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Financial Services Legislative and Regulatory Update

Leading the Past Week

While the Senate was on recess, the House was in, but staffs from both budget committees were hard at work trying to put together a budget deal. By the end of the week, rumors were circulating that a deal that would modestly raise the \$967 billion discretionary spending level under the sequester by \$34 billion to \$1.001 trillion for FY2014, with the increase being distributed evenly across domestic and defense spending. While this would still be a decrease in defense spending from the last fiscal year, it would be \$17 billion more than anticipated under FY2014 sequester levels.

While it remains to be seen if negotiators can come together on a budget deal, the week did close with a better than expected jobs report. The economy added 203,000 jobs in November with the unemployment rate dropping to 7 percent. This successful jobs report was viewed by some as a potential key factor for the Federal Open Market Committee (FOMC) discussion later this month focusing on when, and how, to wind down the Fed's quantitative easing program.

Legislative Branch

Senate

Senate Expected to Vote on Watt this Week, Yellen by End of the Year

According to sources familiar with Senate leadership's plans for this week, the Senate is expected to vote as soon as Tuesday on the nomination of Representative Mel Watt (D-NC) to serve as Director of the Federal Housing Finance Agency (FHFA). In October Watt's nomination was stalled, as he failed to gain enough votes to overcome a filibuster. However, the "nuclear option" exercised by Majority Leader Harry Reid (D-NV) has cleared the way for Watt and several other nominees and he is expected to be successfully confirmed. In addition, it is rumored that a vote on Janet Yellen's nomination to become Fed Chair is also expected to occur before the end of the year.

Brown, Vitter Challenge Lew on Too Big to Fail

Following comments by Treasury Secretary Lew that too big to fail has ended, Senators Sherrod Brown (D-OH) and David Vitter (R-LA) released a statement saying it is premature to declare victory for ending too big to fail. In a speech earlier in the week, Secretary Lew had said that “based on the totality of reforms we are putting in place” he believes the Administration will meet the laugh test for saying they ended too big to fail. Brown and Vitter are the sponsors of S. 798, the Terminating Bailouts for Taxpayer Fairness (TBTF) Act, legislation that would require the largest and most interconnected financial institutions to maintain a 15 percent capital ratio to ensure taxpayers will not serve as the backstop for risky investments.

House of Representatives

House Passes Small Business Capital Access and Job Preservation Act

On December 4th, the House of Representatives approved the Small Business Capital Access and Job Preservation Act ([H.R. 1105](#)) in a vote of 254 to 159. The bill, sponsored by Representatives Robert Hurt (R-VA) and Jim Himes (D-CT), would exempt investment advisers to private equity funds from registration and reporting requirements with the Securities and Exchange Commission (SEC), assuming the funds were not borrowed nor have an outstanding principal amount more than twice their invested capital commitments. The House Financial Services Committee approved the bill in June in a 38 to 18 vote, with 8 Democrats joining the GOP in supporting the proposal. While the bill was successful in the House, there is no Senate companion and House Democrats were vocal in opposition to legislation that would strip away Dodd-Frank protections. Representative Keith Ellison (D-MN) said that, in addition to failing to demonstrate how the bill would create jobs, it will “create a situation where there is less information for investors who need it.” Still, as in Committee, Democrats were not united in opposition of the measure, with several supported the bill, citing its job creation provisions as reason. The White House issued a [Statement of Administration Policy](#) in advance of the vote opposing the bill and promising a veto, stating that the bill would undermine investor protection and “represents a step backwards from the progress made to date.”

House Financial Services Subcommittee Looks to Regulatory Relief for Community Banks

On December 4th, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit heard testimony about the regulatory burdens to community financial institutions and about several pieces of legislation intended to eliminate these burdens by modifying the Dodd-Frank Act. Among the proposals, outlined in a hearing [memo](#), include H.R. 3584, the Capital Access for Small Community Financial Institutions Act of 2013, and H.R. 2672, the CFPB Rural Designation Petition and Correction Act.

House Judiciary Subcommittee Examines Financial Institution Insolvency and the Bankruptcy Code

On December 3rd, the House Judiciary Subcommittee on Regulatory Reform, Commercial and Antitrust Law held a hearing regarding the state of the nation’s Bankruptcy Code and whether that code is equipped to manage insolvencies at both large and small financial institutions. While the Dodd-Frank Act requires large and complex firms to prepare living wills in the event of a failure, lawmakers floated the possibility of improvements to the Code to facilitate the more efficient execution of living wills. President of the Richmond Federal Reserve Jeffrey Lacker told lawmakers that the Bankruptcy Code must be improved to accommodate these changes made by the Dodd-Frank Act, saying that “if resolution in bankruptcy without the expectation of implicit government guarantee comes to be expected as the norm, the incentives of market participants would be better aligned with our public policy goal of a financial system that effectively allocates capital and risks.” Lacker also addressed proposals to address bankruptcy on the front-end by placing limits on size and risk activity with the

goal of eliminating the too big to fail problem. Subcommittee Chairman Spencer Bachus (R-AL) did not outline any specific legislative proposals but noted concern that short-term funding deals may receive a “safe harbor” under the Code so that an individual with a short-term loan to a struggling firm could sell collateral without waiting the result of bankruptcy proceedings. Also testifying were Donald Bernstein of David Polk & Wardwell LLP and Mark Roe of Harvard University.

House Small Business Subcommittee Investigates Burdens on Small Financial Institutions

On December 3rd, the House Small Business Subcommittee on Investigations, Oversight and Regulations met to discuss the effects of burdensome regulation on small banks and credit unions. Chairman of the Subcommittee David Schweikert (R-AZ) said that new rules now require staff of these small institutions to focus on compliance more than consumers. High among the Subcommittee’s concerns were the CFPB’s upcoming qualified mortgage and ability to repay provisions. Doyle Mitchell, testifying on behalf of the Independent Community Bankers of America (ICBA) told Members that more than half of all community banks will not be prepared to comply with the mortgage rules when they become effective. ICBA recommended legislative relief to banks, including through the Community Lending and Regulatory Relief (CLEAR) Act ([H.R. 1750](#)).

House Small Business Subcommittee Probes Post-Recession Small Business Lending

On December 5th, the House Small Business Subcommittee on Economic Growth, Tax and Capital Access held a [hearing](#) to examine the current state of lending for small businesses and their access to functional capital. Introducing the hearing, Subcommittee Chairman Tom Rice (R-SC) pointed to increased regulatory scrutiny as a factor in access to credit. Witnesses generally agreed that post-recession it has become more difficult for small businesses to access capital. Ann Marie Wiersch, a policy analyst at the Federal Reserve Bank of Cleveland told lawmakers that “at the same time that fewer small businesses are able to meet lenders’ standards for cash flow, credit scores, and collateral, bankers have increased their credit standards, making even fewer small businesses appropriate candidates for bank loans than before the economic downturn.” On possible solution floated by a witness testifying on behalf of the National Association of Credit Unions (NCUA) was to lift the member business lending cap for credit unions, a policy that the credit unions have long sought to address, but which is strongly opposed by banks.

Executive Branch

Federal Reserve

Regulators Move Ahead on Volcker Rule

Last week regulators indicated they would vote on a final version of the Volcker rule on December 10th. Five agencies, the Fed, SEC, Federal Deposit Insurance Corporation (FDIC), Commodity Futures Trading Commission (CFTC), and Office of the Comptroller of the Currency (OCC), have jurisdiction over the rulemaking and, through the agencies are not required to complete the rule at the same time; all regulators must approve a version of the final rule before it can go into effect. However, all of the agencies have announced they intend to vote on the 10th, though it is worth noting that the SEC intends to hold its consideration via a closed meeting to “enable all of [the] Commissioners to participate in the vote and express their views.”

Scuttlebutt about the rule picked up in the last week, with some rumors indicating that the final rule may total close to 1000 pages. While the final announcement may be that long, we have been lead to believe that the rule itself will still clock in around 30-45 pages, with the remaining amount of paper spent dealing with responses to the more than 16,000 comments regulators received since the rule was

initially proposed. Additionally, stakeholders generally expect the final rule to be stronger than previous iterations. Speaking on the final rule last week, Treasury Secretary Jack Lew indicated that the rule will prohibit “risky trading bets like the ‘London Whale’ that are masked as risk-mitigating hedges.” Lew also said that the final rule would have “strong compliance requirements that require those in charge of financial institutions,” including a provision requiring CEO attestation that they will take responsibility for trading at their institutions. Concerns that regulators will overcorrect in the wake of the London Whale trades are compounded by the industry fears that the timeline for compliance will not be enough for industry to digest the rule. It is expected regulators will give industry between six and 12 months to comply but the Fed has indicated it may delay the compliance date from July 2014 to July 2015.

Beige Book Outlines Modest to Moderate Growth

On December 4th, the Fed released its economic conditions survey known as the [Beige Book](#). The December survey, reflecting economic growth from October through mid-November, finds that increases in manufacturing, technology, and housing supported “modest to moderate” economic growth. The Fed also notes that banking conditions remained “largely stable” with improved loan demand and some “easing of lending standards.”

Fed Outlines Guidance for Bank Consultants

On December 5th, the Fed released [guidance](#) to remind banks to “exercise appropriate risk management and oversight when using service providers.” The guidance does not discourage outsourcing activities to service providers but seeks to outline best practices and underscore the legal risks posed by the sector. The Fed follows similar guidance released by the OCC in November. Congress has criticized agencies for relying too much on third parties and regulators have been under pressure by Congress to more closely monitor the use of outside firms hired by banks.

Fed Approves Revised Capital Plans from Goldman, JPMorgan

On December 2nd, the Fed announced it has not objected to capital plans resubmitted by Goldman Sachs and JPMorgan as part of its stress testing process. Both institutions submitted and had plans approved in March as part of the 2013 Comprehensive Capital Analysis and Review (CCAR); however, the resubmitted plans were required to address weaknesses identified in their capital planning process.

Treasury

Treasury Seeks to Close Dividend Equivalent Tax Loophole

On December 4th, Treasury [proposed](#) regulations to levy a tax on dividend equivalents that can be used by foreign investors to avoid paying taxes on dividend payments from American companies. Investors owe a 30 percent tax on dividend payments; however, a clause in the tax code allows foreign citizens to claim untaxed “dividend equivalents” in place of traditional payments. The GAO estimated in 2003 that the IRS only collected about 5 percent of the \$40 billion of dividend payments sent abroad.

FSOC To Meet December 9th

The Financial Stability Oversight Council (FSOC) will [meet](#) on December 9th in an open session. The Council is set to discuss cybersecurity and to receive a presentation from the Office of Financial Research (OFR) on financial market developments, among other things. The meeting will be webcast [here](#).

CFPB

Bureau to Oversee Nonbank Student Loan Servicers

On December 3rd, the Consumer Financial Protection Bureau (CFPB) issued a [final rule](#) that would enable the agency to supervise certain nonbank student loan servicers. Under the final rule, which was proposed in March, the Bureau believes it will be able to supervise the seven largest loan services in the market, representing more than 49 million borrower accounts. Specifically, the rule allows the Bureau to supervise nonbank firms for compliance with consumer financial protection laws such as the Electronic Funds Transfer Act, the Fair Credit Reporting Act and the Servicemembers Civil Relief Act. The rule is meant to ensure that issues raised in the annual Student Loan Ombudsman [report](#), such as prepayment issues, partial payment problems, and servicing transfer snags, are addressed.

CFPB Releases Regulatory Priorities for 2014

In its fall statement of regulatory priorities for November 1, 2013 to October 31, 2014, the CFPB laid out an agenda that reflects continued work in Dodd-Frank mortgage protections, rulemakings to address other consumer protection issues, and additional efforts to streamline and modernize regulations inherited from other agencies. Some of these mortgage proposals include changes to the Home Mortgage Disclosure Act (HMDA), ability to repay provisions, qualified mortgages, mortgage servicing rules, loan originator compensation requirements, escrow requirements for high-cost mortgages, and appraisal requirements under the Equal Credit Opportunity Act, among others. In addition to these mortgage-related requirements of Dodd-Frank, it is expected that the Bureau will soon finalize a rule to combine disclosures consumers receive when applying for mortgages under the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA). To complement this effort, the CFPB is also involved in interagency rulemakings to implement amendments to TILA and the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) relating to mortgage appraisals. Outside of the mortgage space, the Bureau also outlined work on consumer payment services. This will include building on an Advanced Notice of Proposed Rulemaking (ANPRM) on general purpose reloadable (GPR) prepaid cards, which is expected to occur around May. The CFPB also expects to begin working on a rulemaking governing remittance transfers and will also continue rulemaking to establish additional supervisory authority over nonbank entities.

SEC

Agency Lays Out 2014 Regulatory Agenda – Faces Backlash for Omission on Political Spending Rule

Last week the OMB published a regulatory [agenda](#) for the SEC, containing 43 items that the agency is looking to finalize in the new year. While the SEC does not have to hem closely to the agenda, it does provide a peek into their Dodd-Frank implementation priorities for 2014. Among items on the agenda are a rule to raise investment advice standards for brokers, compensation clawbacks and pay for performance rules, and a number of Jumpstart Our Business Startups (JOBS) Act rules. The SEC also removed a rule from the agenda that would require political spending disclosures for public companies. The removal of this and some other rules from the outlook sparked some rancor among Capitol Hill Democrats backing the political spending disclosures. While Chairman Mary Jo White noted that the decision to remove the items from the OMB agenda reflects her “best estimate” as to what the Commission can accomplish, Senator Bob Menendez (D-NJ) said that though the SEC has a lot on its plate the disclosure should continue to be a priority. Ranking Member of the House Financial Services Committee Maxine Waters (D-CA) also urged the SEC to replace some of the dropped items including the political disclosure rule, proxy access, and a re-proposal of a court vacated rule regarding oil company payments to foreign governments.

SEC Commissioners Note Concern with Proxy Advisory Services

On December 5th, the SEC held a [roundtable](#) on the current use of proxy advisory firm services by institutional investors and investment advisers. The forum builds on a 2010 concept release that “sought public comment on proxy advisory firm services, potential conflicts of interest that may exist for proxy advisory firms and users of their services, and the transparency and accuracy of recommendations by proxy advisory firms.” SEC Chairman Mary Jo White noted in her opening comments that she is particularly concerned with conflicts of interest. Republican SEC Commissioners Dan Gallagher and Michael Piwowar were both critical of the industry, with Piwowar noting concerns that proxy advisory firms “may exercise outsized influence on shareholder voting.” Gallagher has in the past recommended that the SEC take action to reduce institutional shareholders reliance on proxy advisory firms.

CFTC

Industry Groups Mount Suit Over CFTC Cross Border Rules

On December 4th, the Securities Industry and Financial Markets Association (SIFMA), the International Swaps and Derivatives Association, Inc. (ISDA), and the Institute of International Bankers (IIB) filed a [lawsuit](#) against the CFTC’s cross border rule. The Associations charge that in crafting the rule, the CFTC “unlawfully circumvented” the requirements of the Administrative Procedures Act and the Commodity Exchange Act by drafting the rules as “guidance” and failed to conduct a cost-benefit analysis, among other things. It is likely the suit will have the support of Congressional Republicans and some Democrats as lawmakers have long characterized the rule as problematic to energy and agricultural companies who rely on financial institutions to hedge risk. Though facing pressure from industry, lawmakers, and international partners, speaking to NPR the next day, Chairman Gensler said he believes the cross border guidance was done “appropriately” and that he feels “very good” about what the CFTC accomplished with the guidance.

O’Malia Indicates Cross Border Deadline May Slip

In a [speech](#) before the FIA Asia Derivatives Conference, CFTC Commission Scott O’Malia said he is “increasingly concerned” that the agency may miss the December 21st deadline to make substituted compliance determinations necessary to recognize the swaps rules of other jurisdictions. O’Malia has been a critic of the CFTC’s handling of international derivatives rules, and reiterated concerns with recent CFTC staff advisories on cross-border issues and questioned “the wisdom of spending Commission resources to chase after a foreign swap transaction that has nothing to do with the United States.”

FDIC

FDIC Releases Technical Assistance Materials for Flood Insurance

On December 5th, the FDIC released two new videos in a series of technical assistance materials for bank directors, officers, and employees on regulatory issues and proposed regulatory changes. This set of videos is designed to help banks with flood insurance appraisals and evaluations. The agency plans to release additional materials later this month to cover fair lending, troubled debt restructurings, the allowance for loan and lease losses, and evaluation of municipal securities. These and other materials can be found at the FDIC [resource center](#).

OCC

Report Advises OCC to Overhaul Supervision of Large and Midsized Institutions

On December 5th, the OCC [released](#) a [report](#) prepared by a team of international regulators, requested earlier in the year by Comptroller Thomas Curry, which recommends the OCC overhaul its bank

supervision program by moving examiners out of institutions and into field offices. The report is a result of criticism of the OCC's in-house examination practices that have long been critiqued as being "cozy" with the banks it supervises. The audit was led by a former International Monetary Fund official and included representatives from Canada, Australia, and Singapore. The international regulators note that moving examiners would improve internal communications and information sharing and allow for easier reviews of the agency's operations.

Upcoming Hearings

On Tuesday, December 10th at 10am, in 538 Dirksen, the Senate Banking, Housing, and Urban Affairs Committee will hold a hearing titled "Housing Finance Reform: Fundamentals of Transferring Credit Risk in a Future Housing Finance System."

On Tuesday, December 10th at 10am, in 215 Dirksen, the Senate Finance Committee will hold a hearing to consider the nomination of John Koskinen to be commissioner of the Internal Revenue Service.

On Tuesday, December 10th at 12:30pm, in Room 2123 Rayburn, the House Energy and Commerce Committee Subcommittee on Commerce, Manufacturing and Trade, will hold a hearing on the State of Online Gaming.

On Wednesday, December 11th 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 status of the international financial system.

On Wednesday, December 11th at 1pm, the Oversight Subcommittee and Social Security Subcommittee of House Ways and Means Committee will hold a hearing on the IRS's efforts to curb improper payments and identity theft.

On Wednesday, December 11th at 2:30pm, in 538 Dirksen, the Senate Banking, Housing, and Urban Affairs Subcommittee on Economic Policy will hold a hearing titled "Rebuilding American Manufacturing."

On Thursday, December 12th at 10am, in 538 Dirksen, the Senate Banking, Housing, and Urban Affairs Committee will hold a hearing titled "Assessing the P5+1 Interim Nuclear Agreement with Iran: Administration Perspectives."

On Thursday, December 12th at 10am, in 2128 Rayburn, the House Financial Services Committee will hold a hearing titled "Rethinking the Federal Reserve's Many Mandates on Its 100-Year Anniversary."