April 2009

Association for Financial Professionals

# Legislative and Regulatory Status Update

A monthly summary of federal issues



Date of Last Change

04/09

**Overview** – April 29, 2009, marked President Barack Obama's 100th day in office. Since President Franklin Roosevelt took office, this has been considered an important landmark for assessing the direction of an administration. While this is no doubt an arbitrary benchmark, there has been a great deal of action that has affected the economy and financial professionals. Among the noteworthy accomplishments are the passage of the stimulus package and the Public-Private Investment Plan meant to move toxic assets off banks' balance sheets (page 3). While a central focus of the first 100 days has been to rescue the economy, little has been done to fundamentally reform the financial regulatory system. This is expected to be a long term effort and could fundamentally change the way derivatives products and other nontraditional financial instruments are handled (page 5).

Just before the 100 day marker, a major change occurred on Capitol Hill. Senator Arlen Specter, a moderate Republican from Pennsylvania, changed parties due to what promised to be a difficult Republican primary in 2010. This turn of events gives the Democrats 59 votes in the Senate, including Senators Lieberman (I-CT) and Sanders (I-VT) who caucus with the Democrats With Democratic candidate Al Franken the likely winner of the pending Minnesota Supreme Court case to determine the outcome of last year's Senate race, this will give the Democrats 60 votes in the Senate. This is the critical threshold needed in the Senate to halt debate in order to vote on a bill.

This month, AFP President and CEO Jim Kaitz, participated in a roundtable at the Securities and Exchange Commission (SEC) on regulating credit rating agencies (pages 7 & 15). Kaitz introduced several new proposals for reforming the credit rating system. Additionally, AFP members participated in a call with senior-level staff of the Federal Reserve to discuss a proposal to expand the Fed's commercial paper program (page 1). AFP members gave a unique practitioner's perspective on the credit markets and provided examples of how changes to the program could open up credit markets for Tier II issuers as well as other companies.

Date of
Last Change

## CREDIT CRISIS

04/09 **AFP Presents Case to the Fed for Expanding Commercial Paper Program –** On April 13, 2009, AFP members and staff participated in a conference call with the staff of the Federal Reserve Board of Governors and the Federal Reserve Bank of New York to discuss our previous request to extend the Commercial Paper Funding Facility (CPFF) to Tier 2 commercial paper issuers. (Click here to view AFP's original request to the Fed). AFP members provided the Fed staff with concrete examples of the impact that extending this program would have on many companies. AFP members argued that this expansion is necessary and will help ease credit availability for Tier 2 companies and other organizations. The Tier 2 commercial paper market is approximately $80 billion in size and includes such household names as FedEx, Kraft, Kroger, Safeway, and Time Warner.

The Fed staff expressed their appreciation to AFP for bringing this issue to their attention. AFP will continue to monitor the Fed's actions for any movement on this issue and continue to work to expand access to credit.

04/09 **Treasury Extends Temporary Guarantee Program for Money Market Funds -** On March 31, 2009, the Treasury Department announced an extension of its temporary Money Market Funds Guarantee Program through September 18, 2009, in order to support ongoing stability in financial markets. The program was scheduled to end on April 30, 2009.

As a result of this extension, the temporary guarantee program will continue to provide coverage to shareholders up to the amount held in participating money market funds as of the close of business on September 19, 2008. All money market funds that currently participate in the program and meet the extension requirements under the Guarantee Agreements are eligible to continue to participate. Funds that are not currently participating are not eligible. For more information, click here.

04/09 **Senate Passes Financial Fraud Bill –** On April 28, 2009, the Senate passed S. 386, the Fraud Enforcement and Recovery Act, which would provide new legal tools and more funding to combat mortgage, commodities and securities fraud. This measure gives federal authorities more funding and broader powers to investigate a wide range of financial crimes and defines financial institutions to include mortgage brokers and lenders not related or insured by the federal government.

The financial fraud bill contains a number of amendments of particular interests including:

Date of
Last Change

- An amendment to authorize funds for the TARP special inspector general to audit and investigate recipients of the federal funds under the Public-Private Investment Program (PPIP) and the Term Asset Loan Facility (TALF);
- An amendment to require the Treasury Department to use any TARP amounts repaid by a financial institution to reduce the national debt; and
- An amendment to ban the use of TARP funds for the purchase of common stock

04/09 **FDIC & Fed Duties Increase Under New Financial Stability Plan –** The Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve duties have dramatically increased under the recently released Financial Stability Plan. Several weeks ago, the Treasury Department announced that that FDIC and the Federal Reserve (the Fed) would split duties under the Public-Private Investment Program, where the FDIC would guarantee and hold auctions for debt used to buy toxic loans through the Legacy Loans Program, while the Fed would oversee a program designed to create a market for illiquid securities. The Treasury Department will rely on both these entities to run a critical piece of the plan to remove toxic assets from bank balance sheets. For more information, click here.

03/09 **Money Market Funds Reforms Announced –** On March 18, 2009, the Investment Company Institute (ICI), announced their adoption of new standards for money market funds in an effort to improve their functioning and regulation. The ICI Board of Governors adopted a resolution that would, for the first time, require money market funds to meet new mandated daily and weekly minimum liquidity standards. Along with the adoption of the new standards, the ICI Board also announced that they will encourage the SEC to require that the funds choosing not to implement the recommendations disclose that fact to their investors. The ICI is the major trade group representing the mutual fund industry. To view the new money market funds standards in their entirety, click here.

03/09 **Term Asset-backed Loan Facility (TALF) –** On March 13, 2009, the Federal Reserve Bank of New York announced that it extended the application period for the Fed's Term Asset-backed Loan Facility to accommodate participants filling out the lengthy application. The TALF program was designed to jump start the secondary credit markets in an effort to further unlock the flow of and access to credit. Originally, the New York Fed announced it would accept applications through March 13, 2009, but that deadline was extended to March 19, 2009. Additionally, the lending rate for TALF loans was established on March 19, 2009.

Date of
Last Change

The Term Asset-backed Loan Facility (TALF) was designed to renew the issuance of consumer and business asset-backed securities (ABS). The program will initially lend up to $200 billion to eligible owners of certain AAA-rated asset-backed securities backed by newly and recently originated auto loans, credit card loans, student loans and SBA-guaranteed small business loans. The Fed signaled that this program could be expanded up to $1 trillion dollars in the future.

The first loans accepted into the program were awarded on March 25, 2009.

For additional information on this new program, click here.

03/09 **FDIC Debt Guarantee –** On March 17, 2009, the board of directors of the Federal Deposit Insurance Corporation (FDIC) voted to extend the debt guarantee portion of the Temporary Liquidity Guarantee Program (TLGP) from June 30, 2009 to October 31, 2009. The board also voted to impose a surcharge on debt issued on or after April 1, 2009, and with a maturity of one year or longer.

The surcharge will be in addition to current fees for guaranteed debt and will be put into the deposit insurance fund (DIF) to keep down special assessments. Current TLGP fees are being set aside to cover potential program losses.

The FDIC created the TLGP program to strengthen confidence and encourage liquidity in the banking system by guaranteeing newly issued senior unsecured debt of banks, thrifts, and certain holding companies, and by providing full coverage of non-interest bearing deposit transaction accounts, regardless of dollar amount. The TLGP was created in October 2008, as part of a coordinated effort by the FDIC, the U.S. Department of the Treasury, and the Federal Reserve to remedy unprecedented disruptions in credit markets and the resultant inability of financial institutions to fund themselves and make loans to creditworthy borrowers.

For more information on this program, click here.



**AFP has compiled a cumulative list of programs implemented following the Emergency Economic Stabilization Act of 2008. Ro view a continuously updated list, please click here.**

Date of
Last Change

# Legislative Issues

## *TREASURY AND FINANCE*

04/09 **Interchange Fees -** Representatives Peter Welch (D-VT) and Bill Shuster (R-PA) were planning to offer an amendment to Congresswoman Carolyn Maloney's *Credit Cardholder's Bill of Rights Act of 2009* (H.R. 627) that would addresses credit card interchange fees. However, the sponsors have withdrawn their amendment. The Welch-Shuster interchange amendment would have sought to eliminate the anticompetitive rules Visa and MasterCard impose on merchants. This amendment would have increased transparency in the payments card industry and make the true cost of card acceptance evident to consumers in making an informed decision regarding their choice of payment.

04/09 **Data Security –** On April 1, 2009, the Senate Commerce Committee Chairman John Rockefeller (D-WV) and Sen. Olympia Snowe (R-ME) introduced S. 773, the *Cybersecurity Act of 2009.*The bill seeks to create a comprehensive national strategy for cybersecurity, including private industry. The bill would create a Cybersecurity Advisor in the White House who, along with a panel, would create rules and regulations regarding network security standards for the Federal government, federal contractors, and "critical infrastructure," which is likely to include financial and payments systems.

AFP has long advocated national data security standards to provide a uniform compliance standard for companies accepting electronic payments and a ceiling for merchant liability in the event of criminal breaches.

04/09 **Futures and Derivatives –** Futures and derivatives legislation is on hold. The most ambitious plan to date, H.R. 977, *The Derivatives Markets Transparency Act of 2009*, has not advanced since it was approved by the House Agriculture Committee earlier in the year. (AFP submitted a letter voicing concern on the inclusion of commonly-used risk mitigation products, such as interest rate and foreign exchange swaps, in the bill.)

There has been a great deal of discussion of a package of financial market regulatory reforms, with derivatives products at the heart of the effort. Key figures in the Obama Administration have hinted at measures ranging from requiring clearing for credit default swaps to mandating the clearing and reporting of *all* over-the- counter derivatives.

On March 10, 2009, AFP's Government Relations Committee (GRC) met with legislators to discuss their concerns about proposals to require all derivatives contracts to be cleared. GRC members told congressional staff that contracts would likely need to be standardized to be cleared and elaborated on the difficulty they would face complying with FAS-133 under such conditions. They further elaborated that the loss of these products would cost their firms millions of dollars and increase volatility and risk.

Date of
Last Change

03/09 **CFTC Chairman Nomination on Hold –** U.S. Senator Bernard Sanders (I-VT) placed a hold on the nomination of Gary Gensler to be chairman of the Commodity Futures Trading Commission (CFTC) citing Gensler's work 10 years ago to exempt derivatives traded off-exchange from regulation. This move may block Gensler from being considered by the full Senate despite the fact that the Senate Agriculture Committee voted to favorably recommend Gensler. In 2008, Senator Maria Cantwell (D-WA) placed a hold on former CFTC Acting Chairman Walter Lukken. Because of her hold, Lukken was never confirmed by the full Senate despite the Agriculture Committee's favorable recommendation.

***PENSIONS AND INVESTMENTS***

04/09 **401(k) Fee Disclosure** - Rep. George Miller (D-CA) Chairman of the House Education and Labor Committee and Rep. Robert Andrews (D-NJ) chairman of the Subcommittee on Health, Employment, Labor and Pensions have introduced a bill (H.R. 1984) to significantly expand the rules governing disclosure of fee information in defined contribution plans. The legislation covers disclosure by service providers to plan sponsors; disclosure to participants and a requirement for all plans to offer at least one broad index fund (stocks or bonds). The bill calls for detailed information on investment expenses, administrative and transaction fees and any other charges that may be deducted from a participant's account. A hearing was held on the bill shortly after introduction and action by the House is expected this year.

04/09 **Defined Benefit Plan Funding** - Congress provided some relief from massive increases in funding for traditional pension plans by passing the *Worker, Retiree and Employer Recovery Act of 2008* (WRERA) at the end of last year. However, additional relief is needed or plan sponsors will have to divert cash from operations to meet significantly increased funding requirements. A coalition of groups, including the Committee on Investment of Employee Benefits Assets (CIEBA), are pursuing additional temporary relief from funding requirements that have grown because of the current economic crisis.

House Minority Leader John Boehner (R-OH) – the father of the Pension Protection Act – has introduced The *Savings Recovery Act* (H.R. 2021). The bill provides funding relief by allowing greater flexibility in recognizing losses and increase the amount of time that plan sponsors have to fund up their plans from seven to nine years. The legislation also includes temporary capital gains relief and increased contribution limits for defined contribution plans.

Date of
Last Change

# REGULATORY ISSUES

## *TREASURY AND FINANCE*

04/09 **AFP Participates in SEC Roundtable on Oversight of Credit Rating Agencies –** On April 15, 2009, AFP unveiled a proposal to fundamentally change the current business models of credit rating agencies. At a roundtable hosted by the Securities and Exchange Commission (SEC), AFP's President and CEO Jim Kaitz provided two proposals for credit rating agency reform that would significantly alter the way the ratings business is run. The first proposal would have rating agencies adopt a stand-alone model, where the only business of the credit rating agency would be to produce credible and reliable ratings. The second proposal recommended that the Federal government be required to use alternative rating organizations, encouraging competition and breaking the government's addiction to Standard & Poor's and Moody's. In addition to working with the SEC, AFP is working to ensure members of Congress will consider these proposals as they consider additional rating agency reform.

To read AFP's complete written statement, click here. For additional insight on this issue, see this month's Issue Analysis on the credit rating agency reform on page 15.

04/09 **Connecticut AG Focuses on Oversight of Credit Rating Agencies** - In a letter to Federal Reserve Chairman Ben Bernanke, Connecticut Attorney General Richard Blumenthal requested that the agency revise its rules under the Term Asset-Back Securities Loan Facility (TALF) program to expand participation beyond the nation's three largest credit rating businesses. In the letter, Blumenthal asserts that the Federal Reserve's $1 trillion TALF bailout program unfairly directs up to $400 million in fees to the Big Three credit rating agencies who helped create the economic meltdown by overrating risky securities. As a result, Blumenthal has launched an investigation into the three major credit ratings agencies' "possible influence on TALF rules that steer them business". A subpoena to the three major rating agencies has been issued as part of Connecticut's antitrust inquiry.

AFP also expressed great concern over the large fees that the rating agencies stand to collect from TALF and released a statement that suggesting that credit rating agencies should waive their fees as restitution to taxpayers for their role in the market meltdown. "It's outrageous that credit rating agencies are going to make millions of dollars rating new debt while those same agencies are culpable for arbitrary and poor quality ratings that resulted in the financial meltdown we have seen over the last year," said Jim Kaitz, AFP President & CEO. Click here to view AFP's full statement.

Date of
Last Change

04/09 **SEC Announces New Enforcement Efforts –** On April 27, 2009, U.S. Securities and Exchange Commission Chairman Mary Schapiro highlighted the agency's more aggressive approach to oversight of money market and hedge funds. During a recent address, Chairman Schapiro said that money market funds will soon face stricter rules on credit quality, maturity, and liquidity. This announcement comes after the SEC's division of trading and markets investigated more than fifty cases involving credit default swaps, collateralized debt obligations and municipal securities fraud. Further, she announced that the SEC staff is also evaluating whether more fundamental changes may be necessary to protect investors from "runs on funds" or sudden outflows during distressed financial times. To read Chairman Schapiro's entire speech, click here.

04/09 **MSRB Releases Report that Addresses Unregulated Financial Advisers –** According to a recently released Municipal Securities Rulemaking Board (MSRB) report, the majority of financial advisers who helped steer state and local governments through the complex world of municipal bond issuances were neither registered nor regulated causing the Board to call for federal oversight of unregulated market participants. The report cites financial advisers, swaps advisers and guaranteed investment contracts brokers as some of the unregulated and unregistered participants that influenced bond purchase decisions. According to the MSRB report, these individuals play a significant role in financing deals and related derivative transactions that are considered during a municipal bond issuance. The MSRB believes that municipal credit default swaps should be included in Treasury Secretary Geithner's proposed new oversight for derivatives. To read the complete report, click here.

04/09 **Fed Opens Foreign Swap Lines to Foster International Liquidity –** On April 6, 2009, the Federal Reserve announced four new swap arrangements with overseas counterparts to help provide foreign currency liquidity to domestic banks. The agreement gives U.S. financial firms access to Euros, Yen, Pound Sterling and Swiss Francs through the Fed. For more information, click here.

***PENSIONS AND INVESTMENTS***

4/09 **Borzi Nominated for EBSA -** The Obama Administration has nominated Phyllis Borzi to serve as Assistant Secretary of Labor for Employee Benefit Security. In this capacity, Borzi will lead the Employee Benefit Security Administration (EBSA) at the Department of Labor. EBSA is primarily responsible for regulation and enforcement of ERISA's fiduciary requirements. Borzi has long experience in the employee benefits arena, including serving as pension and employee benefits counsel to the House Education and Labor Committee for 16 years. Borzi is currently a research professor at the School of Public Health and Health Services at the George Washington University and she is of counsel to O'Donoghue & O'Donoghue, a law firm specializing in employee benefits.

Date of
Last Change

03/09 **Defined Benefit Plan Funding -** Responding to requests from plan sponsors; CIEBA and other groups, and members of Congress, the Treasury Department has revised proposed funding regulations dealing with the interest rate used to value pension liabilities to allow plan sponsors additional flexibility. The Pension Protection Act (PPA) allows plan sponsors to choose to use an interest rate derived from a 24-month smoothed yield curve or a one-month yield curve. The law uses the term 'applicable month' to describe the one-month option. The original proposed regulation called for calendar year plans to use December 2008 as the 'applicable month.' The new guidance says that "… for a calendar year plan with a January 1, 2009 valuation date, the Internal Revenue Service (IRS) will not challenge the use of the monthly yield curve for January 2009, or any one of the four months immediately preceding January 2009."

CIEBA will continue to press the Treasury Department to allow plan sponsors additional flexibility in changing their methodology for valuing liabilities for the next two years. Under current rules, plans need the IRS' consent to change valuation methods. Plans choosing the one-month yield curve option, described above, may face significant volatility in their future funding requirements.

## ***FINANCIAL ACCOUNTING AND REPORTING***

04/09 **Accounting Standard Setters Response to Credit Crisis –** The Financial Crisis Advisory Group (FCAG) held its fourth meeting in London. One of the important topics discussed was responding to the rising political pressure being exerted on standard setters, particularly on the Financial Accounting Standards Board (FASB). Too much external interference with the standard setting process could damage the rulemaking process. U.S. convergence with the International Standards was also a high priority. FASB Chairman Robert Herz acknowledged that the U.S. has still not yet fully committed to adoption of the International Financial Reporting Standards (IFRS). In fact, he was quoted as saying that he expects full convergence will take as long as 10-15 years.

04/09 **FASB Issues New FSP's on Fair Value Accounting -** Following increased pressure from key members of Congress, the Financial Accounting Standards Board (FASB) has issued two Financial Statements of Positions (FSPs). The first FSP (FSP FAS 157-e) provides additional guidance for determining the fair value of financial assets when the market is not active and a transaction is not distressed. The second FSP (FSP FAS 115-a, and EITF 99-20-b) modifies the current indicator for recognizing other than temporary impairments (OTTI) in debt securities and requires additional disclosures related to the methodology for assessing OTTI under the new model.

Date of
Last Change

AFP sent two letters to FASB during the comment period in support of FASB's efforts to resolve these accounting rules that were having unintended negative effects on our members. AFP also urged FASB to change the effective date to allow more time to implement the guidance. In response, FASB changed the effective date from March 15, 2009 to June 15, 2009 and will permit early adoption.

04/09 **Fair Value Disclosures -** FASB finalized three FSPs intended to provide additional application guidance and enhance disclosures regarding fair value measurements and impairments of securities. FSP FAS 157-4 relates to determining fair values when there is no active market or where the price inputs being used represent distressed sales. It reaffirms the need to use judgment to ascertain if a formerly active market has become inactive and in determining fair values when markets have become inactive. FSP FAS 107-1 and APB 28-1 relate to fair value disclosures for any financial instruments that are not currently reflected on the balance sheet at fair value. The FSP now requires these disclosures on a quarterly basis, providing qualitative and quantitative information about fair value estimates for all those financial instruments not measured on the balance sheet at fair value. FSP FAS 115-2 and FAS 124-2 on other-than-temporary impairments is intended to bring greater consistency to the timing of impairment recognition, and provide greater clarity to investors about the credit and noncredit components of impaired debt securities that are not expected to be sold. The measure of impairment in comprehensive income remains fair value. FASB received over 600 written comment letters on this topic. The FSPs are effective for interim and annual periods ending after June 15, 2009, but entities may early adopt the FSPs for the interim and annual periods ending after March 15, 2009.

04/09 **Off Balance Sheet Accounting -** The IASB announced that it will hold several round-table discussions in June on consolidation and derecognition of financial instruments. The objective of the round tables is to seek further views on the consolidation proposals (for which the comment deadline closed in March) and to discuss the interaction of those proposals and the proposals on derecognition, particularly with regard to securitizations and the use of structured vehicles for off balance sheet accounting. Off balance sheet accounting was identified as a matter of concern by the G-and led to the acceleration the work on this issue.



04/09 **SEC Road Map for U.S. Adoption of IFRS –** The comment period ended on the SEC's IFRS road map for adopting IFRS. Many comments expressed concern with the current timeline established for US firms to adopt the standard and urged the SEC to make a decision soon so that companies will have ample opportunity to comply. There was concern that the current US financial, legal and regulatory environment may not be ready for the shift to the principle based accounting framework, which would give prepares the ability to exercise greater judgment as a result. Comments also expressed concern regarding whether the IASB's credibility, independence and oversight over their standard setting process is subpar to that of US GAAP.

Date of
Last Change

04/09 **Emissions trading** - The accounting related to initial recognition and measurement of tradable offsets that are issued to an entity free of charge in a cap and trade emissions trading scheme was on the FASB's meeting agenda this month. However, no conclusions were reached. Instead, FASB directed the staff to conduct additional research to ensure that the conclusions the FASB may reach on this topic are consistent with conclusions reached in other ongoing projects.

04/09 **Financial Statement Presentation -** The comment period recently ended in April on a joint FASB/IASB discussion paper outlining their preliminary ideas for changes to financial statements that would fundamentally alter the way information is presented on financial statements. A key feature of the proposal is that the balance sheet, income statement, and cash-flow statement will be divided into two major sections: business and financing. The financing section would include those activities that fund a company's business. For nonfinancial institutions, that would primarily include cash, bank loans, bonds, and other items that arise from general capital-raising efforts. The business section would be further subdivided into operating and investing categories. The section would focus on what a company does to produce goods and provide services. The operating category will include primary or "core" revenue and expense-generating activities, and the investing category will include activities that generate a return but are not "core." The single greatest concern of preparers that commented was the suggestion that businesses be required to use the direct cash flow method (rather than the indirect method) as most businesses are not set up to prepare to collect data in this manner. This could be a costly expense to companies if passed.

03/09 **Lease Accounting** - The IASB and FASB launched a public discussion on lease accounting by publishing their preliminary views in a joint discussion paper that discuss a possible new approach to lease accounting. The IASB and the FASB will each be holding a live web presentation introducing the discussion paper in May 2009. The discussion paper can be found at FASB's website.

02/09 **XBRL Implementation -** Extensible Business Reporting Language (XBRL) format for financial statement reporting went into effect on April 1, 2009, requiring the largest public companies to implement for the June 30, 2009 quarterly filing. Accelerated filers will be required to implement XBRL filing by 2010, while all others will be required to do so by 2011. The SEC will allow the first XBRL filing to be submitted 30 days after the regular filing date. The new rules are intended to assist with automating regulatory filings and simplifying the process for analyzing the information. The final ruling can be found here.

Date of
Last Change

02/09 **Joint Revenue Recognition Project** - The IASB and FASB published a discussion paper setting out a joint approach for the recognition of revenue. The objective is to develop a single revenue model that can be applied consistently regardless of industry. Comments on this paper are due by June 19, 2009. The discussion paper can be found here.

## PAYMENTS AND STANDARDS

04/09 **EU Brings Antitrust Charges Against Visa Europe for Fee Over-Charging –** European Union regulators have brought antitrust charges against Visa Europe on the grounds of the payment card company's restricting competition between banks due to its too high interchange fees for cross-border transactions.

The move follows MasterCard's decision to lower the same type of fees within its card network, as a result of pressure from European Union regulators. According to the interim agreement between the two parties, MasterCard lowered interchange fees on international credit card and debit card transactions to an average of 0.3 percent and 0.2 percent, respectively. Presently, Visa applies a 0.61 percent rate for international EU credit transactions and EUR 0.18 for debit payments and it recently cut fees for cross-border credit transactions to an average of 0.61 percent, from 0.7 percent.

### *NACHA UPDATE*

04/09 **Growth in Electronic Payments -** NACHA has reported that the number of ACH payments in 2008 has reached over 18.2 billion, growing by 1.2 billion over the previous year.  The portion of ACH payment volume passing through the ACH Operators has increased by 7.1 percent year-over-year to 14.96 billion, with $29.96 trillion in value. Internet-initiated ACH debits known as “WEB” entries increased 19.7 percent to almost 2.1 billion payments. When combined with consumer-initiated credit payments (CIE), the dollar value of consumer ACH payments made via the Internet totaled $939 billion in 2008. The number of EDI-formatted addenda records which have been transmitted via the ACH Network for invoice and other payment-related details rose by 14.6 percent year-over-year to 1 billion, while NACHA corporate trade exchange (CTX) payments and Cash Concentration or Disbursement (CCD) payments have grown by 16.1 percent and 17.9 percent, respectively. The volume of payments via back office conversion (BOC), which allows retailers that accept checks at the POS to convert eligible checks to ACH debits in the back-office, has increased by 1,772 percent in 2008 to 78.46 million payments. Federal government ACH payments grew 10.2 percent to 1.14 billion payments in 2008.

Date of
Last Change

03/09 **NACHA Proposed Rule Changes** - NACHA is developing a formal rules proposal and considering consolidating some or all of the three ACH SEC Codes: ARC, BOC and POP. Potential rules change may have an impact on your business if you convert checks to ACH at the lockbox (ARC), in the back office (BOC) or at the point of sale (POP).

Three possible approaches to SEC consolidation are:

1. Leave the current SEC codes in place, but work to simplify and align the ACH Rules for ARC, BOC and POP.
2. Simplify and align the ACH Rules for ARC, BOC and POP and also combine ARC and BOC into one SEC code.
3. Simplify and align the ACH Rules for ARC, BOC and POP and combine them into one SEC Code.

NACHA is also looking at Check 21 solutions and possible convergence of Check 21 with ACH. The passage of the *Check 21 Act* in 2003 – which created a new negotiable instrument or the substitute check – has enabled business customers to use remote deposit captures services to transit scanned checks to be deposited into a bank account.

NACHA is currently attempting to better determine how the current differing requirements for the three SEC Codes affect ACH participants and what impact combining them could have on the efficiency of the ACH Network.

# ISSUE ANALYSIS

## Credit Rating Agencies – Significant Reforms are Needed to Fix a Fatally Flawed System

*By Jeanine H. Arnett, Government Relations Manager, Association for Financial Professionals*

For nearly 100 years, credit rating agencies have been providing opinions on the creditworthiness of issuers of debt to assist investors. The Securities and Exchange Commission (SEC), banking regulators, and the Federal Government rely on ratings from rating agencies to make decisions that impact the American public. Recent turmoil in the U.S. credit markets, coupled with a growing distrust of the system itself has set the stage for fundamental reform and AFP has made two suggestions to help achieve that reform.

The model and structure of the ratings agencies is flawed and AFP believes that minor changes to current rules will not adequately address these flaws - **significant changes** are necessary in order to fix this inherently broken system. There is no doubt that that the credit rating process and investor confidence in those ratings are vital to efficient global capital markets. The ratings produced by Nationally Recognized Statistical Rating Organizations (NRSROs) must be sound and reliable if our markets are to operate in the way they were intended.

Since 2002, AFP has been a vocal advocate for the reform of the credit ratings industry. During that time, we conducted several surveys that found that both issuers of corporate/municipal debt and investors of corporate cash and pension assets believe: 1) the information provided by credit rating agencies is neither timely nor accurate, 2) the rating agencies are primarily serving the interest of their shareholders and other parties rather than investors, and 3) the SEC or some other regulatory body must increase its oversight of rating agencies and takes steps to foster greater competition in the market for credit rating information. We worked closely with key policymakers to successfully pass the *Credit Rating Agency Reform Act of 2006* (CRRA) which provided the SEC with the authority to make significant strides toward removing barriers to competition. Regrettably, passage of the CRRA has not led to real competition in the credit ratings market. AFP believes that tinkering with the current rules will not adequately address flaws – we must come up with a new approach.

**Limiting Mission of Rating Agencies**

On April 15, 2009, AFP unveiled two proposals to fundamentally change the current business models of credit rating agencies and alter the way the ratings business is run. The first proposal suggested a stand-alone model, where the only business of the credit rating agency would be to produce credible and reliable ratings. This model - similar in nature to a utility-would support ratings organizations whose *sole* business purpose would be to provide credible and reliable ratings. These new ratings organizations could be financed by a transaction fee levied on investors and issuers alike. As an example, the fee may be based on the amount of debt outstanding of an issuer or assets under management of an investor. The goal is to separate compensation from the actual ratings process. Rating agencies operating under this model would be able to interact with and advise organizations being rated, but could *not* charge fees for providing advice, as Moody's and S&P do today. AFP believes this model is a viable way to subsidize rating organizations dedicated to provide credible and reliable ratings as their sole business purpose. Additionally, this type of transaction fee model would have built-in price controls because it is based on a flat fee. With this stand-alone model, most of the conflicts-of-interest that the current CRAs have would be mitigated. By creating a funding source that is independent of the issuers and investors, the focus of the CRAs will be on producing the most accurate and timely credit analysis rather than satisfying the desires of any vested interest. However, the SEC would still have to exercise vigorous oversight of the CRAs to ensure that they are fulfilling their mission and are held accountable for inaccurate ratings.

**Ending Dependence on the "Big Two"**

The other proposal that AFP believes is worth exploring would be for the U.S. government to require itself and all federal programs that require credit ratings, as well as any business that has had a capital infusion from the U.S. government, to utilize the alternative NRSROs as additional credit analysis providers. This departure from tradition by such a key market participant would encourage the development of a truly competitive environment and give credibility to alternative rating agencies. Given the dominant market position that S&P and Moody's currently possess, the barriers to having one of the alternative NRSROs grow to the point of being an equal competitor seems remote. The U.S. government must break its own addiction to S&P and Moody's. These dominant players should not be rewarded for failure. We believe others should have the opportunity to take part in this industry if it is to be truly competitive. Under this proposal, the government, including the Treasury Department, would immediately begin to use alternative NRSROs rather than relying solely on those provided by S&P and Moody's. We further propose that federal agencies be required to utilize at least one non-issuer/non-subscriber service/new rating agency (as envisioned by our first proposal) for all transactions with underlying assets of $50 million or more.

Although corporate America currently has the ability to utilize alternative NRSROs, until these entities are viewed as being on a level playing field with the major ratings agencies, this is unlikely to occur. Individual companies will be unwilling to spend the time, resources, and money on ratings that aren't view as being "as good as" the majors. If the government were to support alternative NRSROs, they would have the opportunity to grow to be worthy competitors, establish reputations, and provide needed competition in the credit rating agency world.

The rating agencies are an ingrained component of the investment decision process, but they have clearly failed, as a group, to provide accurate and timely information to investors over most of this current decade. Over this timeframe, market participants have

Date of
Last Change

been punished severely, while the major rating agency management teams and shareholders have benefited greatly from 'cranking out' ratings without performing the necessary credit review and stress testing that is required by the SEC.

Over the past seven years, the AFP has posited that with increased competition and oversight, the inherent problems of having a government-created duopoly would be corrected. Given the utter failure of the rating agencies over the past several years to identify the credit crisis, AFP believes it is time to try a new approach to provide investors with the information they need to make prudent investment decisions.

AFP fully supports increased disclosure requirements, but we argue for model agnostic disclosure – it must be the same across the board for all NRSROs regardless of how they are compensated. Above all, whether we move to a different rating agency model or not, the SEC must enforce strong anti-conflict of interest rules. Recent history has shown that NRSRO's CANNOT police themselves.

It has been argued that professional investment managers do not require the analysis of rating agencies. Since their core business is making investment decisions, they should have the resources in place to perform their own robust due diligence. However, AFP is concerned about corporate America's ability to make prudent investment decisions in a timely and effective fashion. Given the highly competitive global economy we operate in, most of our membership is unable to allocate resources purely for the purpose of investment credit analysis. In order to participate in the purchase of securities other than the most safe type, i.e. U.S. Treasuries, companies need to be able to rely on third-party credit analysis as a basic credit framework. If investors do not or cannot rely on credit ratings, then ratings agencies serve no purpose in our economic system.

* * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * *

## -- Washington on the Web --

The AFP Web site is your direct link to current Washington activities impacting treasury and banking.  Links to the following sites, and others, are located at the Government Relations section of http://www.AFPonline.org.

| | |
|---|---|
| **Congressional Record** | http://www.access.gpo.gov/su_docs/aces/aces150.html |
| **Department of the Treasury** | http://www.ustreas.gov |
| **Federal Register** | http://www.access.gpo.gov/su_docs/aces/aces140.html |
| **Financial Accounting Standards Board** | http://www.fasb.org |
| **Federal Deposit Insurance Corporation** | http://www.fdic.gov |
| **Federal Reserve Board** | http://www.federalreserve.gov |
| **The Federal Web Locator** | http://www.infoctr.edu/fwl |
| ***FedWorld** | http://fedworld.gov |
| **Financial Management Service** | http://www.fms.treas.gov |
| **International Accounting Standards Board** | http://www.iasb.org.uk/cmt/0001.asp |
| **Office of the Comptroller of the Currency** | http://www.occ.treas.gov |
| **Securities and Exchange Commission** | http://www.sec.gov |
| **SEC EDGAR Database** | http://www.sec.gov/edgar.shtml |
| ****THOMAS** | http://thomas.loc.gov |
| **The U.S. House of Representatives** | http://www.house.gov |
| **The U.S. Senate** | http://www.senate.gov |
| **The White House** | http://www.whitehouse.gov |

## --Canada on the Web --

| | |
|---|---|
| **Canadian Payments Association** | http://www.cdnpay.ca/ |
| **Government of Canada** | http://www.canada.gc.ca |
| **Department of Finance** | http://www.fin.gc.ca |
| **Canadian Institute of Chartered Accountants** | http://www.cica.ca |
| **Canada Deposit Insurance Corporation** | http://www.cdic.ca |
| **Bank of Canada** | http://www.bankofcanada.ca |
| **Investment Dealers Association of Canada** | http://www.ida.ca |
| **Canada Customs and Revenue Agency** | http://www.tbs-sct.gc.ca |
| **Canada Pension Plan Investment Board** | http://www.cppib.ca |
| **Invest In Canada** | http://www.investincanada.com |
| **Canada Business Network** | http://www.cbsc.org |
| **Canada Mortgage and Housing Corporation** | http//www.cmhc-schl.gc.ca |
| **Auditor General of Canada** | http://www.oag-bug.gc.ca |

## --Europe on the Web --

| | |
|---|---|
| **European Commission Euro** | http://europa.eu.int/comm/economy_finance/euro_en.htm |
| **European Union General** | http://europa.eu.int/index-en.htm |
| **European Central Bank** | http://www.ecb.int/ |

* * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * *

* FedWorld is a central access point to locate and acquire government information

** THOMAS is the Library of Congress legislative information site