

## A Defining Fines Time; Corker-Warren; PLS Mortgages; P. Rico; For-Profit Colleges; Rating Agencies

### Financials

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#### **Mortgages: A Corker-Warren Reform-Bill "Plan B"?**

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#### **Rating Agencies: Franken's Time?**

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### Education

#### **For-Profit Colleges: House and Senate Signal Partisan Divide**

Prop school stocks mostly stabilized amid volatility last week, even as 12 Dem. Senators piled onto COCO's recent woes and House & Senate ed committees signaled directly opposed stances on ED's Gainful Employment proposals.

### Macro

#### **Congress: House and Senate Out For Independence Day**

Policy-related news flow will be extremely light. Fed Chairman Yellen will speak at the IMF Wednesday morning, July 2, as observers await the Obama administration's next moves on Iraq.

### **Also Inside**

- **Non-financial quick takes for the Week of June 30: Energy; Health Care; Telecom, Media & Tech; Defense and Infrastructure** (click [here](#) for the full report).
- **Capital Alpha's newly-launched "10 Trending Policy Issues for Investors"** (available [here](#)).

June 30, 2014

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### **Tickers**

Student Loans: SLM, NAVI, NNI

Payday Lenders/Installment Loans:

CSH, DLLR, FCFS, QCCO, EPPZ, WRLD

Auto Lenders/Auto Dealers:

ALLY, TD, F GM, GPI, SAH, ABG, LAD, PAG, AN, KMX

Campus-based Debit: ONE, HPY

Prepaid Cards: GDOT, NTSP,

TPNL, AXP, V, MA, DFS

Banks: JPM, BAC, WFC, C, RDN

Mortgage Insurers/Non-bank

Servicers: MTG, GNW, ESNT, NMIH, OCN, NSM, WAC

Homebuilding/Retail: PUL, TOL,

PHM, LEN, HD, LOW

GSE Common/Preferreds: FNMA,

FMCC, FNMA, FMCKJ

Exchanges: CME, ICE, GS, MS,

BAC, C

Mutual Funds/Asset Managers:

FII, BLK, SCHW

Insurance: MET, PRU, AIG

## This Week's DC Financial Catalysts

### **MULTI-DAY**

*The House and Senate will be in recess from June 30 - July 4*

*Healthcare:* [CMS could propose hospital outpatient, physician, ESRD and home health rates](#)

*Healthcare:* [Potential for release of 340B "mega-reg", though recent litigation could cause delay](#)

*Financials:* [Insured Retirement Institute holds gov't, legal and regulatory conference](#) - June 30- July 1

### **MONDAY - June 30th**

*Defense:* [CSIS holds an event on Russian defense capabilities and security strategy](#) - 9:00 AM

*Healthcare:* [SCOTUS decision expected in \*Sebelius v. Hobby Lobby Stores\*](#) - 10:00 AM

### **TUESDAY - July 1**

*Defense:* [CSIS holds event on the Joint Multi-Role Technology Demonstration \(BA, UTX\)](#) - 8:30 AM

*Healthcare:* [D.C. Circuit Court decision possible in \*Halbig v. Sebelius\*](#) - 10:00 AM

*Telecom & Media:* [Release of final agenda for July 11 FCC open meeting](#)

*Energy:* [CSIS hosts event on EU energy security and transatlantic cooperation](#) - 1:00 PM

### **WEDNESDAY - July 2**

*Financials:* [Fed Chair Yellen to speak at IMF. IMF Director Lagarde to follow with Q&A](#) - 11:00 AM

### **THURSDAY - July 3rd**

*Infrastructure:* [Capital Alpha's Loren Smith will hold a Highway Trust Fund conf call](#) - 11:00 AM

*Healthcare:* [Pre-holiday "trash day" presents opening for employer mandate delay or water-down](#)

### **FRIDAY - July 4th**

*Telecom & Media:* [Release of final agenda for July 11 FCC open meeting](#)

Download a PDF of the full DC Catalyst Calendar [here](#).

**Financials** - Charles Gabriel & Joseph Engelhard

**Banks: \$9 Billion BNP Settlement A Signal for Future Fines**

We believe BNP's settlement, likely this week, is just the latest step in the growing politicization of bank enforcement cases. LIBOR & FX cases are likely, but there may not be enough evidence to obtain large settlements.

The investigations of BNP Paribas by the the NY Department of Financial Services and the Department of Justice into violations of U.S. sanctions law appears to be near a final agreement. As we have noted previously, we are most concerned by the apparent policy decision at the DOJ to seek maximalist criminal charges as well as the highest possible settlement amount. Given the massive amount of dollar transactions involved in the investigated trade finance and other banking transactions executed by BNP with respect to Iran and Sudan, there is at least some justification for such a large fine compared to other sanctions cases. We remain concerned, however, that the real impetus behind the DOJ's new approach to bank investigations is ultimately political. This theory may be tested by the ongoing LIBOR and FX trading investigations, in which we expect at least a few U.S. banks will be hit with similarly high settlement demands. But unless there is sufficient evidence to justify multi-billion dollar settlements, we believe it is possible that the banks, whether U.S. or foreign based, may object to any demands that are not justified by the evidence.

**Puerto Rico: Constitutional Suit v Debt Restructuring Likely to Fail**

While there is significant merit to the legal challenge against Puerto Rico's new law allowing restructuring of revenue bonds, absent economic growth a default is likely.

The biggest problem with investors' legal challenge to the new Puerto Rico (PR) law that creates a mechanism for restructuring its revenue bonds is that even if they were to succeed, it may be a pyrrhic victory. It could be very hard to enforce such a decision if the relevant municipal authority does not have sufficient money to continue operating and pay back bondholders. So far, few appear to be reading the law's passages as a threat for the government obligation (GO) bonds as well. GO bonds are not included in the new law and the PR constitution provides specific protections for GO bonds against default. In the case of GO bonds, the PR constitution ensures they receive payment priority. There is no similar provision in the PR constitution for revenue bonds, and presumably that is the reason why PR authorities appear to have decided to prepare for an eventual restructuring of at least the worst performing municipal authorities.

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**Mortgages: A Corker-Warren Reform-Bill "Plan B"?**

On top of a *National Journal* article musing that he might be angling to run for the presidency, Sen. Bob Corker (R-TN) may soon introduce a Fannie-Freddie bill with liberal Sen. Liz Warren (D-MA).

We have noted chatter about a notional joint offering from the two senators for several weeks, expressing curiosity about any additional affordable housing-related concessions the ambitious Tennessee "deal-maker" (Corker) might make and whether the increasingly-watched progressive standard-bearer (Warren) might meet him halfway.

It's almost certain that any new template will fall short of spurring Senate floor action this summer, as there are barely two dozen legislative sessions remaining before scheduled adjournment. Meanwhile, we also find doubtful that any new outline might move the needle in the next Congress.

To begin with, minority and low income housing advocates were, in our view, cheered by the underwhelming committee vote on the Johnson-Crapo bill, which would eliminate the GSEs' affordable housing goals as part of the reform outline advanced by Corker along with moderate Virginia Democrat Mark Warner in 2013. [These groups vocally reject that the GSEs' goals were behind the crisis, and are increasingly turning up the heat on FHFA Director

Mel Watt to turn them back on, administratively.] This raises the question of just how far Warren might go in response to frustrated post-vote spin from the White House (to the effect that Fannie and Freddie still pose far greater risks to housing stakeholders and taxpayers than generally perceived). We think not far.

Of even greater fascination is that Corker's efforts come amid heavy Republican anticipation of taking back the Senate. This reportedly produced back-room lobbying from Sen. Richard Shelby (R-AI) against the Johnson-Crapo bill, which: 1) he almost surely would write quite differently as the next Banking Committee chairman; and 2) might be moved even further to center-left in any deal that Corker and Warren might agree to.

As one source recently observed upon the arguable failure of Johnson-Crapo in committee, Corker was widely seen by many Hill Republicans as once again "way over his skis" - with Crapo possibly erring (politically) by following his lead. Meanwhile, the litany of episodes wherein the former Chatanooga mayor has taken stances ultimately at odds with his party caucus seemed well documented (albeit not purposefully) by the *National Journal's* Michael Catalani in a June 26 [article](#).

In early 2010, for instance, Corker infuriated Shelby and other conservatives by trying to work on his own with then-Sen. Chris Dodd (D-CT), ultimately helping to produce what became the Dodd-Frank Act. Facing a GOP Senate Banking caucus arguably more disunited as a result of Corker's free-lancing, then-ranking-Republican Shelby felt compelled to drop dozens of blocking amendments in the panel, allowing the bill to squirt through to the Senate floor. Amid burgeoning populist fever fanned by the Obama White House (which had just been burned by the initial ACA-related Tea Party rebellion that saw Scott Brown defeat Martha Coakley for then-deceased Teddy Kennedy's Massachusetts Senate seat), the final Senate version went on to carry some of Dodd-Frank's most controversial and pro-cyclical provisions, including the Durbin debit interchange amendment, the Volcker amendment, the Lincoln swaps push-out bill, and Sen. Susan Collins' (R-ME) amendment dealing with TRUPs and minimum bank capital requirements.

In 2013, meanwhile, "Corker wrote a border-security amendment that pushed an overhaul of the immigration system through the Senate against conservative opposition," Catalani added. He more recently cast procedural votes along with Democrats to advance a minimum-wage bill and student-loan legislation—"both Democratic election-year priorities. And now, he's working with Sen. Chris Murphy of Connecticut on a long-shot plan to shore up the depleting Highway Trust Fund and offering a plan that would hike the gas tax."

In short, along with a low rating from conservative groups like Heritage Action, the engaging and energetic Corker may be earning a reputation as a John McCain-like maverick. But his leadership role on GSE reform may already be reaping diminished returns.

### **Rating Agencies: Franken's Time?**

Perhaps pressured by Democrats worried about Sen. Franken's (D-MN) at-risk Senate seat, the SEC may soon follow through with benign new rating agency rules calling attention to the former comedian's related (DFA) amendment.

The *Wall Street Journal* [flagged](#) a perhaps imminent SEC announcement last Wednesday (June 25). Meanwhile, we listed the issue as one of our [Trending Ten](#) catalysts last Friday.

Our expectation has been that, while the Commission will devote much of its effort to bolstering protections against conflicts of interest between analysts' rating efforts and companies' marketing (e.g., through bolstering of Rule 17g-5 to encourage unsolicited ratings), a slightly more provocative package of reforms could mirror the Europeans' adoption of forced-rotation rules. We doubt much, if any, material effect, regardless.

**Education** - *Charles Gabriel*

Prop school stocks mostly stabilized amid volatility last week, even as 12 Democratic senators piled onto COCO's recent woes and House and Senate education committees signaled directly opposed stances on ED's Gainful Employment proposals.

As we noted during our June 19 [Spotlight Call](#), we expect Corinthian College's funding problems to prove unique, with perhaps a troubled institution or two to follow but most others surviving. With at least some hope of modest regulatory relief from a more Republican 114th Congress, this could empower those schools emerging as innovators to further adapt to the new paradigm slowly gripping the entire higher ed sector.

Last week's events were remarkable, nevertheless, in that they represented the equivalent of a pre-July 4 shoot-out, ahead of the encroaching August recess and scheduled adjournment in early October.

Long-time industry nemesis Sen. Richard Durbin (D-IL) co-authored a June 25 [letter](#) urging Education Secretary Arne Duncan to "protect students while continuing to hold Corinthian Colleges, Inc. accountable, including immediately prohibiting them from enrolling any new students."

The letter goes on to starkly cast COCO's fate -- but to project opportunity along with associated risks for related institutions' attendees: "After failing to provide required data to the Department of Education about its practices, including falsifying job placement data used in marketing claims to prospective students and allegations of altered grades and attendance, Corinthian has now agreed to sell or close its campuses across the country. This places the company's 70,000 current students at risk, but also presents the opportunity to find better educational opportunities for these students. The for-profit college is currently under investigation by 20 states, the Consumer Financial Protection Bureau, the U.S. Department of Justice, and the Securities and Exchange Commission."

Meanwhile, Senate HELP Chairman Tom Harkin (D-IA) proposed a stricter 90-10 rule and marketing restrictions for prop schools in a draft Higher Education Act (HEA) reauthorization [bill](#) introduced the same day. And the Republican-led House Education & the Workforce Committee followed the next day by rolling out three separate bills comporting with a broad [white paper](#). As we've expected, the GOP majority calls for, among other things, repeal of the Obama administration's emerging "Program Integrity" rules, dealing most notably with outcomes-based "Gainful Employment" criteria that for-profit vocational schools would have to adhere to in order to stay eligible for Title IV student aid.

Under a section dubbed "Promoting Innovation, Access, and Completion", the EWF white paper focused more surgically on "Eliminating Overly Burdensome Federal Regulations."

It read:

"Beginning in 2010, the Department of Education released several regulations purportedly to improve the integrity of student financial aid programs. Two of these so-called "program integrity" rules expanded federal authority into areas historically reserved for states and institutions. A third regulation would impose federal cost controls on institutions and make it more difficult for disadvantaged students to receive a postsecondary education. Taken together, these regulatory schemes will impede innovation, usurp the authority of decision-makers at the state and institutional levels, and hurt some of the nation's most vulnerable students.

"Leaders in the higher education community, the federal court system,<sup>18</sup> and a bipartisan coalition of congressional members have firmly rejected these regulations.<sup>19</sup> The federal government should not be used to unjustly penalize institutions preparing individuals to succeed in the workforce. Furthermore, the right of each student to attend the institution of his or her choice must be protected."

Separately, the House Republicans also pledged to prevent the administration's proposed federal government rating system for all colleges:

"Members of the committee are deeply concerned about the Postsecondary Institution Ratings System (PIRS) being developed by the Department of Education. This is an attempt by the administration to rate institutions based on access, affordability, and student outcomes. The administration is then expected to tie these ratings to an institution's eligibility to participate in federal financial aid programs. While we must increase transparency, it is not the role of the federal government to impose a one-size-fits-all formula that arbitrarily rates institutions, especially when we know that selecting a college or university is a uniquely personal decision for each student and family. The PIRS will unfairly judge our nation's diverse colleges and universities, restrict consumer choice, confuse families, and limit postsecondary options for low- and middle-income students. Rather than implementing an arbitrary ratings scheme that attempts to dictate students' needs, the federal government should provide useful information so students can make the best possible decision."

Our bottom line continues to be that we would expect worrisome 90-10 changes to be rejected by a Republican-led HELP Committee, under likely Chairman Lamar Alexander (R, TN). Such changes would continue to be opposed by House Republicans, in any event, so the for-profit industry would seem at least somewhat insulated regardless of election outcomes this November. Meanwhile, we would also anticipate resistance to the administration's broader higher ed "scorecard system" (i.e., the PIRS) to be used by the GOP as a leveraging tool in negotiations with the White House.

**Macro** - Charles Gabriel and Loren Smith

#### **Congress: House and Senate Out For Independence Day**

Policy-related news flow will be extremely light. Fed Chairman Yellen will speak at the IMF Wednesday morning, July 2, as observers await the Obama administration's next moves on Iraq.

#### **Upcoming Capital Alpha Events**

[July 3: Highway Trust Fund Spotlight Call](#)

Contact [Rich Linville](#), [Tom Butler](#), or [Courtney Oldham](#) for further details about Capital Alpha's research. MP3 replays of our past calls are also available upon request.

Other notes today from Capital Alpha below (with extended commentary available [here](#)).

**Multi-Industry** - Loren Smith

#### **Congress Might Let Transportation Funding Slow Down**

In August the U.S. Department of Transportation will have to slow down payments by 25-30% as the Highway Trust Fund balance falls towards zero. Congress is working on a bailout, but might not get there.

#### **Highway Trust Fund Conference Call Thursday at 11:00 AM ET**

Loren Smith will host Capital Alpha's Spotlight Call this week to address the possible tax implications of a Highway Trust Fund bailout.



### **Railroads/Crude-by-Rail: New Rules Might Wait Until After Elections**

We've expected for some time that the Obama administration would unveil new rail safety rules this summer. However, it now seems possible that the administration might choose to wait until after Election Day.

### **Healthcare - Kim Monk and Rob Smith**

#### **ACA: Hobby Lobby Supreme Court Decision Day**

We see negligible impact on the health sector if SCOTUS overturns the ACA's contraceptive coverage mandate given the high levels of contraceptive and other benefits in employer-sponsored plans prior to the ACA's enactment.

#### **CMS Issues Exchange Auto Renewal Reg**

In an effort to maintain enrollment, CMS last week published guidance allowing most individuals to continue to receive exchange coverage and subsidies in 2015 automatically.

#### **Physician, Outpatient, Lab, Home Health and ESRD Rates**

CMS is expected to issue several major 2015 rate proposals this week. Overall, we believe the proposals will be fairly benign, but home health could another round of cuts, and we're looking for clues on lab reform implementation.

#### **Republicans Question FDA's Proposed Generic Labeling Rule**

The House Judiciary Chairman and Senate HELP ranking member sent a letter to the White House budget office questioning FDA's legal authority to implement its controversial and potentially costly generic labeling proposal.

### **Telecom & Media - Robert Kaminski**

*After the broadcasters' win in the Aereo Supreme Court case last week, we run through the next policy catalysts for broadcasters.*

#### **Broadcast Spectrum Auction: Pricing This Summer**

How many stations might turn in their spectrum to the FCC in exchange for money? Proposed spectrum prices are coming this summer and the auction in mid-2015.

#### **STELA Bill in Congress as Vehicle for Broadcast Items**

What other broadcast items might be attached to this satellite legislation? The Senate version should come this summer/fall and finalized before year-end.

#### **JSA/SSAs: M&A Overhang for Next Two Years**

When will pending deals be approved and how will future deals change? The 2-year JSA compliance period has begun with potential new waiver rules later this year. SSA deal guidance decreases company clarity.

### **Defense - Byron Callan**

#### **Main Defense Catalysts for 2H 2014**

We see the main defense catalysts in 2H 2014 as the NATO Summit, the mid-term election in the U.S, and macro-GDP expectations. Wild cards include the influence of geopolitical developments on defense plans.

#### **Defense Week Ahead**

CSIS is holding a June 30 event on Russian defense capabilities and strategy and a July 1 event on Joint Multi-Role technology. JMR aims to advance vertical lift and may be of interest to BA, TXT, and UTX.

**Capital Alpha: Ten Trending Policy Issues for Investors**

*We recently launched our quick takes on the top policy issues for institutional investors. This "Trending Ten" will be updated regularly.*

Download the full report with detailed coverage [here](#).

*Halbig* decision on insurance subsidies through federal exchanges could upend ACA, roil hospitals & managed care (**HCA, THC, UHS, CYH, WLP, AET, HUM**).

Claims that brokers (**BCS, AMTD**) favor HFT over investors will drive SEC to heighten dark pool scrutiny, benefiting lit exchanges (**NDAQ**).

Highway Trust Fund payments could slow 25-30% by August. Tax proposals - repatriation, inversions, etc - are not likely to be adopted.

Capital standards for insurers likely to pass pre-recess to the benefit of **PRU, AIG, MET**. 90% odds. Stress tests may still hinder capital management.

Tax inversion chatter increases, though tax reform remains distant and uncertain. Wyden schedules SFC hearings for June/July (**WAG, PFE/AZN, MDT/COV**).

Ex-Im could lapse Oct. 1, amid House GOP resistance. However, reauthorization w/ significant reforms likely after Election Day (**BA** & suppliers, **CAT**).

Final QRM standard will sync MBS risk-retention safe harbor with CFPB's QM rule. Mortgage insurers win, ahead of FHFA min capital decision.

Crude export dam not bursting, but splitter builds undermined by **PXD, EPD** export permit. Refiners to recover until next policy change, likely in 2015.

SCOTUS to issue contraceptive coverage decision in *Hobby Lobby* on 6/30. Our contrarian view: It will have limited impact on the health sector or ACA.

Hill pressure amid risk to Al Franken's (D-MN) Senate seat will finally spur benign SEC rating-agency rules to highlight his DFA amendment



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**Analyst Certification**

The following analysts hereby certify (1) that their views about any and all of the subject companies and securities discussed in this report are accurately expressed and (2) that no part of their compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in this report: Charles Gabriel, Joseph Engelhard, Loren Smith, Robert Rose.

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