AMERICANS FOR FINANCIAL REFORM

THIS WEEK IN WALL STREET REFORM
OCTOBER 18-24, 2014

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Fed to Banks: Shape Up or Risk Breakup
Ryan Tracy and Victoria McGrane, Wall St. Journal, 10/20/14
Federal Reserve officials sent a warning shot across Wall Street on Monday, telling bank executives they must do more to curb excessive risk-taking and improve employee behavior at their firms or face stiff repercussions, including being broken into smaller pieces.

Federal Reserve Gov. Daniel Tarullo and Federal Reserve Bank of New York President William Dudley, in closed-door speeches Monday to bank executives gathered at the New York Fed, said Wall Street must clean up its behavior and image, according to copies of their remarks provided by the Fed. The regulators made it clear they aren't satisfied with bank's efforts in the six years since the financial crisis shattered public trust in big banks, citing ongoing probes of banks for currency-market and interest-rate manipulation, tax evasion and efforts to skirt international sanctions.

Mr. Dudley raised the specter of breaking up big banks, saying if firms don't prove they can comply with the law, "the inevitable conclusion will be reached that your firms are too big and complex to manage effectively. In that case, financial-stability concerns would dictate that your firms need to be dramatically downsized and simplified so they can be managed effectively."

See **American Banker story on Tarullo speech** and **text of Dudley speech**.

Decimate Wall Street
Bart Naylor, Citizen Vox, 10/20/14
[N.Y. Fed President] Dudley proposes that part of senior bankers' pay be sequestered in a "performance bond." If the bank must pay a large fine, this bond is forfeited and paid as part of the fine. "This would increase the financial incentive of those individuals who are best placed to identify bad activities at an early stage, or prevent them from occurring in the first place."

Nobel Laureate Jean Tirole Calls for Tough Rules for Banks
Ben Moshinsky, Bloomberg, 10/13/14
Jean Tirole, winner of the 2014 Nobel Prize in Economic Sciences, said banks that benefit from government support should face tough regulation.

"We need strong rules that are going to prevent banks from gambling with taxpayers' money," Tirole, an economics professor at the University of Toulouse, said in an interview with Erik Schatzker on Bloomberg Television today. "If they are to be bailed out, they have to be regulated."

CONSUMER FINANCE & CFPB

A Rate Cap for All Consumer Loans
Editorial, NY Times, 10/18/14
The Obama administration has proposed much-needed improvements in federal rules that are supposed to protect service members from predatory loans that trap them in debt and, in certain circumstances, can end their military careers. The changes would repair glaring weaknesses in the rules used to carry out the Military Lending Act of 2007. But the administration and Congress should not stop there. Millions of civilians are also exposed to ruinously priced loans. What is needed is a national consumer lending standard and interest rate cap to ensure fair credit in the country as a whole.

States Ease Laws That Protected Poor Borrowers
Michael Corkery, N.Y.Times, 10/21/14
Over the last two years, lawmakers in at least eight states have voted to increase the fees or the interest rates that lenders can charge on certain personal loans used by millions of borrowers with subpar credit.

The lenders argued that interest rate caps had not kept pace with the increased costs of doing business, including running branches and hiring employees. Unless they can make an acceptable profit, the industry says, lenders will not be able to offer loans allowing people with damaged credit to pay for car repairs or medical bills.

But a recent regulatory filing by one of the nation's largest subprime consumer lenders, Citigroup's OneMain Financial unit, shows that making personal loans to people on the financial margins can be a highly profitable business — even before state lending laws were changed. Last year, OneMain's profit increased 31 percent from 2012. About 60 percent of OneMain's loans are so-called renewals — a trend one analyst called **"default masking"** because borrowers may be able to refinance before they run into trouble paying back their current balance.

Prepaid Debit Cards Said to Face Rules on Overdrafts, Disclosure
Carter Dougherty, Jesse Hamilton, Bloomberg, 10/16/14

The Banking Lobby's Strategy to Put the CFPB in Check
Interview with Richard Hunt of Consumer Bankers Assn., American Banker 10/21/14

Is the CFPB Committing Regulatory Overreach?
Diana Carew, The Hill, 10/22/14

CFPB Urged by Advocacy Groups to Rein In Small-Dollar Lenders
Bloomberg First Word, 10/23/14

See joint letter from 467 organizations including AFR.

DERIVATIVES, COMMODITIES & THE CFTC

Feds Target Accountants With New Code of Conduct

Tim Devaney, The Hill, 10/22/14

The Commodity Futures Trading Commission (CFTC) is trying to root out corrupt and incompetent accountants from the futures industry. The CFTC proposed Wednesday a new code of professional conduct for accountants that would include sanctions for those who do not follow the rules.

EXECUTIVE COMPENSATION

Should CEOs Really Be Paid Less

Book Review, The Economist, 10/25/14

“Indispensable and Other Myths” is an all-guns-blazing attack on the way that Anglo-Saxon companies pay their bosses. Michael Dorff, who teaches law at Southwestern Law School, has no truck with the idea that the system just needs to be tweaked to avoid absurdities like Mr Sullivan’s jackpot. He thinks that the problem lies with the system itself. Or, more precisely, with the idea that animates the system: that you should pay executives according to their performance.

Mr Dorff believes that performance-related pay should be scrapped and managers paid a salary. This would be good for shareholders: the pay revolution has dramatically increased the proportion of profits that go to the CEOs. It would be good for the country because it would reduce the likelihood of future Enrons or Lehman Brothers. It would even be good for CEOs who would have a guaranteed income.

But is this call for root-and-branch reform really plausible?

Understanding the CEO Pay Debate (a primer)

Susan Holmberg & Michael Umbrecht, Roosevelt Institute, 10/23/14

See **AFR/Demand Progress Petition**

FEDERAL RESERVE

How the Fed Blew Its Most Important Job for Over Three Years

Zach Carter, Huffington Post, 10/22/14

The Federal Reserve was aware of risky practices at JPMorgan Chase as early as 2008 but failed to follow up for more than three years until those risks had snowballed into the company's $6.2 billion London Whale scandal, according to a new report from the central bank's Office of Inspector General.

While the Fed Board of Governors, based in Washington, is a public agency, the regional Fed banks are private sector entities. The London Whale report has led bank watchdogs to suggest that, at the very least, the New York Fed presidency should be a fully public position, appointed by the president and confirmed by the Senate.

“The New York Fed is the key on-the-ground supervisor of the largest Wall Street banks, including JPMorgan," Marcus Stanley, policy director at **Americans for Financial Reform**, told HuffPost. "So I think there are some questions about this hybrid public-private structure given the critical public interest in all these issues."

Something Is Dangerously Wrong at the New York Fed
David Dayen, Fiscal Times, 10/24/14
In response to the Segarra tapes, Sens. Elizabeth Warren (D-MA) and Sherrod Brown (D-OH) called for Banking Committee hearings and an investigation into the New York Fed, and House Democrats have made formal requests as well. So far, committee chairs have given no final word, according to Senate sources. The White House has said nothing. Now, **Americans for Financial Reform** (AFR), the umbrella organization of progressive and labor groups on this issue, has gotten involved in demanding hearings. It's a problem when the "key on-the-ground supervisor for Wall Street banks," as AFR puts it, cannot be trusted to carry out its functions.

See **AFR petition: Investigate the Fed.**

INVESTOR RIGHTS AND THE SEC

Who Should be Accredited These Days?
Investment News (paywalled), 10/19/14
It's about time the Securities and Exchange Commission got serious about updating its definition of an accredited investor. The current definition — a person who either has an income of at least $200,000 ($300,000 for couples) or a net worth of at least $1 million, not including a primary residence — is woefully outdated and does little to keep "unsophisticated" investors from investing in vehicles that are entirely unsuitable for them. Financial thresholds fail to provide adequate protection for investors whose net worth is based on a retirement nest egg or on illiquid holdings.

Private Equity Titans Open Cloistered World to Smaller Investors

William Alden, NY Times, 10/20/14
For decades, David M. Rubenstein has persuaded big institutions like pension funds and university endowments to invest billions of dollars with his private equity firm, the Carlyle Group, promising them better returns than the general market. But in recent months, he has crisscrossed the country in a campaign to attract a type of investor that has relatively little experience in this industry: individuals.

Carlyle, the Washington-based giant that Mr. Rubenstein co-founded in 1987, is at the forefront of an effort to open the cloistered and risky world of private equity to doctors, lawyers, well-heeled entrepreneurs and others with a brokerage account or, one day, a robust 401(k). The firm is close to establishing a new way to give individual investors direct access to a selection of Carlyle's private equity funds, according to people briefed on the matter who were not authorized to speak publicly about the private fund-raising campaign in progress.

SEC Is Steering More Trials to Judges It Appoints
Jean Eaglesham, Wall St. Journal, 10/21/14

SEC Set to Deny Proposal for Nontransparent ETFs
Daisy Maxey, Imarket Reports, 10/22/14

MORTGAGES AND HOUSING

Ocwen allegedly backdated thousands of mortgage letters: NY regulator

Hailey Lee, CNBC, 10/21/14

Ocwen Financial, a provider of residential and commercial mortgage loan servicing, allegedly backdated thousands of time-sensitive letters to mortgage clients and did not take action to fix the issue despite repeated notices of concern, according to New York regulators, Tuesday.

In the majority of cases, borrowers received a letter in the mail that denied mortgage loan adjustments—letters that were dated more than 30 days before it arrived, wrote Benjamin Lawsky, superintendent of New York's Department of Financial Services, in a letter to Timothy Hayes, Ocwen's executive vice president & general counsel. Borrowers are only allowed 30 days to appeal the denial, so the appeal period had largely passed by the time they got the letter, he wrote.

Ocwen's Backdated Letters May Violate Settlement

Greg Farrell, Carter Dougherty, Kathleen M. Howley, Bloomberg, 10/22/14

Ocwen Backdating Probe Draws Attention of Attorneys General

Andrew Harris, Bloomberg, 10/22/14

New Rules Adopted in Hopes of Spurring Home Loans

Marcy Gordon, Associated Press, 10/21/14

Buying a home may have gotten a little easier this week. With the financial crisis and subprime mortgage bust receding further into history, the government is loosening some financial rules, hoping to inject more life into the country's still-recovering housing market.
Both banks and borrowers stand to benefit from the new rules unveiled Tuesday by six federal agencies. While banks will see relaxed guidelines for packaging and selling mortgage securities, fewer borrowers likely will need to make hefty down payments. The board of the Federal Deposit Insurance Corp. voted 4-1 Tuesday to adopt the new rules, and two other agencies approved them as well. The Federal Reserve has scheduled a vote for Wednesday, and two other agencies are expected to adopt the rules soon.

The regulators have dropped a key requirement: a 20-percent down payment from the borrower if a bank didn't hold at least 5 percent of the mortgage securities tied to those loans on its books. The long-delayed final rules include the less stringent condition that borrowers not carry excessive debt relative to their income.

U.S Agencies Approve Relaxed Mortgage-Lending Rules

Andrew Ackerman, Alan Zibel, Wall Street Journal, 10/22/14

Rural Areas Seek Piece of Subprime-loan Settlement

Hope Yen, Associated Press 10/21/14

Long seen as having devastated Sun Belt cities, the subprime mortgage crisis unleashed turmoil on Ohio and other rural areas. Now federal officials are pledging regulatory attention and financial help.

[Home as a Piggy Bank? Not Everywhere]

John F. Wasik, NY Times, 10/22/14
The initial good news for home-equity wealth building — particularly for those who have managed to hold onto their homes — is that in most of the country prices have generally recovered since the 2008 financial crisis.

[The Unequal Mortgage Market Is No Coincidence]
Michela Zonta, Center for American Progress, 10/20/14
[B]lack and Hispanic households continued to represent a shrinking fraction of the mortgage market and received higher-cost loans compared with white borrowers. Tragically, many prospective black and Hispanic homeowners never reach the loan-decision stage of the home buying process. People of color are still being treated unequally in the home mortgage market, even when they demonstrate an ability to repay their loans.

Blacks and Hispanics are more than twice as likely to be denied a mortgage as non-Hispanic whites with comparable incomes and risk profiles. However, the disparate treatment received by people of color is not confined solely to the loan approval stage of the mortgage lending process and does not necessarily take the form of a loan denial.

[Cummings, Warren Request GAO Study on Nonbank Servicer Stability]
Victoria Finkle, American Banker, 10/21/14

[It's Time to End "Exclusionary Lending"]
Jim Carr, American Banker, 10/22/14
Five years into the economic recovery, lending to African-Americans and Latinos is at the lowest levels in nearly 15 years… Some try to justify banks' overly restrictive underwriting practices by arguing that borrowers with lower credit scores and those who can only afford lower down payments — groups that often include black and Latino mortgage applicants — are more likely to default, resulting in losses for lenders.

But much of the research upon which that justification is based relies on analyses of pools of layered-risk loans. In other words, these loans did have low down-payment and credit score requirements. But many were also poorly underwritten, high-cost and included risky features such as second liens, high prepayment penalties and unaffordable upward interest rate adjustments.

An impressive body of research exists showing that modestly lower down payments and credit scores do not in and of themselves result in excessive additional defaults…

POLITICAL INFLUENCE OF WALL STREET

[Financial Companies Find Friends in Hagan, Tillis]
Joseph Neff, Raleigh News-Observer, 10/19/14
As Election Day nears, this much is clear: In one of the nation's most closely watched races, North Carolina voters will choose a U.S. senator from two pro-business candidates with strong backing from the people running financial companies regulated by the government…

On March 6, 2013, Hagan introduced a bill to allow the nation's biggest federally insured banks to stay in the lucrative swaps market… [C]onsumer groups such as **Americans for Financial Reform** and public pension plans say the bill is a bad idea.

In June 2013, the state House passed a bill allowing finance companies to make bigger personal loans at higher interest rates. [Republican candidate Thom Tillis] voted yes. Two weeks later, the principal advocate for this bill, his wife and his mother – all principals in North Carolina's largest consumer finance company – gave $7,700 to Tillis' Senate campaign, $100 below the legal maximum contribution. The consumer-loan industry has given Tillis' campaign nearly $70,000.

Chris Kukla of the Center for Responsible Lending, a nonpartisan group that promotes homeownership and opposes predatory lending, said the higher interest rates and new fees will bring in an extra $40 million to $60 million a year for the finance companies from the pockets of the state's least sophisticated borrowers.

Goldman Goes Republican
John Carney, Wall St. Journal, 10/20/14
The firm, once a reliable supporter of the Democratic Party, is now the biggest backer of the Republican Party on Wall Street. In the current election cycle, Goldman's employees have made $1.75 million in donations to Republicans, according to data from the Center for Responsive Politics. That's 63% of the firm's political donations.

And who Goldman backs matters. Its employees have long been the biggest source of political money on Wall Street. Since 1990, they have sent $47 million to candidates and political action committees. Even the mega-banks—Citigroup, J.P. Morgan Chase, and Bank of America—haven't given that much. For years, though, Goldman's giving skewed toward Democrats. That culminated in 2008, when Goldman cash went to Democrats by a three-to-one margin. Then, in the 2010 mid-term election cycle, Goldman leaned Republican for the first time.

On Eve of Midterm Elections, Public Incorrectly Sees Both Parties Equally Close to Wall Street
Alex Formuzis, Better Markets, 10/20/14
According to a new national survey, 51 percent of likely voters believe both Republicans and Democrats in Washington, D.C. are equally cozy with Wall Street. The poll, commissioned by Politico and conducted between October 3-October 11, finds that of the remaining likely voters, 39 percent think Republicans are closer to Wall Street compared to just 9 percent who believe Democrats are friendlier with the financial industry.

Earlier this year, **Americans for Financial Reform** released a report revealing not just how much cash Wall Street and the big banks have spent lobbying against the financial reform law, but also where their campaign contributions have gone. According to AFR's report, of the *"$202,992,995 contributed by PACs and individuals (in 2013 and 2014) associated with finance, 62% went to Republican candidates and 38% went to Democrats."*

West Virginia Dem's Ad Ties Capito to Wall St.
Kevin Cirilli, The Hill, 10/21/14
West Virginia Democratic senatorial hopeful Natalie Tennant will release an attack ad criticizing GOP opponent Rep. Shelley Moore Capito's ties to Wall Street. In the ad, a male narrator criticizes Capito for drafting legislation that increased consumer credit card fees.

"Just days later, a big-time credit card company gave her husband a cushy Wall Street job," the narrator says in the ad, obtained first by The Hill…

STUDENT LOANS

For-Profit Colleges Get Harsh Grades by Former Students

Megan Woolhouse, Boston Globe, 10/20/14

The pitch made by for-profit colleges, a staple of daytime and late-night TV, often features successful alumni from the schools, from Pulitzer Prize-winning photographers to Hollywood animators. Yet the US Department of Education estimated that 72 percent of the for-profit programs at 7,000 schools produced graduates who on average earned less than high school dropouts.

Employers Shy Away From Online, For-Profit Grads

Katherine Peralta, US News, 10/17/14

New research suggests that employers see jobseekers in a more negative light if they received their degree online from a for-profit institution. Applicants with a bachelor's degree in business from a large, online and for-profit school are about 22 percent less likely to receive a callback from a prospective employer than applicants with similar degrees from nonselective public schools, according to a working paper from the National Bureau of Economic Research.

OTHER TOPICS

In Turnabout, Former Regulators Assail Wall St. Watchdogs

Jesse Eisinger, NY Times, 10/22/14

Last week, I visited an alternate universe. The real world sees a pandemic of bank misconduct, but to the white-collar defense lawyers of Washington, the banks are the victims as they bow beneath the weight of regulators' remarkably harsh punishments.

I was attending the Securities Enforcement Forum, a gathering of top regulators and white-collar defense worthies.

Consumer Unit Born of Crisis to Be Shelby Bank Panel Focus

Cheyenne Hopkins, Bloomberg, 10/24/14

A Republican takeover of the U.S. Senate would be a case of back to the future for the Banking Committee, where Richard Shelby is in line to assume the helm.

Shelby, 80, who was chairman of the panel in the years leading up to the financial crisis when Republicans controlled Congress and the White House, would be seizing the gavel again in an environment reshaped by laws that he opposed.

He'd have to focus on issues with bipartisan support, current and former congressional aides say. Those include seeking to eliminate the director's job at the Consumer Financial Protection Bureau and requiring more disclosure by the Financial Stability Oversight Council. Both panels were created over his objections as part of the 2010 Dodd-Frank Act.

Jeb Hensarling Faces Potential Threat to Gavel

Jake Sherman, Lauren French, John Brewnahan, Politico, 10/22/14

Oklahoma Rep. Frank Lucas is considering a challenge to Texas Rep. Jeb Hensarling for the chairmanship of the House Financial Services Committee, in what could be the first marquee power battle in the House this fall. "I've been approached by several members about their concerns on the direction of the Financial Services Committee and the indication that they would like to have a different way of going about things compared to the last two years," Lucas told POLITICO.

[Regulatory Climate Could Spur Financial Services M&A Deals - Deloitte Risk & Compliance]

Jim Eckenrode, Wall St. Journal, 10/20/14

[JPMorgan CEO Says U.S. Financial System Has 'Completely Recovered']

Saabira Chaudhuri, Wall St. Journal, 10/21/14

Cancer hasn't yet "changed what I want to do with my life," said [Jamie] Dimon in some of his most extensive remarks on his health battles. Mr. Dimon added that while he feels he helps people through his work as a banker, he can help people directly in other roles such as teaching or working with charitable organizations.

On the global economy, he said the U.S. financial system has "completely recovered," and that long term, "the U.S. has the best hand it's ever been dealt."