Financial Services Legislative and Regulatory Update

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Welcome to fall, which used to be marked by events like apple picking, leaf watching and playoff baseball (Go Sox!). However, it seems as if a new standard-bearer for the season has been added to the autumn repertoire, a guessing game as to whether Congress will be able to avoid a government shutdown.

Last week, the House did its part, passing a continuing resolution on a near party line vote that would continue to fund the government through December 15th but would also defund the Affordable Care Act (ACA) (a/k/a "Obamacare"). With less than 10 days until a possible government shutdown, the Senate is expected to strip out the ACA related provisions of the CR before returning the resolution to the House, although a growing chorus of conservative voices is encouraging some Republican Senators to prevent this strategy. Ultimately, the conventional wisdom is that the Senate will send back a "clean" CR , but it is uncertain how a divided House will react, as the GOP conference is split on whether to accept the "best they could do," while Democrats are also split on whether to accept a CR that doesn't fix the cuts in domestic spending caused by sequestration. All of this uncertainty means that final passage of a CR, and thus the continued operation of the US Government after October 1st is anything but certain.

All of the drama and intrigue surrounding the passage of the CR is just a prelude to a fight over the federal debt limit. With the White House and Democrats saying they will not negotiate over the issue and Republicans saying that the better path to successfully defund Obamacare lies with the Debt Ceiling, both sides are digging deep trenches for battle. Whether these positions will hold, or be more like the Maginot Line will have a significant impact on the debate and on our nation's economy.

What is clear is the obvious potential disruptive force that the current uncertainty surrounding Congress' ability to increase the debt ceiling is having on our economy. From CFTC Commissioner Bart Chilton warning that a government shutdown could have "disastrous impacts" on markets, or the Fed surprisingly reversing its decision to start tapering down QE, it seems like we are heading for a volatile fall – both for the markets and congressional politics.

Legislative Branch

Senate

Banking Subcommittee Evaluates Progress of Superstorm Sandy Recovery

On September 19th, the Senate Banking Subcommittee on Housing, Transportation, and Community Development met to consider the progress of recovery from Superstorm Sandy. Lawmakers, including Chairman of the Subcommittee Robert Menendez (D-NJ) and Senator Chuck Schumer (D-NY), praised Housing and Urban Development (HUD) Secretary Shaun Donovan for his work heading the recovery taskforce, but pressed Donovan on why some homeowners and businesses still await assistance. Lawmakers also noted concern that flood insurance premiums are expected to rise considerably in coming months. Peter Rogoff Administrator of the Federal Transit Administration also testified.

Joint Economic Committee Considers Economic Costs of the Debt Ceiling

As Congress approaches a debate over raising the debt limit, on September 18th, the Joint Economic Committee met to consider testimony of the effect of the national debt limit on the economy and consider whether it remains an appropriate fiscal tool. Lawmakers heard testimony from witnesses, including: Mark Zandi, Chief Economist of Moody's Analytics; David Malpass, President of Encima Global; Donald Marron, Director of Economic Policy Initiatives with the Urban Institute; and Daniel Mitchell, Senior Fellow with the Cato Institute. Lawmakers on the panel disagreed on the effectiveness of the hearing, with Chairman Kevin Brady (R-TX) saying it is an "effective" but "imperfect" way of controlling Federal spending, and Vice Chair Amy Klobuchar (D-MN) cautioning that debt ceiling brinkmanship only results in market disruption, constricted access to credit, and other economic harms.

House of Representatives

House Financial Services Subcommittee Examines SEC Money Market Mutual Fund Proposal

On September 18th, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises met to consider testimony from industry stakeholders and interest groups on the Securities and Exchange Commission's (SEC) proposal to overhaul the money market mutual fund industry. In June 2013, the SEC unanimously approved for comment a proposal that would either move the fixed $1 net asset value (NAV) to a floating NAV, impose liquidity fees and redemption gates, or a combination of both proposals. In advance of the hearing, the Systemic Risk Council, headed by former FDIC Chair Sheila Bair who testified at the hearing, submitted comments to the SEC requesting the agency revise proposed rules to require all funds move to a floating NAV as the current proposal will be inadequate to protect the financial system. However, not all witnesses at the hearing agreed that regulations should be strengthened, with Georgia State Treasurer Steve McCoy testifying that the reforms would lead to higher financing cost to issuers of short-term municipal securities. While Representative Scott Garrett (R-NJ), Chairman of the Subcommittee, criticized the SEC's process at arriving at their proposals, he seemed pleased that the current proposal seems more thoughtful and does not include a capital buffer.

House Financial Services Committee Weighs TRIA Reauthorization

On September 19th, the House Financial Services Committee met to consider a reauthorization of the Terrorism Risk Insurance Act (TRIA) which provides a government backstop in the event of losses due to terrorism resulting in more than $100 million in aggregate industry losses and an individual insurer deductible of 20 percent of premiums. Representatives Michael Grimm (R-NY), Carolyn Maloney (D-NY), Peter King (R-NY), and Michael Capuano (D-MA) made up the first panel, presenting to their colleagues on legislation they are sponsoring to reauthorize and extend the program and making arguments for its continued necessity. In general, lawmakers from both parties expressed support for reauthorizing the TRIA program—often noting that they may not like the program or the need for the program but that there is no better option available for ensuring that catastrophic losses due to acts of terror are insured. Chairman Hensarling (R-TX), whose support for allowing TRIA to sunset are well known, raised a number of questions for the panel dealing with Congressional intent of the program being temporary, whether the insurance industry has been able to come up with a private insurance model, and whether this kind of risk is uniquely uninsurable. Throughout the hearing, witnesses from the insurance and reinsurance industries discussed that the unpredictability of terrorism makes it impossible to model the costs of these events, and thus impossible to price insurance, arguing that this is why there must be a Federal ‘cap’ to create competition and pricing. The majority of witnesses also called for a long-term extension. TRIA is scheduled to sunset at the end of 2014.

Executive Branch

Federal Reserve

Fed Stays Course on Quantitative Easing

On September 18th, following a two day meeting of the Federal Open Markets Committee (FOMC), the Federal Reserve (Fed) announced that it would not be tapering its accommodative monetary policies and, in a surprise to markets, would continue asset purchases of $85 billion per month. Reflecting the unexpected news, markets rallied on Wall Street, with the S&P 500 hitting a record high in light of the news. Analysts had largely predicted, following comments made by Chairman Bernanke following the June FOMC meetings that the Fed would begin to reduce QE by $10 to $15 billion per month. In the FOMC statement, the Fed pointed to a stronger housing sector as a positive sign but noted concern with the uncertain state of fiscal policy and its potential effects on the economy. The FOMC said it will “await more evidence that progress will be sustained before adjusting the pace of its purchases.”

Janet Yellen Appears Likely to Receive Nomination for Fed Chairmanship

Following Larry Summers removing himself from consideration for Fed Chair, it appears Janet Yellen is the most likely candidate. Speaking following Summers’ announcement, White House Press Secretary Jay Carney said Summers’ decision will not affect the timeline for a decision on the next Fed Chair, and the President will still make a pick this fall. Following this news, it was reported that White House officials have requested Democratic senators to begin endorsing Janet Yellen and the Wall Street Journal broke that the White House and Yellen have had discussions on the process for nominating Chairman Bernanke’s successor.

Regulators Fine JPMorgan $920 Million in London Whale Case

On September 19th, the Fed announced that JPMorgan Chase will pay regulators a penalty totaling $920 million to resolve "deficiencies in the bank holding company's oversight, management and controls governing its Chief Investment Office." The fine is composed of a $300 million payment to the Office of the Comptroller of the Currency (OCC) to resolve "unsafe and unsound practices," $200 million to the SEC, and fines to the U.K's Financial Conduct Authority (FCA). In addition, the bank will have to repay consumers $309 million resulting from illegal credit card practices under consent orders, in addition to $80 million in fines to the OCC and Consumer Financial Protection Bureau (CFPB) to resolve allegations of unfair billing practices. The Commodities and Futures Trading Commission (CFTC) announced the same day that staff are also recommending enforcement actions against JPMorgan. As part of the SEC's updated enforcement policy, JPMorgan agreed to admit wrongdoing in their settlement, with CEO Jamie Dimon saying that the bank has "accepted responsibility and acknowledged [their] mistakes from the start."

CFPB

Bureau Issues Guidelines to Protect Servicemembers in the Payday Market

On September 17th, the CFPB released guidelines to examiners on how to identify consumer harm and risks from Military Lending Act (MLA) violations when supervising payday lenders. The guidelines, for all closed-end loans of $2,000 or less and with terms of 91 days or less, include: capping the annual percentage rate (APR) at 36 percent; baring rolling over of loans; prohibiting signing away of rights under the Servicemembers Civil Relief Act or other consumer protections; and not requiring allotments to repay. Currently, the MLA only applied to tax-refund loans, certain closed-end payday loans, and auto title loans; however, the Department of Defense, in coordination with the Bureau is considering expanding restrictions to include payday and auto title loans with open-ended terms.

CFPB Launches New Home Mortgage Disclosure Act Tool

On September 18th, the CFPB launched a new website which would enable consumers to easily access public mortgage information collected under the Home Mortgage Disclosure Act (HMDA). The goal of the tool is to increase transparency by educating homeowners and buyers of trends in their mortgage market. The tool includes a heat map showing mortgage application and originations, interactive graphs showing mortgage volumes, and graphs showing the prevalence of Federal Housing Administration (FHA) and Veterans' Affairs (VA) lending.

SEC

SEC Approves Pay Ratio, Municipal Advisor Rules

On September 18th, the SEC voted on two proposals, a CEO pay ratio disclosure rule and registration rules for municipal advisors. The CEO pay ratio rule, approved by the Commission in a 3 to 2 vote, would require public companies to disclose the ratio of the compensation of its chief executive officer (CEO) to the median compensation of its employees. Commission

Republicans Daniel Gallager and Michael Piwowar voted against the disclosure requirements, saying they could mislead investors. Less controversial was the SEC's unanimous approval of registration rules for municipal advisers. This rule will establish a permanent registration regime for individuals that advise state and local governments issuing bonds and other securities for public projects. The rules takes into account Congressional comments that had asked the SEC to exempt government officials, engineers, and certain banks from the definition of "municipal adviser." The CEO pay rule will have a 60-day public comment period following publication in the Federal Register whereas the municipal advisor rule will become effective 60 days after being published in the Federal Register.

SEC Issues Risk Alert on Short Selling

On September 17th, the SEC issued a risk alert explaining Rule 105 of Regulation M which generally prohibits purchasing securities in secondary offerings after the purchaser has already effected short sales within a certain time period. The alert comes after the SEC took action against 23 firms for violations resulting from participating in public offerings too soon after short selling stocks.

CFTC

Farm Industry Urges Caution in CFTC Futures Rule

On September 19th, farm industry stakeholders wrote to CFTC Chairman Gary Gensler requesting the agency "undertake a serious and thorough" cost-benefit analysis of its futures customer protection rules before moving forward. The Commission proposed rules last fall, after the MF Global and Peregrine Financial failures resulting in missing customer funds, that would require enhanced customer protections, risk management programs, internal monitoring and controls, capital and liquidity standards, disclosures, and auditing and examination for futures commission merchants. The letter, signed by 21 stakeholders including the American Farm Bureau Federation, expressed support for enhancing futures consumer protections but cautioned against the capital and residual interest provisions of the rule. The CFTC is currently reviewing a new draft of the proposed rule in advance of a final vote.

Treasury

FSOC Ratifies Votes Made by Cordray While Recess Appointed

On September 20th, the Federal Stability Oversight Council (FSOC) ratified votes made by CFPB Director Richard Cordray between January 2013 and July 2013 while he was serving as a recess appointee. The ratification was "to avoid the appearance of any uncertainty regarding certain actions previously taken by the Council." In each case, Cordray, though among the majority, was not the swing vote in any decision.

FSOC Continues to Designate Prudential as SIFI

On September 19th, the FSOC voted 7 to 2 to designate Prudential Financial as a systemically important financial institution (SIFI), requiring additional oversight due to large firms' potential

to impact the broader economy in the event of instability or failure. In announcing the designation, the FSOC released a rationale that outlines the significant role Prudential plays in the economy. Roy Woodall, independent member of the FSOC with insurance expertise, and acting Federal Housing Finance Agency (FHFA) Director Ed DeMarco, both dissented. Woodall argued that the FSOC's rationale is "antithetical to a fundamental and seasoned understanding of the business of insurance, the insurance regulatory environment, and the state insurance company resolution and guaranty fund systems." Prudential has already appealed the proposed decision in July 2013, and is considering a court challenge. Still, the Fed has yet to complete rules governing institutions deemed systemically important.