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Financial Services Legislative and Regulatory Update

Leading the Past Week

On October 16th, 16 days after the government shut down and on the eve of the a potential default, Congress was able to pass a deal developed by Senate leaders to reopen the government and raise the debt ceiling. The final tally had Senate passage occurring on an 81 to 18 vote early in the evening, and then the House voting afterwards, where it passed on a 285 to 144 vote. The resolution of this self-inflicted crisis, may lead some to invoke the famous words of Gerald Ford, while others wonder what happens when we reach the next bump in the road in the middle of the Q1 next year.

The deal came after House Speaker John Boehner (R-OH), agreed to take up a plan put together by Majority Leader Harry Reid (D-NV) and Minority Leader Mitch McConnell (R-KY). The Reid-McConnell plan funds the government at $986 billion through a continuing resolution (CR) that lasts until January 15th, and that extended the debt ceiling through February 7th. In addition, as part of this deal, the House and Senate will start a budget conference with a report due to Congress on December 13th, although there is no penalty for missing that deadline. In addition, the Senate deal includes an income verification requirement for applicants to the Affordable Care Act (ACA) who would receive subsidies and stipulates that furloughed federal workers are entitled to retroactive pay. The CR also contained $450 million to repair flood damage in Colorado, $100 million for operations of the FAA, and additional funds for a dam project at the confluence of the Mississippi and Ohio Rivers. Notably, the deal did not contain delays of the reinsurance tax or medical device tax.

The realization that a deal had been reached caused markets to rise during early morning trading on Wednesday. After closing 133 points down on Tuesday, and amid the announcement that Fitch Ratings put the U.S. credit rating on a negative watch, the Dow Jones Industrial Index was up more than 90 points in early trading, the Nasdaq rose 25 points, and the S&P 500 was up more than 10 points as the outlines of a deal, and a viable path to compromise, emerged. By the end of Thursday, the S&P 500 closed at a record high of 1732.92 as investor confidence rose in the wake of the deal. However, while the markets have strengthened, there were still costs to the government shutdown; Standard & Poor's has estimated that the shutdown will cause the adjusted gross domestic product (GDP) to fall by 0.6

percent, or $24 billion. The Federal Reserve's Beige Book released on October 16th also underscores the effect of the shutdown, finding that, though the U.S. economy is "poised to grow," the government shutdown and debt ceiling debate will serve as a setback.

With the CR / Debt ceiling issue now behind us, lawmakers and their staff are beginning to turn their attention to the work necessary for meeting the December 13th deadline to report to Congress on a budget. On Thursday, Congressional negotiators appointed to the House-Senate budget conference met for breakfast in talks that were described as cordial but mainly focused on logistical issues. When the Senate returns from recess, there will likely be an open session of the conference in which lawmakers will have a chance to give opening statements. At this point is hard to predict how this will all play out, but predictions range from a conference report that produces a 10 year grand bargain agreement (with tax reform instruction) to simply figuring out a way to move forward into the FY2014 spending with a fix for the sequester, to no deal at all.

Legislative Branch

Senate

Corker, Heitkamp Outline Housing Reform Agenda

On October 15th, Senator Heidi Heitkamp (D-ND) and Senator Bob Corker (R-TN) spoke together in an interview on CNN, saying that they are anxious to begin working on legislation which would overhaul the housing finance sector. Heitkamp told CNN that the Senate has delayed a lot of important pieces of legislation, such as housing reform and the farm bill. Corker added that the housing reform plan which he has crafted with Senator Mark Warner (D-VA) is high on his list of priority legislation.

House of Representatives

Representative Capito Pushing for Delay of Mortgage Rules

Representative Shelley Moore Capito (R-WV), Chairman of the House Financial Services Subcommittee on Financial Institutions, is circulating a letter urging CFPB Director Richard Cordray to delay the new mortgage rules taking hold in January by one year. Capito is asking her colleagues to sign onto the letter, saying that financial institutions need additional time "to transition their systems to be in full compliance with the rules."

Executive Branch

Federal Reserve

Bernanke Will Not Have to Provide Testimony on AIG Bailout As Chairman

On October 16th, the U.S. Court of Appeals for the Federal Circuit ruled that Fed Chairman Ben Bernanke does not have to testify in a lawsuit filed by the former CEO of American International Group Inc. (AIG) until after he leaves office. The former head of AIG, Hank Greenberg, sued the Federal government over the $182 billion bailout, arguing that the terms were overly burdensome. The Court held that deposing Bernanke while he remains Fed Chairman could disrupt "significant" government activities but his testimony could be sought after he leaves office if a better case is made to justify the need for his statement.

Fed to Proposed Liquidity Rules This Week

On October 17th, the Fed announced that at an open meeting on October 24th, it would propose new liquidity rules for large banks. The proposal will include Dodd-Frank provisions establishing enhanced liquidity requirements and Basel III capital agreements such as a liquidity coverage ratio and higher capital requirements.

Treasury

Shutdown Forces Treasury to Delay Currency Report

As a result of the government shutdown, the Treasury Department delayed the release of its semiannual exchange rate report. The last report was issued in April and has touched on issues such as Chinese currency manipulation and macroeconomic trends. The Treasury also announced that it would delay its international capital data report.

SEC

White Outlines Ideas on Company Disclosure Requirements, Private Offering Safety

On October 15th, speaking at a National Association of Corporate Directors conference, SEC Chairman Mary Jo White questioned if public company disclosure requirements should be updated or scaled back so as to avoid "information overload." White said a staff report, required by the Jumpstart Our Business Startups (JOBS) Act, will soon be made public, positing "modernizing and simplifying" disclosure requirements and other ways in which to decrease costs for emerging companies. For one, White pointed to the availability of information on the internet as a rationale for no longer requiring companies to disclose historical share closing prices. Speaking later in the week to the Managed Funds Association, White again addressed JOBS Act implementation, saying that the SEC must move "expeditiously" to finalize investor protections related to the JOBS Act's abolishment of restrictions on how funds may promote unregistered offerings.

SEC Issues Penalty for Knight Capital

On October 16th, the SEC announced that Knight Capital Americas LLC agreed to pay $12 million to resolve charges that it violated market access rules in connection with the company's August 2012 trading incident resulting in market disruptions. The SEC found that Knight Capital did not have adequate safeguards to limit risk resulting in millions of erroneous orders. The $12 million fine is on top of the $460 million loss which Knight suffered as a result of the errors. In a statement, SEC Enforcement Co-Director Andrew Ceresney said that "given the rapid pace of trading in today's markets and the potential massive impact of control breakdowns, broker-dealers must be held to the high standards of compliance necessary for the safe and orderly operation of the markets."

CFTC

JPM to Pay $100 Million to Resolve London Whale Claims

On October 16, the CFTC announced an agreement with JPMorgan for the bank to pay $100 million to settle "charges for employing a manipulative device in connection with the Bank's trading of certain credit default swaps (CDS), in violation of the new Dodd-Frank prohibition against manipulative conduct." As part of the settlement, JPMorgan admitted to reckless conduct. Speaking on the agreement, Commissioner Bart Chilton said he would not have supported an agreement in which the bank did not admit fault and that the penalty and admission were appropriate for "egregious manipulative conduct that took place." Still, Commissioner Scott O'Malia dissented, saying that the agency should have taken additional time to weigh whether JPMorgan was liable for more serious market manipulation. This fine would be on top of the rumored $13 billion dollar settlement the bank was reportedly close to nearing with the Department of Justice regarding the banks mortgage securities business.

O'Malia Pushing for Additional Time for SEF Compliance

Speaking at the Electric Institute CFTC Compliance Forum on October 17th, Commissioner Scott O'Malia said that he believes the agency should give swap execution facilities (SEFs) additional time to come into compliance. O'Malia charged that the "arbitrary" November 1st deadline for the new derivatives platforms is looming but the agency has "yet to provide confused swap market participants with necessary guidance on a host of unresolved issues, often stemming from a lack of clarity in the SEF rules."

CFPB

Bureau Outlines Guidance on Mortgage Servicing Rules
On October 15th, the CFPB released a bulletin and interim final rule to provide additional clarity to industry concerning mortgage servicing rules that take effect in January 2014. The bulletin addresses communications with family members after a borrower dies, contact with delinquent borrowers, and treatment of consumers who have filed for bankruptcy or invoked certain protections under the Fair Debt Collection Practices Act. The interim final rule also makes clear that consumers must receive housing counseling before taking out a high-cost mortgage and federally required disclosure must be used as the basis for counseling for a small subset of closed-end loans that are not subject to the Real Estate Settlement Procedures Act.

CFPB Student Loan Ombudsman Releases Report on Private Student Loan Payments
On October 16th, the Bureau Student Loan Ombudsman released a report outlining complaints the agency has received from private student loan borrowers. The report finds that private student loan borrowers can face payment issues that lead to increased costs, prolonged repayment, and harm to credit profiles. The report is based on an analysis of over 3,800 consumer complaints submitted to the CFPB and finds that payment processing can be confusing resulting in extra payments and higher costs. The Ombudsman called on the agency to step up regulatory efforts to improve the servicing of mortgages and credit cards that may be applicable to private student loans. In conjunction with the report, the Bureau also released guidance to help certain borrowers communicate their payment preferences to servicers so as to better control their loans. The advisory notes that if a borrower has multiple loans with the same servicer, and the servicer does not provide instructions on how to process money sent each month, the servicer generally allocates payments, which may not be in the borrowers' best interest.

Judge Dismisses Constitutional Challenge to CFPB
On October 17th, U.S. District Judge Colleen Kollar-Kotelly dismissed a request from debt settlement services to consider the constitutionality of the CFPB. Following the Bureau's charge that the company Morgan Drexen illegally charged upfront fees to consumers, the firm and a client involved in the suit filed a challenge in the U.S. District Court for the District of Columbia alleging that the Dodd-Frank Act violated the Constitution's separation of powers clause in establishing the Bureau. However, Judge Kollar-Kotelly dismissed the challenge, saying that Morgan Drexen may make this case as part of the CFPB's enforcement action in the U.S. District Court for the Central District of California.

<u>Miscellaneous</u>
FINRA Releases Conflict of Interest Report
On October 14th, the Financial Industry Regulatory Authority (FINRA) released a report stating that broker dealers need to do more to resolve conflicts of interest in the industry. To address these problems, the report suggests that broker dealers taking a "tone from the top" method for identifying

potential conflicts and creating new product reviews to protect consumers. FINRA also said it would consider investor protection rulemakings.

IOSCO Cites Concerns Over Global Collateral Supply
On October 15th, prior to the resolution of the debt ceiling crisis, the International Organization of Securities Commissions (IOSCO), of which the SEC and CFTC are members, released a report on securities market risks, which outlines concerns with the financial sector's supply of high-quality collateral. The report finds that high quality collateral is being squeezed as a result of new bank requirements, central banks' attempts at stimulus, and the need for increased margins to guarantee derivatives.

Report Finds Penalties Against Financial Institutions Are Up.
According to a report released by the Committee on Capital Markets Regulation on October 17th, $2.3 billion in government penalties were levied against financial institutions in the third quarter. The sum, is greater than the annual total imposed in any year before 2012. So far, financial institutions have been penalized a total of $24.9 billion in 2013 through a combination of public class action settlements, regulatory penalties, and enforcement actions brought by regulators including the SEC, CFTC, and others. The Committee is comprised of academics, industry officials, and business, legal, and accounting leaders.

IAIS Seeking Comment on International Insurer Rules
On October 18th the International Association of Insurance Supervisors (IAIS) requested public comment on plans overseeing internationally active insurers. The plan, Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame), is in its third draft form after the IAIS began consultations on new international standards. Among the proposals are a global insurance capital standard. Public comment will remain open until December 16, 2013 after which IAIS will develop a new draft and begin conducting impact analyses on the proposal.

Upcoming Hearings

The Senate is Recess.

On Thursday, October 24th at 10am, in 2360 Rayburn, the Investigations, Oversight and Regulations Subcommittee of House Small Business Committee will hold a hearing titled "Regulatory Landscape: Burdens on Small Financial Institutions."

On Thursday, October 24th at 10am, in 2128 Rayburn, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing titled "Legislation to Further Reduce Impediments to Capital Formation."

On Thursday, October 24th at 2pm, in 2128 Rayburn, the House Financial Services Subcommittee on Financial Institutions and Consumer Credit will hold a hearing titled "Examining Legislative Proposals to Reform the Consumer Financial Protection Bureau."