RSC Republican Study Committee

Financial Services Working Group

Congressman Scott Garrett (R-NJ), Chairman

Congressman Tom Price (R-GA), RSC Chairman

April 28, 2010

GOLDMAN ENDORSES DODD BILL

Where is the change?

Democrats claim they are "cracking down" on Wall Street, but where is the change? The Dodd bill empowers the Federal Reserve, the same regulator that failed to anticipate the most recent economic crisis. Republicans want REAL change on Wall Street and want to stop the culture of bailouts in Washington.

FIRM	BAILOUT	OLD REGULATOR	NEW REGULATOR
Citigroup	$45 billion	Federal Reserve	Federal Reserve
Bank of America	$45 billion	Federal Reserve	Federal Reserve
JP Morgan	$25 billion	Federal Reserve	Federal Reserve
Goldman Sachs	$10 billion	Federal Reserve	Federal Reserve
Morgan Stanley	$10 billion	Federal Reserve	Federal Reserve

Republicans Have A Plan to Rein In Wall Street and Protect American Taxpayers

The components of the Republican financial services regulatory reform proposal are as follows:

Enhanced Bankruptcy. Republicans call for the resolution of insolvent non-bank institutions—no matter how large or systemically important—by creating a new chapter of the bankruptcy code to make it more efficient and better suited for resolving large non-bank financial institutions.

Market Stability and Capital Adequacy Board. Under the Republican plan, this Board will not have independent enforcement or supervisory authority over individual firms but would be tasked with monitoring the interactions of various sectors of the financial system, and identifying risks that could endanger the stability and soundness of the system.

Regulatory Restructuring. The plan combines the Office of the Comptroller of the Currency (OCC) and Office of Thrift Supervision (OTS) into one agency and shifts the supervisory functions of the Federal Reserve and Federal Deposit Insurance Corporation (FDIC) to that agency, including the responsibility for overseeing bank and financial holding companies.

Fundamental Reform of the Federal Reserve. The plan refocuses the Fed on its core mission of conducting monetary policy by relieving it of current regulatory and supervisory responsibilities and reassigning them to other agencies, and requiring an explicit inflation target. The Republican Plan would impose limitations on the Fed's use of its authority under section 13(3) of the Federal Reserve Act to respond to "unusual and exigent" circumstances by subjecting actions under 13(3) to Treasury approval and giving Congress the ability to disapprove, placing 13(3) transactions on Treasury's balance sheet, and eliminating the use of this authority on behalf of specific institutions.

Government Sponsored Enterprise (GSE) Reform. The Republican plan would phase out taxpayer subsidies of Fannie Mae and Freddie Mac over a number of years and end the current model of privatized profits and socialized losses. It sunsets the current GSE conservatorship by a date certain, placing Fannie and Freddie in receivership if they are not financially viable at that time.

Credit Rating Agency Reform. The Republican plan changes the definition of the Nationally Recognized Statistical Ratings Organization to "nationally registered statistical rating organizations" and removes all references to ratings throughout Federal law and regulation, so that the rating agencies will no longer operate as a government-sanctioned oligopoly.

Protecting Consumers Through Improved Disclosure and Complaint Resolution Procedures. The Republican plan expands the mission of the Financial Literacy and Education Commission to include consumer protection and disclosure issues by giving it the authority to direct regulated entities to disclose relevant policies, procedures, guidelines, standards and regulatory filings on their websites.

Strengthening Anti-Fraud Enforcement. The plan increases both civil and criminal money penalties in government enforcement actions, maximizes restitution for victims of fraud, improves surveillance of bad actors who prey on consumers, and allows regulators to share information with foreign regulators and law enforcement agencies engaged in the investigation and prosecution of violations of financial laws without waiving privileges.

For more information contact Chris Russell at 5-4465 or Brad Watson at 6-9719

THE WALL STREET JOURNAL

Taxpayers and the Dodd Bill

The FDIC could borrow vast sums to bail out failing banks and their creditors.

By PETER J. WALLISON
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Last Thursday, at New York's Cooper Union, President Obama promoted the Senate financial reform bill while castigating its opponents. "Now, there's a legitimate debate taking place about how best to ensure taxpayers are held harmless," he said of Sen. Chris Dodd's legislation. "But what's not legitimate is to suggest that somehow the legislation being proposed is going to encourage future taxpayer bailouts, as some have claimed. That makes for a good sound bite, but it's not factually accurate. It is not true. . . . And nobody should be fooled in this debate."

Who is actually fooling the taxpayers about bailouts?

Last week, the Congressional Budget Office reported on the costs of the Dodd bill. It reviewed the budgetary effects of the bill's $50 billion resolution fund for the large nonbank financial firms—insurance companies, securities firms, hedge funds, bank holding companies, finance companies and others—that are considered "systemically important" and thus too big to fail. These firms, among others, would be assessed for the $50 billion fund, which Mr. Obama apparently believes will not be a cost to the taxpayers.

But in a footnote the CBO reported that "such assessments would become an additional business expense for the companies required to pay them." This means the assessments will be tax deductible, and place additional costs on other U.S. taxpayers to make up the difference in government revenue. Thus, even on the face of it, taxpayers will not completely escape the tax costs that are associated with this fund.

That is merely the beginning. The footnote goes on to say, somewhat elliptically, that "those additional expenses would result in decreases in taxable income somewhere in the economy, which would produce a loss of government revenue from income and payroll taxes." The meaning? A loss of government revenue from income and payroll taxes means a loss of the things that produce income and payroll taxes—that is, jobs.

This will occur simply because of the size of the fund. It doesn't account for the jobs that will be lost if large U.S. financial firms are priced out of foreign markets because of the costs of the resolution fund. Nor does it include the added costs that will be built into the products that taxpayers—as consumers—will buy. Thus the $50 billion resolution fund is not cost-free to the taxpayers.

If the Dodd-Obama resolution plan is ever actually put to use, the direct or indirect costs could be many times greater. For example, the bill authorizes the Federal Deposit Insurance Corporation to borrow from the Treasury "up to 90 percent of the fair value of assets" of any company the FDIC is resolving. Yet one institution alone—Citigroup—has assets currently valued at about $1.8 trillion. The potential costs of resolving it (not to mention others) would be spectacularly higher than $50 billion. In short, the $50 billion in the resolution fund is a political number—a fraction of what the FDIC is authorized to borrow and spend.

Why would this vast sum be necessary? The Dodd bill has one answer. It says that the FDIC "may make additional payments," over and above what a claimant might be entitled to in bankruptcy, if these payments are necessary "to minimize losses" to the FDIC "from the orderly liquidation" of the failing firm.

In other words, the agency would be able to borrow huge sums so that it could make more generous payments to creditors than they would receive in a bankruptcy. Generous payments to creditors would certainly make unwinding a firm "orderly"—but it would also encourage lending to the too-big-to-fail financial institutions while disadvantaging smaller, less favored institutions. This in itself will have a profound and destructive effect on competition.

Another possible purpose for the FDIC's borrowing power is to enable the agency to provide what it calls "open bank assistance." Here, instead of liquidating a failed bank, the agency keeps it in operation by paying off its creditors and avoiding the disruption a bank closing might entail. This practice is a straightforward bailout of all creditors, and it has been criticized extensively by Congress over the years. Yet here it is, back again, in the guise of an innocuous power to make additional payments to some creditors, coupled with virtually unlimited authority to borrow from the Treasury.

The FDIC certainly knows what to do with a failed bank, but it has no experience taking control of a giant financial institution like Lehman Brothers. It is authorized to borrow against the assets of the failed firm because eventually, in theory, the assets could be sold to repay the Treasury. However, the FDIC's operation of the failed firm could easily be unsuccessful, with losses quickly diminishing the value of its assets.

If that happens, the FDIC would have to impose an additional assessment on the financial industry—again adversely affecting the solvency and stability of those firms and causing the loss in employment, tax revenue and competitive position outlined above. Or the taxpayers would have to bear the loss, which could be enormous. Congress, accordingly, by passing the Dodd bill, will be courting serious taxpayer costs in the event of another financial panic.

These are only a few of the land mines that litter this 1,400-page bill, which Senate Democrats are seeking to rush to judgment with a cloture vote today. Does anyone really know what's in this bill, or what other unintended consequences will flow from its adoption? The American people may detest Wall Street, but imagine what they'll think of senators who vote for this bill because Mr. Obama has told them it will not impose any costs on taxpayers.

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