ML Strategies Update

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Financial Services Legislative and Regulatory Update

Leading the Past Week

President Obama touched on both new and old initiatives in his State of the Union though avoided rhetorical attacks against large financial institutions. Instead, that torch was picked up by Senator Elizabeth Warren, who did not disappoint her supporters on the left with her sharp questioning of regulators at her first hearing of the Senate Banking Committee. Raising issues such as whether large institutions were "too large to jail" certainly generated attention that to date, Senator Warren had worked to avoid. In the Finance Committee, Treasury nominee Jack Lew easily survived his nomination hearing as was widely anticipated. Not so lucky was FHA Commissioner Carol Galante, who was grilled by the House Financial Services as part of a series of hearings on the agency's financial situation.

In the Administration, last week saw the announcement of the long awaited executive order related to cybersecurity, which will impact the nation's critical infrastructure, including banks and financial institutions. The EO is seen by many as a first step but one which will require additional legislation to be effective. Also, the CFPB continues to grapple implementation of new mortgage rules and the FSOC attempts to get its arms around its pending money market proposals.

Legislative Branch

Senate

Senate Banking Committee Holds Hearing on Dodd-Frank Implementation with Top Regulators

On February 14th, the Senate Banking Committee met to hear testimony from key regulators from the Fed, Treasury, FDIC, CFPB, SEC and CFTC. Lawmakers questioned witnesses on a variety of topics including implementation of the Volcker Rule, new mortgage regulations, the impact of Basel III capital regulations on small banks, and how the agencies are coordinating implementation. Ranking Member Mike Crapo (R-ID) told regulators he remains concerned about how new rules governing the over-the-counter swaps market will apply overseas and noted "bipartisan concern that some of the Dodd-Frank rules go too far and need to be fixed."

In general, regulators told the Committee that they have made substantial progress toward strengthening the financial system and sought to assuage lawmaker concerns of slow progress and other efforts to reign in the financial reforms. Mary Miller, Treasury Undersecretary for Domestic Finance, told the Senators that progress has been made in spite of efforts to repeal or underfund the Dodd-Frank Act, which have caused "uncertainty to fester, and be corrosive to the strength and stability of our financial system." In his remarks, Fed Governor Daniel Tarullo said that the agency will propose risk-based capital standards for the largest banks this year and regulators will finalize Basel III capital requirements in the spring. However, the real fireworks at the hearing came when Senator Elizabeth Warren grilled the regulators about their enforcement practices, questioning why there appeared to be a reliance on settlements rather than trials, and questioning whether the market's underpricing of bank stocks was indicative of a lack of trust in their accounting or management.

Lew Appears Before Senate Finance in Treasury Secretary Nomination Hearing

On February 13th, the Senate Finance Committee met to consider the nomination of Jack Lew to be Treasury Secretary. In his testimony, Lew underscored the need for the continued implementation of the Dodd-Frank Act and the need to balance the importance of the financial reforms with the potential regulatory burdens they pose. For example, Lew said, though many of the new laws treat small banks differently, he would look forward to working with the Committee to "make sure that we implement the laws in a way that does help get capital flowing to small banks." In response to a question from Senator Robert Menendez (D-NJ), Lew said the implementation of oversight provisions in Dodd-Frank and the modernizations of financial services regulation contained in the bill would be "an extraordinarily high priority" as chairman of the FSOC. Still, Lew would not go so far as to endorse a return to Glass-Steagall, rebutting a question from Senator Maria Cantwell (D-WA) by indicating that he did not see it as a cure-all. Lew's nomination will not be voted on by the Committee until after the Senate returns from the President's Day Recess.

Chairman Johnson Sets Banking Committee Agenda for 113th Congress

On February 12th, Senate Banking, Housing and Urban Affairs Committee Chairman Tim Johnson (D-SD) released the Committee agenda for the 113th Congress. The focus of the Committee's efforts will continue to be on sustaining and strengthening the economic recovery through implementation of the Dodd-Frank Act, stabilizing the housing market, and reauthorizing key programs such as the Terrorism Risk Insurance Act and the Export-Import Bank. Other priorities listed in the agenda include: promoting economic growth and access to capital in rural America; strengthening federal public transportation programs; continuing oversight of the consumer financial services market, including the burgeoning prepaid card industry and oversight of JOBS Act implementation.

Members of Senate Appropriations Financial Services Panel Finalized

Last week, the Senate Appropriations Committee finalized its subcommittee membership. The Financial Services and General Government Subcommittee, with oversight of the SEC and other regulators will be chaired by Senator Frank Lautenberg (D-NJ), and Mike Johanns will be the ranking Republican. Other members will include Dick Durbin (D-IL), Tom Udall (D-NM), and Jerry Moran (R-KS).

Senators Call on Regulators to Loosen QRM Rule

On February 14th, a bipartisan group of Senators sent a letter to federal regulators asking them to relax their proposed definition for Qualified Residential Mortgages (QRM). The letter was signed by senators Kay Hagan (D-NC), Johnny Isakson (R-GA), and Mary Landrieu (D-LA). The letter informed regulators that the current definition does not reflect the intent of Congress as it sets a high down payment requirement. The lawmakers noted that Congress purposefully did not assign a down payment requirement in the stature and urged regulators to revise the rule to more accurately reflect the intent of Congress.

Johnson, Crapo Call on Regulators to Address Basel III Concerns
On February 13th, Chairman and Ranking Member of the Senate Banking Committee, Senators Johnson (D-SD) and Crapo (R-ID), wrote to the Fed, OCC and FDIC, urging regulators to carefully consider the impact of Basel III proposals on community banks and insurance companies. The lawmakers warned against unintended consequences and asked regulators to ensure that the rules are "clear, well calibrated, and work effectively in concert with other prudential requirements."

Warren Speaks Out on Basel III and Small Banks
Last week, Senator Elizabeth Warren (D-MA) spoke to MassLive.com on several issues relevant to her role on the Banking Committee. Warren said Basel III rules should not apply to small banks and that there is "no reason to believe that current regulations are not completely adequate for managing the risks posed by small banks;" however, she went on to say that, if not adequate, she would consider a new version of Glass-Steagall, though she indicated she would wait until see how the final Volcker Rule looked before pursuing a return to Glass-Steagall. Warren also told the paper that regulators must be held more accountable when they fail and banks must be held accountable when they break the law, a theme she returned to during Thursday's Senate Banking Committee hearing.

Treasury Pilots Senator Merkley's Program for Underwater Homeowners
On February 11th, Senator Jeff Merkley (D-OR) announced that the Treasury Department approved a new pilot program to help homeowners who are underwater on their mortgages. The pilot will allow homeowners in Multnomah County, Oregon to apply for the program in April. The program, based on a 2012 proposal from Senator Merkley, would allow underwater homeowners who have remained current on their payments to refinance their mortgage to a lower interest rate. The program utilizes a trust of Troubled Asset Relief Program (TARP) funds to buy loans owned by private investors. Senator Merkley also said that he is speaking with Republicans about drafting broader mortgage refinancing legislation, similar to what President Obama proposed in his State of the Union address.

House of Representatives
FHA Commissioner Galante Defends FHA Before House Financial Services Committee
As part of its continued oversight of the Federal Housing Administration, the House Financial Services Committee met to hear testimony from Commissioner Carol Galante on the FHA's actuarial report. Galante defended the agency against accusations that the FHA is "broke," telling lawmakers that the agency needs time to determine how effective recent policies will be at strengthening the Mutual Mortgage Insurance (MMI) Fund. While the President's 2014 budget may include money for potential assistance from the Treasury, Galante stressed the real need for aid will not be known until the agency reviews its finances at the end of 2013. Currently, the FHA has the authority to draw on an existing line of credit from the Treasury without approval of Congress. While the President's FY 2012 budget provided for as much as $700 million in assistance from the Treasury, a large infusion of funds to the FHA was avoided due to an

additional $1 billion in revenue from the settlement with large banks over improper foreclosure practices.

Still, Chairman Jeb Hensarling (R-TX) and other Republicans on the Committee were skeptical of the FHA's ability to shore up its reserves in the near-term. Hensarling noted that the agency has, for four consecutive years failed to meet the Congressionally mandated minimum capital standard of 2 percent. Republican lawmakers also noted that the FHA has strayed from its intended mission by insuring high-cost loans to borrowers who could afford other options. Galante defended the FHA, saying its focus remains on low-income and first-time borrowers and high-cost loans represent less than 1 percent of total loans at the agency.

Financial Services Committee Approves Oversight Plan
On February 15th, a day after a marathon mark-up the House Financial Services Committee approved its nonbinding oversight plan for the 113th Congress. The plan was approved on a straight party line vote, of 33 to 27. During the mark-up Democrats, offered 33 amendments to the plan, many of which were adopted. The plan, while nonbinding, lays out Committee priorities, including: oversight of Dodd-Frank including of the FSOC, OFR, Volcker Rule, and CFPB; restructuring the government sponsored entities (GSEs) Fannie Mae and Freddie Mac; addressing housing and the FHA; and the economy and jobs, among other things. Tensions in the Committee rose during portions of the hearing, including during a debate over language which would instruct the Committee to examine the CFPB's budgetary process.

Leaders of House Ways and Means Tax Reform Working Groups Chosen
Last week both parties chose Members to lead House Ways and Means eleven working groups on tax reform. The goal of the working groups will be to interface and compile feedback from stakeholders for a report to the Joint Committee on Taxation. The co-chairs are as follows:

- Charitable and exempt organizations: Representatives David Reichert (R-WA) and John Lewis (D-GA)
- Debt, Equity and Capital: Representatives Kenny Marchant (R-TX) and Jim McDermott (D-WA)
- Education and Family Benefits: Representatives Diane Black (R-TN) and Danny Davis (D-IL)
- Energy: Representatives Kevin Brady (R-TX) and Mike Thompson (D-CA)
- Financial Services: Representative Adrian Smith (R-NE) and John Larson (D-CT)
- Income and Tax Distribution: Representatives Lynn Jenkins (R-KS) and Joseph Crowley (D-NY)
- International: Representatives Devin Nunes (R-CA) and Earl Blumenauer (D-OR)
- Manufacturing: Representatives Jim Gerlach (R-PA) and Linda Sanchez (D-CA)
- Pensions/Retirement: Representatives Pat Tiberi (R-OH) and Ron Kind (R-WI)
- Real Estate: Representatives Sam Johnson (R-TX) and Bill Pascrell (D-NJ)
- Small Business/Pass Throughs: Representatives Vern Buchanan (R-FL) and Allyson Schwartz (D-PA)

House Ways and Means Committee Meets to Consider Charitable Deductions
On February 14th, the House Ways and Means Committee met to consider the role of charitable contributions as part of its ongoing series of hearings related to comprehensive tax reform. The hearing, which lasted all day and featured six panels of 42 witnesses, all who generally offered the same testimony -- that a potential reduction or elimination of the charitable tax credit would

negatively impact charities and the services they support. Ranking Member Sander Levin (D-MI) noted that the charitable deduction should not be seen as a "loophole" but rather should be viewed just like the deduction for mortgage interest. It was unclear from the hearing whether the Committee would modify the current treatment of charitable contributions under the code.

Bill to Raise the Credit Union's Member Business Lending ("MBL") Cap Introduced
On February 14th, Representatives Ed Royce (R-CA) and Carolyn McCarthy (D-NY) introduced legislation (H.R. 688) that would raise the credit union member business lending (MBL) cap from 12.25 percent to 27.25 percent. H.R. 688 currently has 37 cosponsors. There was a strong last minute push to pass similar legislation during the 2012 lame duck which drew lines in the sand between credit unions and banks. President of the Credit Union National Association Bill Cheney thanked Royce and McCarthy for "credit unions greater options for serving their growing memberships."

In other news related to credit unions, on February 12th the National Association of Federal Credit Unions wrote to the leadership of the Senate Banking and House Financial Services Committees, calling on Members to provide regulatory relief to the nation's federal credit unions. "Federal credit unions are well-managed, well-run institutions whose activities did not contribute to the financial crisis, yet their regulatory burden has reached epic proportions," wrote NAFCU President Fred Becker. NAFCU has proposed a five-point plan for addressing regulatory burdens, including administrative, capital, structural, operational and data security reforms.

Lawmakers Re-introduce Legislation Clarifying Exemption of End-Users from Margin Requirements
On February 13th, bipartisan lawmakers introduced the Business Risk Mitigation and Price Stabilization Act (H.R. 634), a bill to provide end-user exemptions for companies that use derivatives to manage "actual business risk." The legislation was introduced by Representatives Michael Grimm (R-NY), Austin Scott (R-GA), Mike McIntyre (D-NC), and Gary Peters (D-MI). The bill is the same as H.R. 2682, which was introduced in the last Congress and passed the House in a 370 to 24 vote before failing to move in the Senate. The CFTC's proposed rule on margin requirements for derivatives and swaps does not impose margin requirements on end-users.

House Democrats Urge Swift Completion of JOBS Act Rules
On February 15th, 33 House Democrats, all members of the New Dem caucus wrote to the SEC, urging Chairman Elisse Walter to "swiftly" complete any remaining JOBS Act rulemakings. The letter charged that "the SEC's delay in implementing these important reforms has hindered the ability of the startups and small businesses that drive our nation's recovery and job creation to flourish and grow." The letter comes as Chairman Walter assured Senators on the Banking Committee that JOBS Act rulemaking are "at the top of our plate."

House Agriculture Committee Approves CFTC Oversight Agenda
On February 13th, the House Agriculture Committee voted to approve its oversight agenda for the CFTC as part of the committee's oversight plan for the 113th Congress. The agenda includes a reauthorization of the CFTC, which will require a comprehensive examination of "all-sectors" of the U.S. securities and derivatives markets. The committee will also continue to oversee the implementation of new Dodd-Frank and CFTC regulations. In a statement before the vote, Chairman Lucas pledged that "the committee will continue to introduce and pass legislation that will protect end-users—our nation's farmers, ranchers and businesses—from disruptions in their

operations caused by a flood of new CFTC rules and regulations."

Executive Branch

Federal Reserve

Federal Reserve Bank Presidents Write to FSOC in Support of Money Market Reforms

On February 12th, the Presidents of twelve Federal Reserve banks responded to the Financial Stability Oversight Council's (FSOC) proposal on money market mutual fund reform. The twelve Presidents support the FSOC's plan to reform the money market and "agree with the Council's proposed determination that the conduct, nature, size, scale, concentration, and interconnectedness of MMFs' activities and practices could create or increase the risk of significant liquidity and credit problems spreading among bank holding companies, nonbank financial companies, and the financial markets of the United States." The letter also concurs with the FSOC that there are a number of viable options for addressing the concerns raised by the money market, including moving to a floating NAV or retaining a stable NAV with capital buffers.

The Investment Company Institute, which has been critical of efforts to reform the industry so far, lauded the letter from the Presidents. The letter, in addition to supporting the FSOC's proposals, suggested preliminary reforms to "prime" funds. ICI welcomed the notion that money market funds have "distinct risk profiles." Fund operator Charles Schwab also came out supporting additional reform and oversight of prime funds.

Eight States Join Lawsuit Challenging Orderly Liquidation Authority

On February 13th, eight additional states joined a lawsuit challenging the legality of the Orderly Liquidation Authority under the Dodd-Frank Act. The state attorney general of Alabama, Georgia, Kansas, Montana, Nebraska, Ohio, Texas, and West Virginia join Michigan, Oklahoma, South Carolina, and three private plaintiffs in the suit. The orderly liquidation provision under fire allows the government to liquidate extremely large banks in the event of failure, which the states claim is unconstitutional because it allows the federal government to unilaterally decide which creditors, including state governments, receive repayment without meaningful judicial review. The three private plaintiffs in the suit have separately challenging the validity of the FSOC, the CFPB and the authority of CFPB Director Cordray.

CFPB

Bureau Warns Mortgage Servicers About Legal Protections for Loan Transfers

On February 11th, the CFPB issued a bulletin advising mortgage companies about the legal obligations that protect consumers during loan transfers between mortgage servicers. Specifically the Bureau warned against losing paperwork, losing track of a homeowner's loss mitigation plans, or hindering a consumer's chances of saving their home from unnecessary foreclosure. The CFPB said the bulletin reminder stems from having received word of a significant number of servicing complications related to the large amount of servicing transfers that have occurred in the last year. To combat further issues, the CFPB advised mortgage servicers it would be looking more closely at how servicers prepare for the transfer of rights or responsibilities; how the new servicer handles the files it receives in a transfer; and what policies servicers have to prevent borrower harm for loans with ongoing loss mitigations.

CFPB Releases Implementation Plan for New Mortgage Rules

On February 13th, the CFPB announced a plan it will implement over the next year focusing on the mortgage industry's compliance with new consumer protections that go into effect in January

2014. The new rules include the Bureau's ability-to-repay rule and new mortgage servicing rules. The implementation plan includes coordinating with other agencies, publishing plain-language guides, update official interpretations, publish readiness guides, and educate consumers.

White House Sends Cordray Nomination to Congress
Following the January 24th announcement that President Obama would nominate CFPB Director Richard Cordray for a full, five year term as Director, on February 13th the White House officially sent the nomination to the Hill. On February 14th, 54 Senate Democrats wrote to President Obama lauding his support of the CFPB and pledging support for the re-nomination of Cordray. The letter also assured the President that a majority in the Senate would support the nomination and opposes any structural changes to the Bureau.

FDIC
FDIC Clarifies Definition of Deposit; Deposits in Foreign Branches of U.S. Banks Not Insured
On February 12th, the FDIC approved a notice of proposed rulemaking to clarify that deposits held in foreign branches of U.S. banks are not insured by the FDIC. The proposed rule follows a recent proposal by the U.K.'s Financial Services Authority related to national depositor preference laws which could cause large U.S. banks to change their deposit agreements to make their U.K. branch deposits payable in both the U.K. and U.S. The FDIC said it was concerned that the FSA change would expose the Deposit Insurance Fund (DIF) to greater liability.

White House
Cyber Executive Order Praised by ABA
Following President Obama's announcement of a cybersecurity executive order at the State of the Union, ABA President Frank Keating praised the move, saying cybersecurity is a "top priority" for banks and financial services companies. The executive order would provide "important direction to the public sector on the need to share information associated with threats to our critical infrastructure" and places the Treasury Department in charge of overseeing cyber issues for the financial services industry.

GAO
GAO Releases Report on Dodd-Frank and the Financial Crisis
On February 14th, the GAO released a report analyzing the impact of the recent financial crisis and the potential effects of the Dodd-Frank Act. The report details losses in household wealth and persistently high unemployment caused by the crisis and estimates that total losses could be greater than $13 trillion dollars. The GAO also highlights some of the reforms which could help reduce the probability and severity of future crises, including subjecting large, complex financial institutions to enhanced prudential supervision, authorizing regulators to liquidate a financial firm whose failure could pose systemic risk, and regulating certain complex financial instruments. The report was requested by Chairman Tim Johnson (D-SD) and Representative Michael Capuano (D-MA) in July 2011. Both lawmakers expressed hope this study will remind Congress of Dodd-Frank's importance and help ensure that the financial reforms are implemented in a timely and effective manner.

<u>Upcoming Hearings</u>

The House and Senate Will be in Recess

On February 26th at time TBA, the House Financial Services Subcommittee on Housing and

Insurance will hold a follow-up hearing with the FHA.

On February 27th at time TBA, the Senate Agriculture Committee will hold a hearing to conduct oversight of the CFTC.

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