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THE FINANCIAL REFORM BILL

Main Street's anger over Wall Street reaches the Senate floor.

Provided by Frank DeMaio

Another reform bill is now making its way through the Senate – a bill that would reregulate the financial services industry with a few goals in mind:

1) Preventing failures of large banks and financial services firms, or at least insulating taxpayers and the economy in such an emergency
2) Creating a new financial watchdog agency to protect consumers
3) Tightening regulations on derivatives
4) Banning banks from proprietary trading (with the "Volcker Rule")
5) Increasing transparency[1,2,3]

Anger on Main Street, while palpable, won't pass these reforms. In the Senate, Democrats are largely driving them; Republicans want to see them altered. Let's look at them briefly.

The bailout issue. The bill introduced by Senate Banking Committee Chairman Chris Dodd (D-CT) would set up an "orderly liquidation fund" - $50 billion deep – to help the federal government wind down any big banks that threaten to go belly up.[3] Senate Republicans argue that this would amount to a permanent "bailout fund" that would implicitly encourage federal bank rescues. Some Republicans think it perpetuates the "too big to fail" mentality.

A group of Congressional Democrats have introduced the S.A.F.E. Banking Act, which would cap bank size: no U.S. bank or bank holding company could hold more than 10% of the country's insured deposits. The S.A.F.E. Act would also hold the amount of non-deposit liabilities at financial institutions at 2% of GDP for banks, and set a 6% leverage limit for bank holding companies.[4]

The proposed new Bureau. The reform bill proposes creating a Bureau of Consumer Financial Protection, possibly as an offshoot of the Federal Reserve. It would watch over banks and credit unions with $10 billion or more in assets, as well as major investment firms and mortgage lenders apart from the banking industry. In addition to trying to protect people from predatory or discriminatory practices, the BCFP would also seek to better inform consumers via an Office of Financial Literacy.[2] Skeptics see this as another multibillion-dollar layer of bureaucracy, a "fifth wheel" whose mission could just as well be handled by an augmented Fed.

Crackdowns on derivatives & proprietary trading. Ah yes, derivatives - those investments no one really understood. Or watched closely. The reform bill would require banks to build a wall between their derivatives trading and their commercial banking operations - in other words, the "Volcker Rule" would be the law. Well, banks do make a lot of money through proprietary trading in their own accounts. In late April, JP Morgan analysts concluded that if the Volcker Rule went into effect, the six biggest global investment banks would need $85 billion more to capitalize the new investment banking divisions they would need to create. According to the JPMorgan scenario, Deutsche Bank would have to grab $26 billion alone and BNP Paribas would have to come up with $21.1 billion.[5]

A better understanding for all? If the reforms become law, regulators would work to make the "fine print" that comes with a credit card, a mutual fund or a mortgage product clearer, so that fees and other quietly assessed charges would become easier to understand. Hedge funds would have to register with the federal government. Certain Democrat-driven amendments would even demand more transparency at the Federal Reserve. As Sen. Bernard Sanders [I-VT] remarked in late April, "During the bailout, the Fed lent trillions of dollars at zero or near-zero interest rates to large financial institutions. During the Budget Committee hearing, I asked Chairman Bernanke who received that money, [and] he refused to tell us."

A new chapter, or a whole new book? You could argue - convincingly - that a loosely regulated Wall Street caused or least exacerbated the "Great Recession". In the aftermath of that downturn, we may see the biggest rewrite of financial rules and regulations since the Great Depression coming before 2010 ends.

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