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Financial Services Legislative and Regulatory Update

Leading the Past Week

Last week ended with a stronger than expected jobs report at plus 204,000 jobs, a stronger than anticipated announcement of economic growth, at 2.8%, and an internet company stock "popping" on the IPO. It was almost as if someone who had been in a coma since March 10, 2000 suddenly woke up, they might not think anything had changed -- except that they would likely be confused as to why the Office of Management and Budget (OMB) was reporting that the federal government shutdown cost taxpayers $2 billion dollars, and why the Republicans were battling with a Tea Party.

So while those of us in northern climates may wish it was March, we are, in fact, in November, and with the deadline for the budget conference just about one month away, lawmakers appear to be refocusing their attention to potential tax cuts and entitlement reforms on which budget negotiators may be able to find bipartisan agreement. Last week, several lawmakers introduced measures to make various changes to the tax code, including a proposal by Senator John McCain (R-AZ) to eliminate a corporate tax deduction for stock options. McCain's proposal, which is backed by Senator Carl Levin (D-MI), would raise $23 billion over ten years and would be used to offset the sequester. In addition, Senators Jack Reed (D-RI) and Chuck Grassley (R-IA) introduced legislation that would limit the tax breaks available to companies that make settlements with the government. The legislation (S. 1654) comes on the heels of reports that JPMorgan Chase will likely be able to write off as a business expense portions of the $13 billion mortgage settlement with the Justice Department. Other ideas floated as a means of cutting deficits is the notion of raising retirement insurance premiums. This proposal would raise revenues and stabilize the finances of the Pension Benefit Guarantee Corporation (PBGC). The proposal to include the PBGC as part of budget negotiations will grow increasingly timely as the agency releases its FY2013 deficit estimate in mid-November.

While Congress may have turned its attention to budget negotiations, the Financial Stability Oversight Council (FSOC) has continues to examine the industry and appears to be turning its attention towards asset managers, as during the October 31st meeting FSOC agreed to review whether BlackRock Inc. and Fidelity Investments, and potentially others, pose a systemic risk to the financial sector.

As domestic regulators turned to asset managers, on November 8th, the Financial Stability Board (FSB) met to determine how to regulate the "Shadow Banking" world. The meeting, which took place in Moscow, included a discussion of a draft of ways to identify institutions outside of the banking and insurance industries for increased supervision. In addition, the FSB considered its 2014-2015 work plan, which including policies to regulate the shadow banking industry and how regulators can confront financial institutions "risk culture."

<u>Legislative Branch</u>

Senate

Senate Banking Committee Continues Probe into Revamped Housing Finance System

On November 5th, the Senate Banking Committee met to continue a series of hearings on housing reform and the Corker-Warner bill (S. 1217), and this time focused on the secondary mortgage market. Speaking at the hearing, Chairman Tim Johnson (D-SD) said the Federal Home Loan Banks (FHLBs) could play a larger role in helping small banks compete within an overhauled housing finance system. Johnson, expressing concern that creditworthy borrowers in underserved markets could still be able to obtain mortgages, noted that currently over 7,000 small lenders are members of 12 regional FHLBs, and that an important item for consideration in revamping the federal housing finance sector will be the role small banks play in providing home loans. In his testimony, FHLB of Des Moines CEO Richard Swanson told the Committee that FHLB loans experience comparably small losses during the financial crisis. In the same vein, Senator Elizabeth Warren (D-MA) underscored the need to prevent the largest banks from dominating the secondary market. In addition to Mr. Swanson, witnesses were William Loving, Chairman of Independent Community Bankers of America; Bill Hampel, Senior Vice President and Chief Economist, Research & Policy Analysis, Credit Union National Association; Bill Cosgrove, CMB, President and CEO, Union Home Mortgage Company and Chairman-Elect of Mortgage Bankers Association; John Harwell on behalf of the National Association of Federal Credit Unions; and Jeff Plagge, Chairman of the American Bankers Association.

Senate Committees Turn to Oversight of Bitcoin

Both the Senate Banking Committee and the Senate Homeland Security and Government Affairs Committee (HSGAC) are independently planning hearings in November to examine Bitcoin and other virtual currencies. Details on the Senate Banking hearing have yet to emerge, but the Senate HSGA Committee is asking federal agencies for details on their policies toward virtual currency in advance of the November 18th hearing. On November 5th, the Chairman of the HSGAC wrote to the Government Accountability Office (GAO), noting that virtual currencies are attractive to entrepreneurs and investors in the digital space, but "as evidenced by the recent law enforcement activity against the online drug marketplace Silk Road, through which over a billion dollars of drug transactions were allegedly conducted, virtual currencies pose some serious concerns and risks." As Congress plans hearings into the virtual currency, the Federal Election Commission (FEC) has released a draft rule that may provide an additional dimension to the oversight. In a proposed rule released on November 7th, the FEC would allow campaigns to accept, but not spend, Bitcoins as in-kind contributions similar to how stocks and bonds are treated under elections laws.

Brown Continues Scrutiny of Aluminum Commodities

On November 8th, Senator Sherrod Brown (D-OH) expressed frustrations with the London Metal Exchange's (LME) proposals to resolve questions about its metals warehouses. Brown, Chairman of the Senate Banking Subcommittee on Financial Institutions and Consumer Protection, has long criticized the role financial intuitions play in physical commodities markets and has charged that LME warehouses, owned by Goldman Sachs, have been slowing aluminum deliveries with the goal of driving costs. Brown's subcommittee will be holding a hearing on these issues on November 20th.

House of Representatives

118 House Members Urge Delay of QM Rule

On November 5th, 118 Members of the House wrote to the Consumer Financial Protection Bureau (CFPB), urging the agency to delay the effective date of the qualified mortgage (QM) rules that will take effect January 1, 2014. The letter requests that the Bureau delay the rule by one year in order to give banks additional time to comply with the new requirements, especially the ability-to-repay rule. Lawmakers cite ongoing concerns that small institutions will struggle complying with the new requirements and that "if financial institutions are unable to comply with these rules by the January 2014 deadline, there could be significant distortions in the mortgage market affecting the availability of credit for consumers." The letter was signed by 112 Republicans and six Democrats. In public comments last week, Director Cordray did not seemed swayed by the members concerns and indicated that he had no desire to delay the effective date, adding that the "vast majority" of institutions have reported to the Bureau that they will be in compliance.

Executive Branch

Federal Reserve

Fed Releases Stress-Test Scenarios for Large Banks

On November 1st, the Federal Reserve (Fed) issued supervisory scenarios that will be used in the 2014 capital planning and stress testing program by the 30 largest banks with $50 billion or more in total consolidated assets. The stress tests cover three levels of financial distress, baseline, adverse, and severely adverse, that include 28 variables for banks to consider, such as economic activity, unemployment, exchange rates, prices, incomes, and interest rates. The same day, the Office of the Comptroller of the Currency (OCC) released its Dodd-Frank stress testing scenarios. Later in the week, the Fed released a policy statement providing additional details about how it will develop the scenarios it will use to stress test banks.

Powell Outlines Effects of Eventual Monetary Tightening

On November 4th, speaking before the San Francisco Asia Economic Policy Conference, Fed Governor Jerome Powell said that the Fed should not necessarily be concerned that continued accommodative monetary policy will cause problems and that the U.S. should only taper asset purchases when the economy is clearly on the road to improvement. Even then, Powell said the Fed should act slowly to wean the economy off quantitative easing. Powell also noted that tightened monetary policy in the U.S. will not necessarily harm emerging market economies.

Treasury

Brainard Leaves Treasury

Effective November 8th, Treasury Undersecretary for International Affairs Lael Brainard stepped down from the Treasury. Brainard served for three years as one of the Administration's top advisers on macroeconomic issues and played a key role in crafting global financial services rules following the financial crisis and represented the U.S. at international World Bank, IMF, and other meetings. Though

Brainard has stepped down, she may soon return to the public sector, as it is rumored she is being considered to serve on the Federal Reserve Board.

CFPB

CFPB Responds to Bipartisan Senate Auto Lending Oversight Letter

On November 4th, in an incredibly quick turnaround, the CFPB issued its response to a bipartisan Senate letter that raised concerns about the process by which the CFPB decided to issue a guidance document to automobile finance sources, the Bureau provided additional details about how it scrutinizes indirect auto lenders. Writing to the 22 lawmakers who signed the letter, the CFPB continued to avoid any direct response to questions about its proxy methodology or its determination of when disparate impact occurs in the market. The CFPB did note that it had not considered the impact on the cost of credit when issuing its guidance document, though noting that the Bureau would not be obligated to do so, as it would had it decided to deal with this issue through an Administrative Procedure Act (APA) rulemaking (as it has with other areas, see below). Director Cordray will testify before the Senate Banking Committee on Tuesday and we anticipate that some members will continue to question him on this issue.

Bureau Releases ANPR on Debt Collection

On November 6th, the CFPB released an advance notice of proposed rulemaking (ANPR) on the collection of information on a wide swath of issues related to debt collection, including the accuracy of information used by debt collectors, how to ensure consumers know their rights, and the communication tactics collectors employ to recover debts. Among the specific concerns, the CFPB outlines ways in which to ensure information accuracy of persons, amounts, and documents and ways in which to inform consumers about their debts and legal rights. As part of this initiative, the Bureau is also adding consumer complaints about debt collections to its public Consumer Complaint Database.

CFPB Will Accept Complaints on Payday Loans

On November 6th, the CFPB announced it has begun to accept consumer complaints from borrowers on payday loans, which are short-term, small-dollar, loans also often referred to "cash advances." Specifically, consumers may contact the Bureau about: unexpected fees or interest; unauthorized or incorrect charges to their bank account; payments not being credited to their loan; problems contacting the lender; receiving a loan they did not apply for; and not receiving money after they applied for a loan.

CFPB Plans Field Hearing on Auto Loans, Mortgages

In the coming weeks, the CFPB will be holding field hearings to consider a number of salient issues before the Bureau. On November 14th, the CFPB will hold a field hearing on auto finance in Washington, DC that will feature remarks from the industry, consumer groups, public, and Director Richard Cordray. On November 20th, the agency will hold a field meeting to discuss mortgages as part of its "Know Before You Owe" initiative.

CFTC

CFTC Advances Proposed Position Limits Regulations

On November 5th, the Commodities and Futures Trade Commission (CFTC) met to consider a new proposal to place limits on the ability of banks to speculate on derivatives tied to physical commodities. The agency votes 3 to one to advance the proposed position limits rule, which had been revised after a federal judge in 2012 returned the then-final regulation to the agency as a result of an industry law suit.

The revised proposal attempts to address some industry concerns which resulted in the rule being vacated, including that limits are necessary to address price volatility. Other changes over the 2012 final rule include more options to avoid hitting limits through disaggregation of positions and exemptions for hedge trades. CME Group is still opposed to the rule, saying that the limit on speculation remains too high compared with the company's current activities. Industry groups, including CME, are expected to once again be vocal in their support of looser restrictions. On Capitol Hill, Senator Bernie Sanders (I-VT) noted that the rule does not go far enough to address oil speculation while Senator Carl Levin (D-MI) praised the CFTC for striking "another blow on behalf of consumers, business, and fairer commodity prices."

Commissioner Chilton To Step Down from CFTC
Speaking at the November 5th public meeting, Commissioner Bart Chilton said he is planning to leave the agency "in the not too distant future." He expects that the November 5th meeting to approve position limits proposals will be his final meeting to consider Dodd-Frank rulemakings. Commissioner Mark Wetjen expressed surprise at the announcement while Chairman Gary Gensler said he will further discuss Chilton's plans. Without Commissioner Chilton the CFTC will have three members, two Democrats and one Republican.

CFTC Making Final Tweaks to Final Volcker Draft
Reports emerged last week that regulators are expected to release a final draft of the Volcker Rule as early as this week and vote on a final proposal in December. Chairman Gensler, speaking to reporters, said that there remain challenges in finalizing certain details but that he is planning a vote for the second or third week of December.

SEC
Commissioner Gallagher Envisions a Q1 Push on Derivatives
Speaking at a Futures Industry Association conference, Securities and Exchange Commission (SEC) Commissioner Dan Gallagher said that he expects the Commission to being to finalize many unfinished derivatives rules in the first quarter. Gallagher, noting that the SEC has received pressure to harmonize these rules with the CFTC, which has been out ahead on swaps rules, said that "I think what you'll see starting in the first quarter I would hope of next year is that we start knocking each of the many remaining Title 7 final rules out."

FDIC
International Regulators Push ISDA to Pursue Uniform Derivatives Contract Language
On November 5th, the Federal Deposit Insurance Corporation (FDIC), in conjunction with the Bank of England, the German Federal Supervisory Authority, and the Swiss Financial Market Supervisory Authority, authored a letter to the International Swaps and Derivatives Association (ISDA) to consider adopting derivatives contract language to delay the early termination of those instruments in the event of the resolution of a global systemically important financial institution (G-SIFI). The letter notes that the adoption of such provisions would allow derivatives contracts to remain in effect throughout the resolution process, thereby minimizing disorderly unwinding of such contracts.

Upcoming Hearings

On Tuesday, November 12th at 2:30pm, the Senate Banking, Housing, and Urban Affairs Committee will meet for a hearing titled "The Consumer Financial Protection Bureau's Semi-Annual Report to Congress."

On Wednesday, November 13th at 10am, in 2128 Rayburn, the Housing and Insurance Subcommittee of House Financial Services Committee will hold a hearing titled "The Future of Terrorism Insurance: Fostering Private Market Innovation to Limit Taxpayer Exposure."

On Wednesday, November 13th at 2pm, in 2128 Rayburn, the Monetary Policy and Trade Subcommittee of House Financial Services Committee will hold a hearing titled "What Is Central about Central Banking? A Study of International Models."

On Wednesday, November 13th at 2:30pm, in 216 Hart, the Joint Economic Committee will hold a hearing to examine the current economic outlook.

On Thursday, November 14th at 10am, in 538 Dirksen, the Senate Banking, Housing, and Urban Affairs Committee will meet to consider the nomination of Janet Yellen to be the Chairman of the Federal Reserve.