UBS

U.S. Office of Public Policy Washington Weekly

Under the dome: the week in review

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The UBS U.S. Office of Public Policy (the Office), located in Washington, D.C., publishes a weekly brief report on major public policy and political developments from Washington. The publication focuses on the public policy issues and debates that shaped Washington for the week, with a focus on financial services, tax and regulatory measures that affect UBS, its employees and clients. The report is written by the Office's bipartisan staff that lobbies on public policy issues every day and has decades of experience working with the Congress (for both Democratic and Republican members), the Executive Branch, the White House and the financial services industry.

This week: The Senate spent its week debating health care legislation and awaiting cost estimates of a potential final reform package that could be voted on next week. The House approved a $154 billion "jobs" bill and a number of measures, wrapping up its legislative work for the year. Legislation extending expiring laws, including trade preference programs, elements of the Patriot Act, funding for physician reimbursements in Medicare, jobless benefits, defense spending for 2010, and a very short-term increase in the federal government's legal debt limit were all approved by the House.

Next week: The Senate will continue working on health care legislation with a goal of approving it by December 24. It will also have to approve some of the same year-end provisions that the House voted on this week. Both chambers may have to return the week of December 28 to raise the federal debt limit on a longer-term basis.

UBS high priority activities

Financial regulatory reform. After the House passed reform legislation last week, the ball is now in the Senate's court. Senate Banking Committee Chairman Chris Dodd's (D-CT) bipartisan working groups continue efforts to hammer out a bipartisan deal on reform. Chairman Dodd and Ranking Member Richard Shelby (R-AL) are focusing on reducing the number of banking regulators and how to deal with consumer protection. Senators Jack Reed (D-RI) and Judd Gregg (R-NH) are discussing credit rating agencies and regulation of over-the-counter derivatives. Senators Chuck Schumer (D-NY) and Mike Crapo (R-ID) are working on corporate governance and executive compensation. Senators Mark Warner (D-VA) and Bob Corker (R-TN) are looking to reach agreement on how best to wind down failing large financial institutions and what regulations should apply to non-banks such as mutual funds and hedge funds. This process will continue into January.

New rules for investment accounts. The Securities and Exchange Commission (SEC) approved new rules, generated by the Madoff Ponzi scheme, to strengthen oversight of investment advisors and their custody of investors' funds. The new rules are aimed particularly at advisors who actually hold client assets or who have a degree of discretionary authority over such assets, whether the advisor actually holds them or not. All such accounts would be subject to examination annually by an independent public accountant, and the accounts involving direct custody of assets would be reviewed annually for the controls in place at the custodian. The SEC will now also require auditors of private fund advisers to be registered with the Public Company Accounting Oversight Board (PCAOB). The new rules take effect 60 days after they are published in the Federal Register.

12b-1 fees. Early next year, SEC Chairman Mary Schapiro will direct her staff to present recommendations on the future of 12b-1 fees. As part of her initiative to ensure investors understand the fees they are being charged and the services provided by investment professionals, Chairman Schapiro intends to examine changes involving more than an enhanced disclosure regime. She has cited the $13 billion annual cost of these fees as only one reason she believes they should be re-examined. With the current focus among regulators and Congress on investor protection issues, it seems more than likely the SEC will propose significant changes to the current 12b-1 fee structure.

Federal Reserve Chairman Bernanke. The nomination of Fed Chairman Ben Bernanke for a new term was approved by the Senate Banking Committee on a 16-7 vote. Senator Bernie Sanders (I-VT) has said he will filibuster the nomination when it reaches the Senate floor in January; this tactic will force the Senate leadership to produce 60 votes to bring debate to a halt and allow a vote on the nomination. Final approval of Bernanke will have to take place before his term expires at the end of January or the position will have to be temporarily filled, perhaps by Fed Vice Chairman Donald Kohn. While we expect Bernanke to be confirmed in January, he is likely to have 30 or more Senators voting against him.

Glass-Steagall Reinstatement? Senators Maria Cantwell (D-WA) and John McCain (R-AZ) introduced legislation this week to reinstate the Glass-Steagall Banking Act of 1933, which would effectively restore the prohibition against affiliation of commercial and investment banking. The Gramm-Leach-Bliley Act (GLB) of 1999 repealed the Glass-Steagall prohibitions but left in place the prohibition on commercial banks engaging in securities activities in place. Some in Congress have argued that GLB was in part to blame for the ongoing financial crisis. Senate Banking Committee Chairman Dodd, whose committee has jurisdiction over the bill, downplayed the bill's chances this week. Also, the House rejected an amendment as part of the House regulatory reform debate last week that would have reinstated Glass-Steagall. While this bill introduction makes good theatre and will generate some noise on Capitol Hill, it has little chance of enactment.

Other issues of interest

Healthcare. Senate Democratic leaders seem to have 59 votes locked up for their reform package, which leaves them just one vote shy. Whether they have the 60th vote or not, they intend to put in place the procedures to have a final vote on the bill on December 24. We believe the 60th vote (Nebraska Senator Ben Nelson) will be secured in the next few days after some intense arm-twisting by Senate Democratic leaders and the White House.

Tax extenders, not extended. More than 40 tax provisions, for both individuals and corporations, will lapse on December 31 after the House and Senate failed to reach agreement on their extension. It is likely that the tax provisions will be considered by Congress early in 2010, and possibly reinstated retroactively to January 1, but no timetable is set and delay could disrupt some industries that rely on certain tax credits. A summary of the House-approved tax provisions set to expire can be found at *http://waysandmeans.house.gov/media/pdf/111/Extenders_Summary.pdf*. Included in the summary is a tax increase on the "carried interest" of investment fund managers, which is not as popular in the Senate and will probably not be considered in earnest there until later in 2010.

Estate taxes. House and Senate leaders were unable to reach a solution for extending the estate tax before its expiration on December 31. Two-month, two-year, and permanent extensions were all considered this week, but Senate leaders were unable to broker a compromise. Under current law, the estate tax disappears entirely on January 1, and reappears in 2011 at a higher rate. For 2010, there is also a change in the cost basis of inherited assets. Next year, heirs selling assets over $1.3 million will have to pay capital gains taxes based on the asset's original value, not the value when received. Capital gains tax on assets under $1.3 million will still be based on the "stepped-up" value of the asset when received. The threshold amount is increased for surviving spouses. Despite its inaction, Congress is aware of the awkward policies that taxpayers potentially impacted by the estate tax now face, and Hill leaders intend to address them early in 2010.

"Jobs" legislation. The House passed a package of proposals designed to stimulate job creation and aid those who are without work. The measure includes $75 billion redirected from the TARP program to pay for infrastructure spending and assistance to states to help pay for police, teachers, and fire fighters. The Senate will act on "jobs" legislation early in 2010.

Immigration reform. A key group of Democrats in the House introduced comprehensive immigration reform legislation this week. With a poor economy and high unemployment, the political environment on Capitol Hill doesn't seem ripe for moving broad immigration reform, but there will nonetheless be an effort to advance the bill. The bill introduced this week attracted 90 co-sponsors and will put the estimated 12 million illegal immigrants in the U.S. on a path to legal citizenship and limit certain border security measures now in place, among other things. We believe this issue is too contentious to advance in any meaningful way next year, though it will be subject to lots of debate and stir passions in both parties in the process.

A final word

Census count. All Americans will receive a census form next month, and the replies will be the basis of the country's census count that will be completed by the end of 2010. The decennial census is always politically controversial, as many groups contend they have been misreported in the past. One census challenge this year will be counting citizens who have lost their homes due to foreclosure, as their addresses are in flux. The census is important because it provides a framework for distributing federal funds in many assistance programs, redraws the boundaries for congressional seats, and shifts the assignment of states' electoral votes in presidential elections. It is estimated that eight states (TX, AZ, FL, GA, NV, OR, SC, UT) will gain at least one congressional seat for 2012 and that potentially eleven could lose seats (OH, IL, IA, LA, MA, MI, MN, MO, NJ, NY, PA).