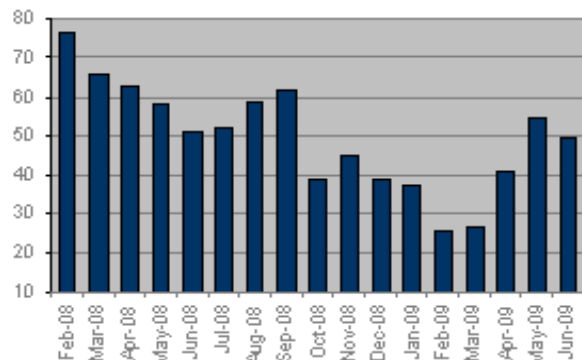


## CHART OF THE DAY

### U.S. Consumer confidence



U.S. consumer confidence index took an unexpectedly steep slide in June to 49.3 from 54.8 in May, suggesting the 18-month-long recession had yet to loosen its grip on the economy.

## TODAY'S TOP NEWS

- Gloomy U.S. consumers clip housing recovery hopes
- U.S. mortgage bond issuance plunges in 1st half
- Fed's Bullard- policy to stay very loose for while
- Obama admin. sets wide scope for consumer agency
- Chrysler, Honda join TALF; sale boosted to \$8.1 bln
- British Q1 GDP posts biggest fall since 1958
- Euro zone inflation negative for first time in June
- AIG gets new directors at subdued annual meeting
- Benchmark rates at lows as H1 ends smoothly

## ECON WATCH

FOR WEDNESDAY JULY 1

ET	Indicators	Unit	Reuters	Prior
-	CA Market holiday			
2:00	DE Retail sales mm real	%	-0.1	0.5
3:48	FR Markit/CDAF Mfg PMI	ind	45.5	43.3
3:53	DE Markit/BME Mfg PMI	ind	40.5	39.6
3:58	EZ Markit Mfg PMI	ind	42.4	40.7
4:28	GB CIPS/Markit Mfg PMI	ind	46.5	45.4
8:15	US ADP National Employ	k	-393	-532
7:30	US Challenger layoffs	ind	-	111.2
10:00	US Construct spending mm	%	-0.5	0.8
10:00	US ISM Manufacturing PMI	ind	44.5	42.8
10:00	US ISM Mfg Prices Paid	ind	46.7	43.5
10:00	US Pending sales chng mm	%	0.0	6.7
-	US Domestic car sales	mln	3.33	3.35
-	US Domestic truck sales	mln	4.00	4.03
-	US Total Vehicle Sales	mln	9.81	9.83

## MARKETS TODAY

**TODAY'S TOP STORY:** U.S. consumer confidence took an unexpectedly steep slide in June, figures showed, suggesting the 18-month-long recession had yet to loosen its grip on the economy.

**For more please click here**

**TREASURIES:** U.S. government bonds were little changed as weak stocks kept a floor under safe-haven Treasuries while thin trading conditions left the market choppy. Treasuries had earlier fallen as traders booked profits on recent price gains and a report showing home price data that was not quite as dire as forecast.

- 30-yr bond fell 20/32 in prices for a yield of 4.32 pct from 4.28 pct on Monday.
- 10-yr Treasury fell 13/32 in prices yielding 3.53 pct from 3.48 pct.
- 2-yr Treasury yield rose to 1.12 pct from 1.1 pct.
- 2-10's part of yield curve steepened by about 3 bps to 241 bps.

**FOREX:** The dollar gained against a basket of currencies after a report showing an unexpected drop in U.S. consumer confidence for June, prompting investors to seek shelter in the greenback.

- The euro fell 0.38 pct against the dollar to \$1.4024, earlier it hit as high as \$1.4152.
- The dollar rose 0.21 pct to 96.3 against the yen.
- The dollar index rose 0.47 pct to 80.21.

**CORPORATES:** U.S. corporate bond spreads were fairly steady as the market closed out a stellar first half and investors mulled whether the country faces a feeble economic recovery.

- The CDX-IG.12 index tightened by about 4 bps to 131 bps.
- Oracle Corp launched a three-part sale which includes \$1.5 bln 5-yr notes launched at 120 bps, \$1.75 bln 10-yr notes launched at 155 bps and \$1.25 bln 30-yr bonds launched at 185 bps more than Treasuries.
- U.S. IG corporate bond sales fell to \$384 bln in first half, from \$503 bln last year.

**STOCKS:** U.S. stocks slid as a surprising drop in a gauge of consumer confidence sparked caution about the economy's recovery prospects, hurting industrial, technology and energy shares.

- Dow fell 0.96 pct 8,447.53, S&P was down 0.85 pct to 919.35 and Nasdaq dropped 0.49 pct to 1,835.04.
- Since its 12-year closing low on March 9, the S&P 500 is up 35.6 pct.
- S&P financials index fell 1.11 pct, S&P energy index fell 0.76 pct and S&P automobile index rose 3.53 pct.

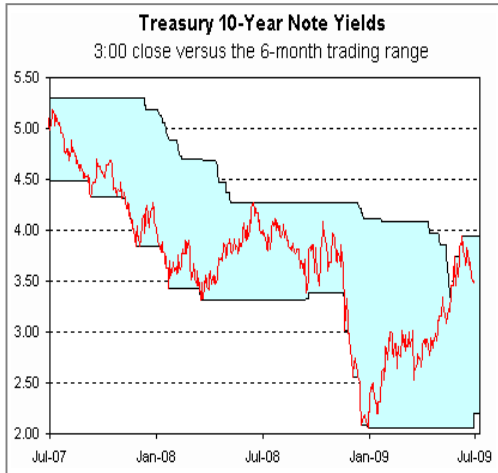
**C & E:** Oil fell after a drop in U.S. consumer confidence data in May added to concerns over a potential economic rebound.

- U.S. crude fell 2.01 pct to \$70.05 a barrel.
- Gold fell 1.06 pct to \$927.1 an ounce.
- The Reuters-Jefferies CRB index was down 1.71 pct to 249.96.

- For MARKET SNAPSHOT click here
- For NEXT UP click here
- For DEEP DIVE click here



MARKET SNAPSHOT as of 3:00 pm EST



TREASURIES <5> <500>

	BID	ASK	YIELD	CHANGE
1-Mo Bill	0.130	0.095	0.132	0.011
3-Mo Bill	0.190	0.175	0.193	0.016
6-Mo Bill	0.355	0.330	0.361	-0.006
1-Year	0.475	0.470	0.483	0.031
2-Year	100.016	100.047	1.118	-0.023
3-Year	100.742	100.781	1.617	-0.008
5-Year	100.359	100.398	2.548	-0.102
7-Year	100.328	100.375	3.197	-0.156
10-Year	96.750	96.813	3.517	-0.273
30-Year	99.125	99.188	4.302	-0.227

EQUITIES

	INDEX	CHANGE
DJIA	8418.96	-110.42
NASDAQ	1831.68	-12.38
S&P 500	916.14	-11.09

OIL

	PRICE	CHANGE
NYMEX	69.9	-1.6
BRENT	69.3	-1.7

EURODOLLAR FUTURES

	CLOSE	CHANGE
Jul-09	99.393	0.003
Sep-09	99.335	0.005
Dec-09	99.105	0.010
Mar-10	98.835	0.010

FUTURES

	PRICE	CHANGE
CBOT 5 yr	114.80	-0.07
CBOT 10 yr	116.36	-0.09
CBOT 30 yr	118.41	-0.16

REPURCHASE AGREEMENTS

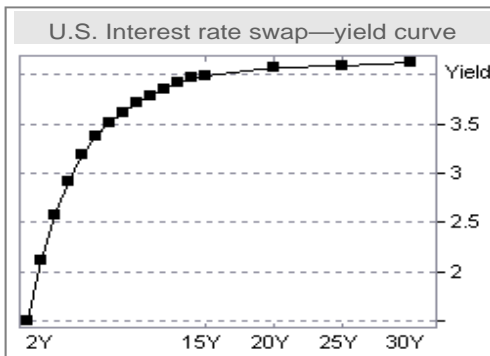
G/C		MORTGAGE REPOS	
O/N	0.150	O/N	0.200
2-Week	0.250	2-Week	0.300
1-Month	0.250	1-Month	0.300
3-Month	0.300	3-Month	0.350
AGENCY REPOS		i-REPO <sup>SM</sup> INDEX	
O/N	0.200	10:00 AM	0.050
2-Week	0.300	3:00 PM	0.099
1-Month	0.300		
3-Month	0.350		

IR SWAPS <19901>

	SPREAD		RATE	
2-Year	39.75	43.75	1.51	1.53
3-Year	50.25	54.25	2.12	2.13
5-Year	39.25	43.25	2.94	2.94
7-Year	19.75	23.75	3.39	3.38
10-Year	22.25	26.25	3.73	3.72
30-Year	-16.00	-12.00	4.14	4.12

EURODOLLAR DEPOSITS & OIS STRIPS (ASKED)

	BID	ASK	BID	ASK
O/N	0.200	0.250		
1-Month	0.250	0.650	0.202	0.212
3-Month	0.450	1.050	0.219	0.229
6-Month	0.900	1.400	0.264	0.274
12-Month	1.400	2.050	0.480	0.490



CURRENCIES

	BID	ASK
Euro	1.4034	1.4036
Sterling	1.6459	1.6464
JP Yen	96.31	96.34
Swiss Franc	1.0860	1.0864
Can Dollar	1.1620	1.1626
Mexico	13.1601	13.1672

FED FUNDS NYFR<sup>SM</sup> - 10AM

Open	0.2400	1m	0.3344
High	0.4000	3m	0.6211
Low	0.0625		

ACTIVE FANNIE MAE AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD	YIELD
2-Year	1.375	28/04/2011	16 14.5	1.28
3-Year	1.875	20/04/2012	17 0	1.79
5-Year	3	28/07/2014	38.5 0	2.93
7-Year	5	15/03/2016	35 0	3.52
10-Year	-	-	- -	-
30-Year	6.625	15/11/2030	55.25 54.75	4.86

ACTIVE FREDDIE MAC AGENCIES

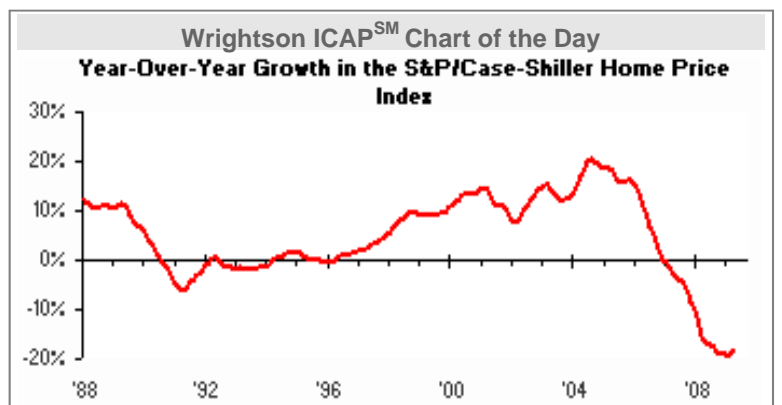
TERM	COUPN	MATURITY	YIELD-SPREAD	YIELD
2-Year	1.625	26/04/2011	16 14.5	1.28
3-Year	1.75	15/06/2012	24.5 24	1.86
5-Year	2.5	15/05/2014	33 0	2.89
7-Year	4.75	19/01/2016	28 0	3.46
10-Year	3.75	27/03/2019	42.5 0	3.93
30-Year	6.25	15/07/2032	46 45.5	4.76

Active MBS 15YR

	CPN	BID	ASK	YIELD
FNMA	5.0	103.1610	103.1810	3.697
FHLMC	5.0	103.1310	103.1510	3.729
GNMA	5.0	103.1900	103.2100	3.937

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	5.5	103.0810	103.1010	4.198
FHLMC	5.5	103.0810	103.1010	4.198
GNMA	5.5	103.0910	103.1110	4.446



## TODAY'S TOP NEWS

**Gloomy U.S. consumers clip housing recovery hopes**

U.S. consumer confidence took an unexpectedly steep slide in June, figures showed, suggesting the 18-month-long recession had yet to loosen its grip on the economy.

The consumer confidence index fell to 49.3 in June from 54.8 in May. Economists polled by Reuters had expected a healthier reading of 55.0 for the month.

A separate report on April house prices in major cities offered some encouraging signs that the worst of the housing slump may be over, but that was not enough to lift investors' spirits.

S&P's/Case Shiller home price indexes showed prices of single-family homes declined in April from the prior month, but the pace of the slide moderated. The index of 20 metropolitan areas dipped 0.6 percent in April from March, after a 2.2 percent decline the month before, for an 18.1 percent downturn from a year earlier.

The ISM-Chicago business barometer rose to 39.9 from 34.9 in May. Economists had forecast the index at 39.0.

The index of current business conditions tumbled to 44.8 in June from 61.3 in May, while the six-month outlook index rose to 58.3 from 56.1 a month earlier.

**Fed's Bullard- policy to stay very loose for while**

Very accommodative Federal Reserve monetary policy will stay for an extended period and a premature exit from this strategy could thwart U.S. economic recovery, a top Fed official said.

But St. Louis Federal Reserve Bank President James Bullard said having a plan to withdraw the Fed's massive expansion of the U.S. monetary base was important to control inflation expectations. And he said that selling Fed-owned assets was probably the most likely way it would choose to go.

Separately, World Bank President Robert Zoellick said global financial markets have "broken their fall" but urged caution, saying there was still a lot of uncertainty as the crisis shifts to developing countries.

**Chrysler, Honda join TALF; sale boosted to \$8.1 bln**

The fifth round under the Federal Reserve's TALF program grew to \$8.1 billion and is largely being shaped by auto ABS issuers as two new deals join the queue of securities offered ahead of the July 7's subscription deadline.

Honda Auto is the latest auto ABS issuer to join July's lineup of issuers. Its deal includes \$1.5 billion of securities backed by auto loans.

Another \$1.2 billion of TALF-eligible auto ABS will come from Chrysler Financial Auto through lead manager Deutsche Bank and includes AAA-rated one-year and two-year notes, market sources said.

**British Q1 GDP posts biggest fall since 1958**

The British economy shrank at its fastest pace in more than 50 years in the first three months of 2009 and has been in recession for a whole year, boosting expectations ultra-loose monetary policy could get even looser.

But economists said the revised official GDP data raised the chances the Bank of England would boost its 125 billion pounds quantitative easing program to support the economy, especially as inflationary pressures were seen weaker now.

GDP fell by 2.4 percent in the first quarter, the biggest decline since Q2 1958 and much worse than the 1.9 percent decline published last month because of downward revisions to services and construction output.

**U.S. mortgage bond issuance plunges in 1st half 2009**

U.S. mortgage-backed securities issuance plunged in the first six months of 2009, compared with the same period a year ago as uncertainty held sway over the housing market and investors shied away from risky instruments, a survey showed.

Thomson Reuters said U.S. mortgage-backed securities issuance totaled \$87.5 billion in the first half of 2009, down sharply from \$143.2 billion in the same period a year earlier, a drop of 38.9 percent.

The vast majority of new-issue activity came from Fannie Mae, Freddie Mac and Ginnie Mae, but the market began to see a bit of activity in the private-label residential mortgage market in the second quarter, said Matthew Toole, an analyst in the deals group at Thomson Reuters.

In a separate report, U.S. high-grade corporate bond sales fell in the first half as financial firms shifted issuance to government-backed debt, while junk bond sales surged as risk appetite returned, data showed.

Excluding government-backed sales, investment-grade corporate bond sales fell to \$384 billion from \$503 billion a year earlier, according to Thomson Reuters data.

**Obama admin. sets wide scope for consumer agency**

A new U.S. agency would have sweeping powers to write and enforce tough consumer protection rules for banks, mortgage lenders and other financial institutions under proposed legislation the Obama administration sent to Congress.

The proposed Consumer Financial Protection Agency aims to protect Americans from abusive practices employed during the recent housing and credit boom, such as deceptive and undocumented mortgage lending, poor loan disclosures, unfair interest rate increases and "fee traps" on credit cards.

The proposal would consolidate financial consumer protection power in a single new agency, stripping this authority from six current regulators, including the Federal Reserve and the Office of the Comptroller of the Currency.

A Treasury official said the agency will be focused primarily on credit products such as mortgages, credit cards and other consumer loans, savings products and payments services, such as electronic funds transfers.

**Euro zone inflation negative for first time in June**

Euro zone inflation dipped into negative territory for the first time in June as consumer prices fell 0.1 percent year-on-year, slightly less than expected, data showed.

The flash estimate from Eurostat compared with unchanged consumer prices in the 16-nation currency area in May. June marked the first month of negative inflation since the creation of the euro zone in 1999. Economists polled by Reuters had expected inflation to be -0.2 percent in June.

Separately, Euro zone annual loan growth to the private sector slowed to 1.8 percent in May from 2.3 percent in April, its lowest level since data series began in 1992. Annual growth of M3 money supply slowed to 3.7 percent from 4.9 percent in April, compared with the 4.6 percent expected by economists and the lowest since April 1997.

**AIG gets new directors at subdued annual meeting**

American International Group Inc got a new slate of government-backed directors at a subdued annual meeting, effectively revamping its board after the insurer's \$180 billion taxpayer bailout.



## TODAY'S TOP NEWS

Liddy, a former chief executive of Allstate Corp who had viewed his leadership of AIG as temporary, said he was confident the board would soon name a new chairman and CEO. Liddy said the company had agreed to sell 25 assets so far and that there was "an excellent chance" the government would be repaid.

In a separate report, JPMorgan Chase & Co has approved 138,000 trial mortgage modifications since early April, when it started modifying certain loans under a U.S. government program, the bank said.

#### Benchmark rates at lows as H1 ends smoothly

The interbank cost of borrowing euros for three-months marked a new low as the end of the first half of the year looked set to pass with minimal strain on money markets following last week's huge injection of liquidity.

Benchmark three-month dollar and sterling Libor rates also fell, but overnight rates in all three currencies inched higher as banks demanded cash to balance their books on the last day of the month.

The ECB said 242 billion euros were deposited overnight, a five-month high, and interbank trading activity remains subdued.

Three-month euro Libor rates fixed 1.1 basis points lower at 1.095 percent, while equivalent dollar rates crept down to 0.59500 percent.

#### EU's bank plans delayed over bonus spat -sources

The European Union executive's plans to toughen up bank capital rules are being delayed due to disagreement over how far supervisors should be allowed to intervene in bankers' pay, two sources with knowledge of the dossier said.

A second source said McCreevy, EU Internal Market Commissioner, is considering whether to ditch the remuneration element and put forward a CRD proposal in September that would include the rest of the planned elements such as tougher capital requirements on a bank's trading book.

In a separate report, the creditworthiness of Europe's investment-grade companies is likely to deteriorate faster and further than for U.S. borrowers as the recession hits the region harder

and its recovery is weaker, says Goldman Sachs.

Goldman Sachs Credit Strategy has recommended that investors buy credit protection on the Markit iTraxx Europe index and sell protection on the CDX IG, the main index of U.S. investment-grade CDS.

#### Japan job woes dampen hope for demand recovery

Japan's jobless rate rose to a new 5-1/2-year high in May and job availability sank to a record low, fuelling worries that bleak job conditions may overwhelm government efforts to boost consumption, delaying an economic recovery.

The number of employed people fell by 1.36 million from a year earlier, a record rate, as manufacturers and the service sector cut staff even as the country's export industries start to recover from a sharp downturn in the global economy.

Household spending rose 0.3 percent in May from a year earlier, beating market expectations for a decline of 1.6 percent. But economists warned against reading too much into the data, which they say has sampling flaws.

The seasonally adjusted unemployment rate rose to 5.2 percent -- the highest since September 2003 and in line with market forecasts -- from 5.0 percent in April.

#### Canadian economy slips in April, no sign of bottom

Canada's economy contracted for the ninth straight month in April as the manufacturing, energy and retail industries scaled back activity in the deepest downturn since the early 1990s.

GDP by industry fell 0.1 percent in the month compared with March, Statistics Canada said, suggesting the economy is entering its third quarter of recession.

GDP shrank 3 percent from a year earlier and total output by all industries in dollar terms was the lowest since October 2006.

In a separate report, Statscan said the sharp rise in the Canadian dollar against the U.S. dollar in May caused producer prices to fall by a steeper than expected 1.1 percent from April.

## NEXT UP

#### POLL-Global stock rally stunted, but still has legs

Stubborn recession brought a dose of reality to the strong rally that hoisted the world's stock markets from their March lows, and will keep a check on gains until the end of the year, Reuters polls showed.

Investors found green shoots wherever they looked in March, driving 50 percent gains in world shares and wiping out much of the deep losses they sustained in 2008.

Quarterly surveys of more than 150 equity strategists from New York to Sydney showed the main U.S. S&P 500 index rallying a further 8 percent by the end of the year, European shares up 3 percent, and Australian stocks up 6 percent. Tokyo's Nikkei was predicted to hold flat, ending the year at 10,000.

#### Investors' cash reserves hit 23-month low

Investors put a greater share of their funds into stocks, bonds and alternative investments in June than at any time since the financial crisis blew up in the summer of 2007, Reuters polls showed.

Levels of cash held in reserve dropped to the lowest level since

July 2007 as investors bet on an end to the decline of the global economy and on a nascent recovery.

Surveys of 48 top investment houses in the United States, continental Europe, Japan and Britain showed equity holdings at 55.7 percent of an average portfolio, up from 55.2 percent in May and the same as in April. Bond holdings also rose slightly - to 35.8 percent from 35.7 percent -- while cash dropped to 4.0 percent from 4.4.

#### U.S. investor equity holdings at fresh 2009 high in June

U.S. fund managers' exposure to stocks rose to the highest level this year in June, encouraged by growing evidence the economy is coming out of its worst recession in decades, a Reuters poll showed.

Based on 12 U.S.-based fund management firms interviewed between June 16 and 29, firms held an average of 62.5 percent of their assets in equities, up from 61.6 percent a month earlier and 60.6 at the start of the year.

Investors are still maintaining exposure to high-quality investment grade bonds as well as risky "junk" debt for their generous returns.



## DEEP DIVE Commentary and Analysis

**COLUMN-The tough questions after Madoff**

By Matthew Goldstein

Even as Ponzi king Bernard Madoff goes away to prison for the rest of his life and then some, there are still so many unanswered questions -- both big and fundamental.

Were Madoff's sons involved? What did his wife Ruth know? Were the operators of the giant feeder funds that sucked in tens of billions of dollars in investor money in on the charade?

Those questions, though important, ultimately pale when compared with the bigger ones that remain about the root causes of the worst financial crisis since the Great Depression.

Indeed, for all the misery Madoff and his Ponzi brethren have caused, none of those scam artists were the cause of the crisis that brought the financial system to the brink. If anything, it was the financial crisis that helped flush out Madoff and his scurrilous ilk, as many investors rushed for the exits at the same time. So that's why Congress needs to act quickly to get up and running a bipartisan commission to study the underlying causes of the financial crisis. House Speaker Nancy Pelosi likens this new 10-member panel to the Pecora Commission, the famous Depression-era investigative committee that led to passage of Glass-Steagall -- the 1933 law that drove a wall between commercial and investment banking.

The 1999 repeal of Glass-Steagall contributed mightily to the current crisis by opening the door to an anything-goes mentality on Wall Street and allowing far too many banks to become too big to fail.

This new commission, armed with the power to subpoena witnesses and documents, is meant to investigate all aspects of the crisis, including regulatory lapses, Wall Street excesses and deceptive behavior by lenders and securities traders.

A first order of business for the commission should be looking at the Federal Reserve's dereliction of duty for missing the warning signs of trouble. Congress can't consider acting on the Obama administration's proposal to upgrade the Fed's status to supreme financial regulator before there's a full accounting of its missteps.

But there are already worrying signs that this commission will lack the political nerve to tackle the tough issues, let alone ask the right questions.

Reuters reported last week that some of the people being considered for the commission include many former Congressmen, governors and familiar talking heads from Washington think tanks. Let's hope that will not be the case because the financial system can't truly be fixed until there's a candid assessment of who let things get so out of control.

Sure, put some wise political statesmen on the commission. But also allow room for some longtime Wall Street critics, derivatives traders and hedge fund managers -- the kind of people who know the system from the inside out.

Maybe, even include one or two people who were sharp enough to stay away from Bernie Madoff.

**ANALYSIS-Wall St's fear gauge suggests the worst is over**

By Rodrigo Campos

Growing confidence that the U.S. economy is putting the worst recession in decades behind it has pushed the index known as Wall Street's fear gauge to its lowest level since just before Lehman Brothers collapsed last September.

The CBOE Volatility Index, known as the VIX, provides investors with portfolio insurance against fluctuations in the S&P 500 index. It soared to historic highs in the weeks after Lehman's rapid failure pushed financial markets to the brink and left an already crippled economy in tatters.

But amid numerous signs the economy is on the edge of a recovery, coupled with the best quarter for stocks in more than 10 years, the VIX has begun to look like its old self again.

"Investors see a lesser need for protection going forward; it looks like they don't see a revisit to the March lows," said Andrew Wilkinson, senior market analyst at Interactive Brokers Group in Greenwich, Connecticut.

The VIX, which is calculated from Standard & Poor's index options, tracks the market's expectations of volatility over the next 30 days. It often moves inversely to the S&P benchmark and goes up as options premiums are raised.

The S&P 500 hit a more than 12-year low in early March, down more than 57 percent from the record high it set in October 2007, after the bursting of the housing bubble spiraled into a credit crisis and then into a global recession.

The VIX hit an intraday record high of 89.53 in late October, but on Monday it closed at 25.35, its lowest level since Sept. 11, 2008, before the weekend when Lehman collapsed.

"The path forward appears a less treacherous one according to what the VIX is telling us," Wilkinson added.

Stabilization of key economic indicators such as payrolls, home prices, bond yields and consumer confidence, as well as the Obama administration's plan to reactivate the recession-hit economy, have boosted bets on the economy's outlook. Investors are looking forward to this week's key housing and job market data on expectations that it will show further signs that the worst is over.

"I think (the VIX) is down primarily because the expectation is the economy is going to recover and we've started a bull market," said Hugh Johnson, chief investment officer of Johnson Illington Advisors in Albany, New York.

The S&P 500 has risen up to 40 percent from its March lows, and is on path to close its best quarter since the fourth quarter of 1998. But even as some market players expect a correction in the near term, the reading of the VIX suggests that that correction may not happen.

"The bears are beginning to throw in the towel on expecting a substantial stock market decline, so investors are beginning to sell implied volatility," Wilkinson said. "Investors do not perceive there's going to be another big crash."

But although the VIX has returned to levels similar to those seen before financial markets imploded, analysts said that does not mean the economy has recovered from the hit it took last year.

"We've gone through such a change in the economy that has required such drastic steps from both the Federal Reserve and the government that it is going to create a very different landscape going forward," added Wilkinson. "We can't relate (today's) VIX measures to where we've come from."

**U.S. banks on tighter leash after High Court ruling**

By Jonathan Stempel

The U.S. Supreme Court decision to let states enforce their consumer protection laws against federally chartered banks will give regulators greater power to police lending abuses in an industry already under intense pressure to reform.

Monday's 5-4 ruling striking down a rule by the U.S. Office of the Comptroller of the Currency barring state oversight is likely to fuel critics who believe lending abuse has driven millions of people into financial distress, whether through mortgages, credit cards or other forms of consumer credit.

"This is a real win for consumers," said James Cox, a law professor at Duke University in Durham, North Carolina. "It opens up a vast area for state and local regulators, and is a serious loss for the banking industry. One would hope banks will be-



## DEEP DIVE Commentary and Analysis

come more circumspect about their activities, especially given how they're being regulated like never before."

The ruling revives a probe by New York Attorney General Andrew Cuomo into whether banks such as Citigroup Inc, HSBC Holdings Plc, JPMorgan Chase & Co and Wells Fargo & Co were subjecting black and Hispanic borrowers to higher interest rates on mortgage loans. Cuomo's predecessor Eliot Spitzer had begun the probe in 2005.

It remains unclear how the ruling affects President Barack Obama's push for a new Consumer Financial Protection Agency as part of his financial regulation overhaul.

That proposal would move oversight on credit cards, mortgages and other products from about 10 agencies into a single panel. States would be able to enforce the new federal rules, and impose their own tougher rules where appropriate.

But the need for a new pro-consumer agency may prove "not as great as we thought if the states can enforce their own consumer protection laws," said Kevin Petrasic, a lawyer at Paul, Hastings, Janofsky & Walker LLP in Washington, D.C., and former counsel at the Office of Thrift Supervision.

He also said the ruling could backfire on consumers if national banks were suddenly "subject to a whole host of state laws" as well as new federal laws. "It could result in a fairly significant increase in the cost of credit," he said.

## REJECTING "BIZARRE" RESULT

Monday's decision rejected an OCC rule that essentially preempted states from enforcing their own fair lending, consumer protection and anti-discrimination laws, even when federal law appeared inadequate to protect consumers.

The case created a situation in which the states' rights argument, generally associated with more conservative thinking, was advanced on behalf of consumers, while the supremacy of national bank laws was advanced on behalf of lenders.

With the support of the other 49 states and Washington D.C., Cuomo argued that striking the rule would not unfairly burden banks, given that they already have to defend their actions under state law in lawsuits brought by investors.

The OCC opposed the change, as did a group of more than a

dozen big banks, citing the potential for a costly blizzard of conflicting federal and state regulations.

Justice Antonin Scalia, one of the Court's more conservative members, joined the four most liberal justices in concluding it would be "bizarre" for the OCC to block states from enforcing valid, non-preempted laws against national banks, such that "the bark remains, but the bite does not."

In allowing lawsuits, Scalia said it would be up to judges to prevent states from engaging in unwarranted "fishing expeditions" to find evidence of wrongdoing.

Scalia distinguished Monday's ruling from the Court's 2007 decision involving Wachovia Corp. That case concerned mortgage lending units of national banks, but involved banking regulation rather than enforcement of consumer laws in general.

## "HUGE WIN," CUOMO SAYS

"This is a huge win for consumers across the nation," Cuomo said in a statement. He said it will help state attorneys general protect consumers from the "illegal and improper practices by our country's biggest and most powerful banks."

John Dugan, the comptroller of the currency, said his office was disappointed with the ruling, but is committed to strong enforcement of fair lending laws, and ensuring fair access to financial services and fair treatment of consumers.

The Obama administration had urged support for the OCC regulation, as had the Bush administration. The administration and Spitzer were not immediately available for comment.

Seth Galanter, a lawyer at Morrison & Foerster LLP who represented six former OCC chiefs supporting the rejected regulation, said Monday's ruling may lead to only an "extremely small" change in lending practices, even as it provides "less protection than we think the banks should have gotten."

Yet Cox, the Duke law professor, expects regulators to get more aggressive in addressing the country's financial woes.

"The preemption of state laws has been a key cause of the credit crisis," he said. "It prevented states from doing more regulation in the area of subprime mortgages and other debt that consumers get in over their heads."

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(Compiled by Anil Kumar and Lokesh Jain in Bangalore)

For questions or comments about this report, email us at:

[inside.debt@thomsonreuters.com](mailto:inside.debt@thomsonreuters.com)

or contact Chandra Ramarathnam on +91 80 4135 5899

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