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FINANCIAL SERVICES LEGISLATIVE AND REGULATORY UPDATE

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Leading the Past Week

With Congress out of session and official Washington, DC conducting its business in a more relaxed pace, politics, and speculation continues to dominate everything. For example, on the campaign trail, Republican Nominee Mitt Romney met in Denver, and following Mitt's commanding performance we saw an immediate impact, not only in polling (towards Romney's advantage) but also in the stock market, as some health care related stocks fell in anticipation that a Romney win would mean a repeal of "Obamacare". The President's poor performance behind the podium, however, was buoyed by strong jobs number released Friday. The economy added 114,000 jobs in September and estimates for previous months were revised upward—yielding an unemployment number of 7.8 percent, the lowest in nearly four years. The election remains tight, and should stay close through this final month. Back in Washington, the post-election chess game that results in committee shakeups and new chairman and ranking members, is also in full swing, though the election casts such a wide shadow over this process that it is also mostly speculation at this point.

In other news, the SEC held a roundtable to address growing concerns about the impact that technology is having on the stability of our capital markets, the CFTC announced it has filed a record number of enforcement actions, and everyone begins piling against the Basel III capital proposals. And finally, just as more American's are beginning learn about the so-called fiscal cliff, Speaker Boehner makes it clear that Congress isn't likely to come up with a grand bargain to fix it in the lame duck.

Fiscal Cliff

Last week began with warnings that if the U.S. were to go over the fiscal cliff 90 percent of Americans would see increased tax rates. A report by the Tax Policy Center found that the average American household could see taxes rise $3,500—one of the largest tax increases in history. In addition to increased taxes, should the nothing be done to address the fiscal cliff, approximately 277,000 government employees, 14 percent of the Federal workforce, could lose their jobs over a period of 12 months. The George Mason Center for Regional Analysis found that the cliff could cut approximately 48,000 civilian defense jobs and 229,000 from federal jobs.

As analyses of the fiscal cliff continue to predict grim news, a group of eight Senators have come together in a "secret retreat" to start working on a plan to avoid the cuts scheduled to take place at the end of the year. Senators Michael Bennet (D-CO) and Lamar Alexander (R-TN) and members of the former Gang of Six are expected to meet this week to begin discussions on ways in which to avert the fiscal cliff.

However, Democratic and Republican leaders in the Senate have distanced themselves from the effort. While Leadership believes that beginning talks can be helpful, aides say they will not endorse any ideas floated by the Gang of Eight. Specifically, a spokesman for Minority Leader McConnell (R-KY) told reporters "while the leader has encouraged Republican members to seek solutions, and is aware that many members are discussing potential solutions, these efforts are still in the early stages and he has not endorsed any particular effort over another." Towards the end of the week, Speaker Boehner, in an interview with a local Ohio paper, said that he didn't think it was appropriate to have a large scale deficit deal contemplated by the membership of a lame duck Congress, leading many to believe that Congress will deal with some type of short term extension of the tax issue and sequestration in the lame duck and then attempt to tackle both in 2013.

<u>Legislative Branch</u>

Senate

Toomey and Warner lead majority of Senators to voice concerns about Basel III Impacts on smaller US Banks

On September 27th, fifty-three Senators—led by Senators Pat Toomey (R-PA) and Mark Warner (D-VA)—wrote the Fed Chairman Ben Bernanke, FDIC Acting Chairman Martin Gruenberg and Comptroller of the Currency Tom Curry, urging the regulators to consider the impact the Basel III standards would have on US community banks. The letter also asks regulators to consider different capital standards for small banks and large banks. This letter, seen by some Senate insiders as a political "hug" for the potential inability to extend the popular FDIC transaction account guarantee program, also marked the first salvo and what became an onslaught of criticism of the international capital agreements. It was followed on October 3rd, when Greg Gonzales, Chairman of the Conference of State Bank Supervisors, said that while Conference supports stronger capital standards it believes that the proposed rules released in June are too complex. Additionally, FDIC board member Tom Hoenig said in remarks in September that regulators "must" redo the Basel agreement and come up with a "a simpler alternative that takes us back to the basics."

Once again on the other side of the argument was, former FDIC Chairman and current Chair of the Systemic Risk Council, Sheila Bair, who in an a letter reported by the Financial Times, called on regulators to implement stricter rules than those proposed in Basel III. Bair wrote to the heads of the Fed, FDIC and OCC urging regulators to tighten leverage ratios, among other things. The letter, reported on by the Financial Times, said the proposed capital rules "are good minimum standards that can and should be exceeded."

Senators Requests Geither Respond to LIBOR Inquiries
Senators Chuck Grassley (R-IA) and Mark Kirk (R-IL) sent a joint letter to Treasury Secretary Timothy Geithner leveling accusations that, while serving as president of the New York Fed, Geithner did not do enough to address the emerging LIBOR scandal. The letter charges: "Despite what you learned at the NY Fed, during your tenure as Treasury Secretary, nothing has been done to diminish use of this flawed index in U.S. financial markets; to the contrary, Treasury's use of LIBOR has increased." Geithner has already defended his record on LIBOR, saying he addressed concerns to UK regulators. Grassley and Kirk also floated the idea of creating an American-based interest rate index.

Executive Branch
SEC
Hosts Technology Roundtable – First Foray into Possible Regulations of High Frequency Trading
On October 2nd, the SEC held a roundtable focusing on market technologies at use in the securities sector. The roundtable, which comes as some large banks, asset managers and long funds have become more public in callsi for uniform standards for computer controls, consisted of two panels. The morning session focused on the prevention of errors, including discussion about current best practices and the practical constraints for creating, deploying, and operating systems used to automatically generate and route orders, match trades, confirm transactions, and disseminate data. While the afternoon session addressed error response error response, with experts discussing how the market might employ independent filters, objective tests, and other real-time processes or crisis-management procedures to detect, limit, and stop erroneous market activities when they occur. Prompting the roundtable are several recent technology glitches in the markets, including Facebook's IPO and Knight Capital LLC's computer glitch. Speaking on these errors, Chairman Mary Schapiro said "these single-exchange problems are not a result of complexities or fragmented markets, but rather a result of more basic technology 101 issues."

Panelists generally agreed that there must be more rigorous testing and greater independent and peer reviews. However, it is impossible to completely prevent software errors, so we must ensure that processes are in place to manage failures when they do occur. One solution which received a great deal of attention in both panels was a kill switch, which could be tripped in the event that strange or erroneous behavior and trading was noticed. While most panelists generally agreed that a kill switch was a viable plan, there was disagreement over the specific mechanisms of a kill switch and how it would be tripped. A number of other potential solutions were mentioned, but a few panelists mentioned that kill switches would be the only viable short term solution.

SEC Issues Staff Guidance on JOBS Act

On October 1st, the SEC Division of Corporate Finance issued guidance the Jumpstart Our Business Startups (JOBS) Act and how the law will apply to mergers and acquisitions (M&A) deals. While Title I of the JOBS Act relaxes registration, communication and other requirements for emerging growth companies (EGC) conducting IPOs, the SEC has been evaluating whether this easing of rules applies to M&A deals—when such deals are a firm's first public offering. The SEC found that an ECG may use the "test-the-waters" communication opened up by the JOBS Act and submit confidential draft registration statements for an offer or merger to constitute a public offering. The guidance also addressed the number of financial statements merged companies must provide and whether these provisions apply to public reporting companies.

CFTC

Gensler Outlines Timeline for Finalizing Swaps Rules

On October 1st, the CFTC outlined what final swaps rules under Dodd-Frank will look like. Speaking at an event at the Bank of England Chairman Gary Gensler said the agency has completed 39 of the rules required by the financial reforms. Gensler said rules governing minimum margin requirements for uncleared swaps will likely be finalized in early 2013 while the "first set" of clearing determinations could be finalized "as early as this month." The CFTC is also working to extend the comment period on extending the comment period for the margin requirement rule for non-bank swap dealers and major swap participants after the Basel Committee on Banking Supervision and the International Organization of Securities Commissions released a report stressing the need for global consistency on margin requirements. "Later this fall," Gensler added, the CFTC expects to work on minimum block size and swap execution facilities rules.

CFTC Enforcement Division Files Record Enforcement Actions in FY 2012

On October 5th, the CFTC announced it has filed 102 enforcement actions in FY 2012—a record single year total for the agency. This follows announcements that the SEC had a record number of trading suspensions in a single year. The CFTC's enforcement actions included more than 350 new investigations and orders imposing more than $585 million in sanctions, including orders imposing more than $416 million in civil monetary penalties and directing the payment of more than $169 million in restitution and disgorgement. These enforcement actions include charges levied against Barclays for LIBOR manipulation.

White House

Mortgage Fraud Task Force Files Lawsuit Against JPMorgan

On October 1st, the task force established by President Obama to investigate mortgage fraud in securities markets filed its first lawsuit against JPMorgan Chase. The lawsuit contends that JPMorgan packaged faulty mortgages which were sold to investors by Bear Stearns (bought by JPMorgan in 2008) during the housing bubble. Notably, New York Attorney General Eric Schneiderman, co-chair of the task force, said there "will be more to come." Another task force leader was reported Tuesday as saying additional enforcement action will come "in the not too distant future." Schneiderman further said criminal actions are possible in the Bear Stearns case and that "nothing is off the table."

International

EU Experts Recommend Firewall Between Deposit Taking and Risky Trading

On October 2nd, an EU panel of experts recommended banks separate risky trading activities from more traditional banking activities, such as deposit taking. The report, "High-level Expert Group on reforming the structure of the EU banking sector," looked at the need to reform the EU's banking structure and made the case that separating risky trading from depository activities would "limit the implicit or explicit stake of taxpayer in the trading parts of banking groups." The group was formed by the European Commission and is led by Erkki Liikanen, Governor of the Bank of Finland.

Miscellaneous

Economist Makes Case for U.S. Financial Transactions Tax

On October 5th, Dean Baker economist with the Center for Economic and Policy Research found that action by the U.S.—even if unilateral—to implement a financial transactions tax on the purchases of securities would have a positive effect. Baker, discussing the tax on a panel held by the DC Bar Associations Financial Products Committee of the Tax Section said that the tax would realign our financial sector to one geared to "serving the productivity of the economy" by making high volume, risky financial transactions unprofitable. The tax would also reduce the hyper-liquidity of markets while only imposing burdens on those who should bear them. While other on the panel expressed concerns that a transaction, or Robin Hood, tax would reduce American financial competitiveness, Baker said the U.S. has the means to pressure international adoption of the rule. Senator Tom Harkin (D-IA) (S. 2252) and Representatives Peter DeFazio (H.R. 3313) and Keith Ellison (D-MN) (H.R. 6411) have all introduced legislation that would institute a transactions tax with the goal of raising government revenue.

UPCOMING HEARINGS

The Senate and House Are in Recess until November 12th