

Senate Passes Historic Finance-Reform Bill

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HEADLINE: Senate passes historic finance-reform bill

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A previous version of this story misstated the day on which the Senate bill passed. The story has been corrected.

WASHINGTON (MarketWatch) -- Senate lawmakers on Thursday approved the most significant increase in the regulation of U.S. banks since the Great Depression, placing new restrictions on the nation's biggest banks, reining in the Federal Reserve and crafting a major new consumer-protection division for mortgage and credit-card products.

The mammoth legislative package -- which passed 59 to 39, with three Republicans voting for the bill -- requires "too-big-to-fail" banks to install new capital restrictions and divest their derivatives units, sets up a government board to assign credit raters for banks' structured finance securities, and instructs the government to conduct an unprecedented, one-time audit of the Fed's emergency response programs.

Sens. Scott Brown, R-Mass., Olympia Snow, R-Maine and Charles Grassley, R-Iowa were the three Republicans voting for the bill, while two Democrats -- Sens. Russ Feingold, D-Wisc., and Maria Cantwell, D-Wash. -- voted against it.

A bill approved by the House in December now must be reconciled with the Senate bill. Both contain similar and different features than the Senate bill.

Congressional leaders expect a final bill to be approved by Congress and sent to President Obama for approval before July 4.

"Today's bipartisan vote follows many months of hard work," said Treasury Secretary Timothy Geithner. "The House and Senate have now each passed strong bills that protect consumers, limit risk-taking by large institutions, and address the problem of 'too-big-to-fail.'"

Some things in common

Both bills would subsume the Office of Thrift Supervision within the Office of the Comptroller of the Currency and create a council of regulators that would set capital standards for big banks and monitor systemic risk.

The House and Senate bills both create a system to dismantle a failing Lehman-like megabank so that its collapse doesn't unsettle the markets - however, each chamber covers the costs of doing so in different ways.

The House would collect fees from big banks to create a \$150 billion fund to liquidate a failing super-institution, while the Senate is seeking to use taxpayer dollars -- possibly trillions of dollars -- for the measure that would be ostensibly recouped from the financial industry afterwards. The Senate bill also requires congressional approval before the Federal Deposit Insurance Corp. could provide debt guarantees in the event of a crisis, while the House permits debt guarantees.

Both bills seek to impose a major new regulatory regime to bring a huge swath of the \$450 trillion derivatives market into the open.

Proponents of the new oversight have blamed credit default swaps, a controversial insurance derivative product, as central to the financial crisis, in part because the interconnected nature of the CDS securities required a \$190 billion taxpayer bailout of one of their major vendors, American International Group Inc. (AIG)

Based on both bills, a large swath of derivatives transactions made by big banks, hedge funds and other groups would be required to go through transparent clearinghouses, which are intermediaries between buyers and sellers of swaps, and put their contracts through exchanges or swap-execution facilities.

Both the House and Senate would exempt many commercial end-users of derivatives, such as airlines and manufacturers, from the clearinghouse requirement. The House would also exempt pension funds and many hedge-fund investors that are hedging balance-sheet risk, as well as the \$60 trillion foreign-exchange market.

The Senate bill gives the Treasury Department the authority to reject new Commodity Futures Trading Commission rules for the foreign-exchange market. That could amount to the equivalent of exemptions, since the Treasury supports exempting the category.

The Senate bill also includes controversial provisions making it easier for investors to nominate a minority slate of directors onto corporate boards using corporate proxy cards. Democrats believe that if shareholders had a greater say in the makeup of corporate boards and the compensation of company directors and executives, banks might have packaged fewer toxic mortgages, and the crisis might have been averted.

However, Republicans argue they empower labor unions and environmentalist investor groups in behind-the-scenes conversations at the expense of shareholder value.

A Consumer Financial Protection Bureau within the Federal Reserve would be created by the Senate bill, a similar entity to a free-standing agency proposed by the House bill.

The consumer entities would supervise and regulate mortgage and credit-card products including payday lenders and others that have so far escaped regulation.

However, both bills would exempt banks with less than \$10 billion in assets from on-site exams by the consumer regulator.

Volcker Rule?

The Senate legislation includes a provision that would instruct bank regulators to study limiting the speculative activity of big banks and would follow the recommendations made by the agencies' report.

The proposed limit is dubbed the "Volcker Rule" after former Fed Chairman Paul Volcker, who chairs President Barack Obama's economic advisory panel. It would seek to prohibit big banks from making speculative investments in stocks, bonds and derivatives, limit their growth, and force big banks to divest hedge fund and private equity units.

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