Policy Update
September 28, 2009

Regulatory turf wars are something that grabs Washington's attention every ten years or so and the 2009 version will no doubt be just as interesting as previous battles. This week, top banking and regulatory officials testified in full support of suggested reforms as long as they do not diminish their operations and authority. The House Financial Services Committee continues an aggressive hearing schedule and the Senate Banking Committee is starting to get moving on its own hearings.

The Consumer Financial Protection Agency (CFPA) will receive the most attention from lawmakers and regulators in the coming days, but other issues such as derivative reform have made progress as well. The Federal Reserve and Treasury continue to work towards paring back their emergency programs, as continuing signs of recovery have created increased confidence in the markets.

I. Financial Reform Update

Consumer Finance Protection Agency (CFPA)

House Financial Services Chairman Barney Frank released an updated draft of the CFPA bill this week and will hold a hearing September 30th on the proposal. While this draft will certainly undergo changes before any committee votes are cast, it makes a number of changes to the Treasury's original proposal. Removing the requirement for institutions to offer "plain-vanilla products" removes one of the most controversial aspects of the original proposal. However, the draft bill still contains provisions that would allow states to enforce their own, stricter consumer laws, a provision staunchly opposed by the industry and other regulators, including Comptroller of the Currency Chairman John Dugan.

Committees to Examine Credit Rating Agencies

The House Financial Services Committee and Committee on Oversight and Government Reform announced hearings next week on the role of reforming credit agencies. These hearings come on the heels of the release of a letter from a former Moody's analyst claiming executives approved high ratings on securities they knew were soon to be downgraded. Executives from the major rating agencies are expected to testify on their companies' involvement on faulty ratings, and the industry's role in the financial collapse.

FDIC Chairman Bair and Comptroller Dugan Push Back Against Frank

Bair and Dugan appeared before the Financial Services Committee to testify on financial regulatory reform. Both declared their support for the Consumer Financial Protection Agency and its ability to write strong, uniform consumer protection laws, but they argued their agencies should continue examining banks for compliance on consumer issues. Congressman Frank did not seem to find this proposal reasonable, as he derided their previous work in the area. Bair and Dugan staunchly defended their agencies' record.

Congressional Research Service Report on Options for Fannie Mae and Freddie Mac

The CRS released an updated report which expands upon the options for Fannie Mae and Freddie Mac going forward. As with the previous release, the CRS suggest the two could become government agencies, private entities, or utilities. The report also proposes they could be split into smaller GSEs, or they could continue as they did before with additional regulations.

As with the previous report, the CRS suggests Fannie Mae and Freddie Mac could be merged with the FHLBanks. "The FHLBank system could purchase Fannie Mae and Freddie Mac, which would become a mortgage securitization facility (or facilities) within the FHLBank system…Alternatively, Fannie Mae's and Freddie Mac's mortgage portfolios and other assets could be divided among the 12 FHLBanks. Some resources, such as mortgage securitization, could be merged into the FHLBanks' Office of Finance, which provides centralized financial services for the regional banks. The advantage of this approach is that the FHLBank system has never—not even in the Depression—lost money on an advance. The counter argument is that history may not predict the future." The report goes on to say that the FHLBanks' super lien position with the FDIC creates a moral hazard and may lead the System to not risk-adjust interest rates on advances.

Derivatives Bill Introduced in Senate Banking Committee

Senator Reed (D-RI) introduced a bill that would move over-the-counter trades onto a central clearing platform. In addition, it requires prudential supervision of all major traders in the OTC derivatives market and will mandate rigorous reporting requirements for all trades and their parties. This legislation is seen by many as going well beyond the Administration's original proposal for reform of the derivatives market.

II. Other Policy Developments

Options for Troubled Asset Relief Program (TARP) Considered

The Treasury is considering various options when the TARP expires December 31st. While many lawmakers have begun pushing for its scheduled termination, the Treasury wants to maintain the capability to address potential missteps in the economy should they occur. Even if TARP expires, the program continues until the government's investments are repaid and the U.S withdraws ownership from financial institutions.

FDIC Chairman Sheila Bair Considers Prepayments of Future Assessments

As the FDIC's reserves continue to fall, a variety of options have been considered to rebuild the fund. A second special assessment on banks has been met with considerable opposition in the industry due to the strain on institutions during a fragile recovery. Chairman Bair has begun to discuss banks paying future assessments early. This notion has been met with support from banks because the premiums would be an asset until next year, when they convert to expenses in the quarters when they are due. By comparison, the special assessment would an immediate expense.