Treasury officials and others are both "factually incorrect and disproven by historical events, but, most disturbingly, they could undermine investor confidence in the U.S. government's debt, thereby potentially precipitating some of the very reactions the Treasury Department should be preventing." Geithner again responded to Toomey, reiterating that a failure to raise the debt limit could have dire consequences, regardless of the success of Toomey's bill, which he called "harmful."

Members of both parties have gone back and forth on this issue, as GOP leaders in both chambers are pushing the President and Democrats to agree to cut spending and create a mechanism for controlling future spending in exchange for their support of a debt limit increase. See below for more discussion in Congress on the budget and the debt limit.

DRAFT OVERSIGHT PLAN RELEASED BY HOUSE FINANCIAL SERVICES REPUBLICANS

Earlier this week, House Financial Services Committee Chair Spencer Bachus (R-AL) released a 22-page draft of the GOP's plans for monitoring the regulators charged with implementing the Dodd-Frank Act. The strategy does *not* call for a repeal of the law, but rather aims to "strike an appropriate balance between prudent regulation and economic growth." The Committee intends to "identify and remedy" unintended consequences of Dodd-Frank, particularly focusing consumer and business access to credit, as well as rules governing proprietary trading and derivatives. The Committee will also "examine whether federal regulators will impose margin and capital requirements" on non-financial firms that use derivatives as legitimate hedging tools. Overall, the draft plan stated a mission of "improve[ing] those parts of the act that work well while changing those parts that do not."

MARKETS INDICATE FEAR OF CERTAIN DODD-FRANK EFFECTS

Although the debit card fee restrictions authorized under Dodd-Frank have yet to be implemented, a dip in Visa's shares earlier this week indicate that investors are concerned about the law's potential impact on the industry. The new regulations are in the process of being written, and Visa and its peers are lobbying heavily to delay the implementation of Dodd-Frank and study the unintended consequences before any new rules are put into place. Visa's first quarter earnings were up 16% as a result of increased consumer spending, but this positive news was insufficient to quell investors' fears that limits on debit card fees will affect the company's revenue down the road. Currently, the draft proposal would limit these fees to 12 cents per transaction, which is 80% less than current levels. The House Financial Services Subcommittee on Financial Institutions and Consumer Credit is scheduled to have a hearing on the proposed interchange rules on February 17th, which is the first step in the process to mitigate the so-called "Durbin amendment" from Dodd-Frank that set these rates.

SENATE BUDGET COMMITTEE EXAMINES ECONOMIC FORECAST

The Senate Budget Committee gathered on Tuesday to consider the "U.S. Economic Outlook." The panelists were or are chief economists at Bear Stearns, Morgan Stanley and the International Monetary Fund. At the hearing, Committee Chair Kent Conrad (D-ND) called for a fiscal summit in which House and Senate leaders and White House officials could convene to create a bipartisan, credible, long-term plan for the budget before a debt emergency occurs. Conrad forecasts that the debt ceiling will be reached in May, and Treasury Secretary Tim Geithner has similarly stated that it could be reached between March 31st and May 16th. Conrad stressed the urgency of the problem, and also called for reining in spending on large programs such as Medicare and Social Security. He added that the administration's focus on cutting non-defense domestic discretionary spending is an insufficient means of tackling the problem. He also warned that the U.S. risks losing credibility in the bond markets worldwide if the debt limit is extended. In contrast, all three panelists concurred that the debt ceiling must be raised.

Sen. Ron Wyden (D-OR), an advocate for tax reform as a means of cutting the national debt, stated that more than 30 senators gathered before the hearing to discuss the debt problem and the direction of the U.S. economy. One of the panelists, formerly with Bear Stearns, opined that Congress should take advantage of the March 4 expiration of the continuing resolution to cut spending. The other two panelists disagreed, stating that immediate debt reduction could hurt the economic recovery, and that debt problems exist in the long-term, not the short-term.

SEC PROPOSES RULES ON SECURITY-BASED SWAP EXECUTION FACILITIES

On Wednesday, the SEC voted unanimously to propose rules that would define security-based swap execution facilities (SEFs) and establish their duties, core principles and registration requirements. This rule was called for in a Dodd-Frank provision, which authorized the SEC to implement a framework for regulating security-based swaps. Currently these swaps are traded in over-the-counter markets and have little transparency. Please find the full SEC press release here.

WHITE HOUSE BUDGET PROPOSAL TO INCLUDE PERMANENT TAX RELIEF

On January 30, a White House official said that the President's FY2012 budget will have permanent tax relief measures such as the elimination of capital gains taxes. The budget will also include the New Markets Tax Credit designed to promote private sector investment in startups and small business which conduct business in lower-income communities.

In addition, the White House launched "Startup America." Startup America is a national movement aimed to promote entrepreneurship through investments in private sector startups, increased research and lessening barriers to success for entrepreneurs. In addition to Startup America, the administration announced the Small Business Administration will be using $2 billion to match private sector investment in startup and small firm investment in underserved communities. The Department of Commerce is also expanding the i6 Challenge designed to increase marketing of clean technologies.

SHAPIRO OUTLINES SEC PRIORITIES FOR 2011

SEC Chair Mary Shapiro, while emphasizing the strain on resources that the agency is facing, also underscored the SEC's four major areas of action for the coming year:

1. Working with the CFTC to regulate over-the-counter derivatives, including creating trading platforms and reporting requirements;
2. Creating risk-retention requirements for asset-backed securities transactions and requiring ABS issuers to perform and publish reviews of the pooled securitized assets;
3. Creating rules to ensure that financial professionals who give investment advice about securities are subject to the same fiduciary standard and certainly "no less stringent" standard than that of investment advisers; and
4. Finalizing the Commission's whistleblower rules.

Please find Shapiro's full remarks here.

COMMENTS EXPRESS CONCERN WITH SEC'S PROPOSED MUNI ADVISER REGISTRATION

Multiple state and local government officials sent comment letters to the SEC, warning that the proposed rule to create a registration system for municipal advisers could overreach by subjecting good Samaritan volunteers to the same registration requirements. The SEC's proposal, issued on December 20th to replace an expiring temporary rule, would exempt from registration persons serving as elected members of the governing body of the municipality, and ex officio members who hold elective offices. The SEC purposely did not exempt appointed members of a municipality's governing body, because, as the agency stated, they are not directly accountable to citizens for their performance. The SEC has received many letters and taken at least one meeting on this particular concern. The comment period ends on February 22nd, and we expect more clarity from the SEC on the exemption from registration once the public has fully weighed in.

MSRB TO SEEK COMMENT ON FIDUCIARY DUTY PROPOSALS

On a related note, the Municipal Securities Rulemaking Board (MSRB) officials announced on Monday that the Board will be seeking public comment on a number of rulemakings and draft interpretive guidance. This will include rulemakings relevant to federal fiduciary responsibilities for municipal advisors, to fair practices duties of municipal advisors and underwriter and to gifts by municipal advisors and brokers.

As of October 1, the Dodd-Frank Act required the MSRB to oversee municipal advisors in their fiduciary duties to their clients. The draft interpretive guidance on fiduciary duties would require the disclosure of conflict of interest and explain what it means to have a 'federal duty of loyalty and care.' The MSRB will also be seeking public comment on a "fair dealing" rule which would create a code of conduct for all entities regulated by the MSRB. The MSRB is also seeking comment on a rule which would address brokers' activity. MSRB officials also discussed municipal adviser fees and disclosure of public pension fund obligations. Pension disclosures would include information about funding status and bond payments.

SPEIER WORKING ON BILL TO PROTECT CONSUMERS' FINANCIAL PRIVACY

Rep. Jackie Speier (D-CA) is reportedly working on a financial privacy bill that would augment the protections already in the Gramm-Leach-Bliley financial modernization law and according to her staff she will be introducing it the week of February 7th. She worked on similar legislation as a state legislator in California, in which financial consumers had the ability to opt out of sharing information with financial institutions' affiliates, and would require firms to obtain consumer consent before sharing information with third parties. Consumer protection as it relates to online privacy has been a major topic of conversation on the Hill, and we expect much more comprehensive legislation to be introduced by others (including Sen. John Kerry) that would encompass the goals of Speier's bill.

Along these lines, the Department of Commerce released a privacy report late last year, calling for a "privacy bill of rights," among other things. Following this release, the Department also issued a notice of inquiry, to obtain public comments on questions related to its report, including:

1. Should baseline commercial data privacy principles be enacted by statute or some other means?
2. Should baseline privacy legislation include a private right of action?

A variety of organizations have weighed in on the Commerce Department's privacy proposals and questions. The Financial Services Forum notably stated that there would be "severe unintended consequences" if the government imposed an EU-type approach of omnibus privacy requirements across industry sectors. The Forum requested that the U.S. government adhere to the "U.S. approach to privacy, which is customized to address specific types of harm, rather than adopting an omnibus approach and moving closer to the EU." Many other business groups advocated for the efficiency of self-regulation and opposed creating a private right of action.

SEC ANNOUNCES PUBLIC ACCESS TO NEW MUTUAL FUND DISCLOSURES

According to the SEC, investors will now be able to access disclosed information by money market mutual funds, which will be available on the SEC website and updated monthly. This information will include "shadow prices," (or shadow net asset values, NAVs) which are funds' per-share market values. SEC adopted new rules in January 2010, requiring funds to report their portfolio holdings and other information to the Commission on Form N-MFP. The information will be made public after 60 days. The Investment Company Institute released a study prior to the publication of the first set of data, reassuring investors that money funds' market values generally hover around $1 NAV unless there are extreme market conditions.

CFPB HIRING UPDATE – DIRECTOR AND STAFF

Although there hasn't been much news on a new director for the Consumer Financial Protection Bureau, recent reports indicate that special advisor Elizabeth Warren discussed the important position with four Democratic state attorneys general in January – Iowa's Tom Miller, Illinois' Lisa Madigan, North Carolina's Roy Cooper and Massachusetts' Martha Coakley. No job offers were made or even discussed, but many are considering this to be evidence that an attorney general will be a leading contender. The White House is aware of these meetings, but reportedly "isn't close" to choosing a nominee. On that note, Rep. Randy Neugebauer (R-TX), already a staunch opponent of the CFPB, has expressed his displeasure with this delay: "The President needs to… give that agency someone who's in charge… Some pretty important decisiosn are being made, and we need to make sure that we're dealing with the person that's going to be there [in the] long term." Neugebauer did, however, state that he was "pleasantly surprised" by the manner in which Warren is setting up the agency.

Additionally, on Friday, Warren responded by letter to a request of Congressman Neugebauer for more insight into how the CFPB would be stood up. Based on that letter it appears there will be six divisions:

Consumer Engagement and Education; Supervision and Enforcement; Research, Markets, and Regulations; General Counsel; External Affairs; and a Chief Operating Officer.

Four individuals were also just named to the CFPB's "implementation team." Leonard Kenney will serve as general counsel, and was previously general counsel, corporate secretary and chief government affairs officer for Sprint Nextel Corp. Meredith Fuchs, formerly the chief investigative counsel of the House Energy and Commerce Committee and vice president and general counsel of George Washington University's National Security Archive, will serve as principal deputy general counsel. Michael Gordon will be deputy general counsel, and was previously a counselor at the Treasury Department's Office of General Counsel. Roberto J. Gonzalez will also serve as deputy general counsel, and was formerly an associate counsel and special assistant to the president at the Office of White House Counsel.

GAO FAULTS SEC FOR HAVING ITS BOOKS IN DISARRAY

As the SEC requests millions of dollars in increased funding for Dodd-Frank implementation, it was awkwardly noted recently that the Government Accountability Office (GAO) has found the SEC's financial reporting to be flawed almost every year since the SEC began producing audited statements in 2004. The GAO is certainly not accusing the SEC of cooking the books (in fact all errors were corrected before the statements were completed), but has noted that this failure has prevented the SEC from accurately tracking income from filing fees, fines and disgorged profits. Part of this disorder at the Commission is due to the SEC's outdated technology, which is unable to perform sophisticated analysis of large batches of data. SEC analysts have had to resort to printouts and calculators, and this is a prime reason that it took 3 months for the May 6th flash crash to be fully examined.

AIMA WARNS AGAINST PROPOSED EU RULE TO DISCLOSE SHORT NET POSITIONS

Based on a report written by Oliver Wyman, the Alternative Investment Management Association (AIMA, which represents the hedge fund industry) has concluded that aspects of proposed rules by the European Union could risk distorting financial markets. The EU has pending legislation that would require public disclosure of some short net positions, and AIMA believes that there will be "serious unintended consequences" of disclosing "individual managers' positions to the market, including a decrease in liquidity, lower returns for end investors including retail investors and the likelihood that investments will move to other jurisdictions where returns are not constrained by inappropriate regulations." The director of AIMA stated the industry's support for publishing aggregated short positions and reporting positions to national regulators, but drew the line on individual managers' positions. The Oliver Wyman report also recommended that the EU follow all other major financial jurisdictions, none of which require individual managers to publicly disclose their positions.

REPORT FINDS THAT DODD-FRANK WILL INCREASE COMPETITION AMONG DERIVATIVES CLEARINGHOUSES

According to a Woodbine Associates report released earlier this week, the Dodd-Frank provisions that will require all standardized derivatives transactions to be cleared through a qualified clearinghouse will actually increase competition among clearinghouses. This result is expected over time as the CFTC requires an increasing percentage of total derivatives transactions to use a clearinghouse. The report was written in large part to help regulated companies understand their new obligations and recognize practices that are in compliance with Dodd-Frank's derivatives provisions. The report is available for a fee online.

UPCOMING HEARINGS

On Wednesday, February 9th at 9:30am, in HVC-210 Capitol Building, the House Oversight and Government Reform Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs will hold a hearing entitled "State and Municipal Debt: The Coming Crisis."

On Wednesday, February 9th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Domestic Monetary Policy and Technology will hold a hearing on monetary policy and job creation.

On Wednesday, February 9th at 10am, in 210 Cannon, the House Budget Committee will hold a hearing on "The State of the U.S. Economy."

On Wednesday, February 9th at 1pm, in 2360 Rayburn, the House Small Business Committee will hold a hearing entitled "Buried in Paperwork: A 1099 Update," focusing on the impact on small businesses of the expanded 1099 reporting requirement that was included as Section 9006 of the Patient Protection and Affordable Care Act.

On Wednesday, February 9th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing on revising the operations of government sponsored enterprises.

On Thursday, February 10th at 9:30am, in HVC-210 Capitol Building, the House Oversight and Government Reform Committee will hold a hearing on "Regulatory Impediments to Job Creation."

On Thursday, February 10th at 10am, in 2128 Rayburn, the House Financial Services Committee will meet to consider the committee's oversight plan.

On Thursday, February 10th at 10am, in 210 Cannon, the House Budget Committee will hold a hearing on budget and economic outlook prepared by the Congressional Budget Office.

On Thursday, February 10th at 10am, in 1300 Longworth, the House Agriculture Committee will hold a hearing on Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Title VII covers some of the activities of the CFTC, which regulates financial aspects of commodities trading.

On Friday, February 11th at 10am, in HVC-210 Capitol Building, the House Oversight and Government Reform Subcommittee on Government Organization, Efficiency and Financial Management will hold a hearing on "A Look at the FY2010 Consolidated Financial Report of the U.S. Government."

On Tuesday, February 15th at 10am, in 2128 Rayburn, the House Financial Services Committee will hold a hearing on the implementation of derivatives provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act.

On Tuesday, February 15th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Oversight and Investigations will hold a hearing on the legal fees of government sponsored enterprises.

On Wednesday, February 16th at 10am, in 2128 Rayburn, the House Financial Services Committee will hold a hearing on the report issued by the Financial Crisis Inquiry Commission.

On Wednesday, February 16th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Insurance, Housing and Community Opportunity will hold a hearing on housing finance issues.

On Thursday, February 17th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit will hold a hearing on the proposal of the Federal Reserve System to regulate the fees charged by the banks and payment card networks (e.g., Visa and Mastercard) for processing debit card transactions.