RSC Republican Study Committee **Financial Services Working Group**

Congressman Scott Garrett (R-NJ), Chairman — Congressman Tom Price (R-GA), RSC Chairman

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Legislation Greatly Expands Government Reach (and no, it's not Health Care)

The Financial Services Committee continues to mark up several bills that aim to expand our government greatly, and the concerns over which are certainly worth highlighting. Last Thursday, House Financial Services Committee voted 39 to 29 to create the Consumer Financial Protection Agency, which would have broad reach to examine and punish companies, without regard for safety and soundness.

Earlier this week, the Committee marked up the Private Fund Investment Advisers Registration Act of 2009 and the Accountability and Transparency in Rating Agencies Act. Today, we will mark up Investor Protection Act of 2009, and next week, we will be marking up the Federal Insurance Office Act of 2009, and possibly Chairman Frank's "Too Big to Fail" legislation.

Last week's edition of the Financial Services Newsletter had a preview of two pieces of legislation; this week, we will preview two other pieces up for consideration, leaving the most inflammatory piece of legislation, the "Too Big to Fail" monstrosity, for next week.

Accountability and Transparency in Rating Agencies Act

The Accountability and Transparency in Rating Agencies Act would fundamentally reform the regulation, operation, and oversight of credit rating agencies, or Nationally Recognized Statistical Ratings Organizations (NRSROs). Investors have become increasingly, and too often, solely reliant on the use of these ratings in determining the safety and soundness of any investment. This situation, like many of the other problems of this financial crisis, has in large part been created by government policy.

In literally hundreds of federal and state government statutes and regulations, there are specific requirements mandating certain grades from the approved agencies. It is this formal requirement that provides an implicit stamp of approval to investors. When investors see that the government is requiring a specific grade to make a "safe investment," it reinforces the belief that any investment attaining such a grade is "safe." Congress should re-examine all of the areas where statute mandates such ratings. Credit ratings are only one piece of the puzzle in determining creditworthiness. Investors must be encouraged to do their proper due diligence in evaluating issuer credit quality.

Investor Protection Act of 2009

"The Investor Protection Act of 2009" aims to reform the securities laws in relation to investor rights, investment advisers, broker-dealers, and the oversight performed by the Securities and Exchange Commission (SEC or Commission) and other industry regulators.

The legislation seeks to harmonize the fiduciary standard for investment advisers and broker-dealers, restrict the use of mandatory arbitration agreements, double the SEC budget, and amend both the Security Investor Protection Act and the Sarbanes-Oxley Act.

Fighting for Small Businesses! Rep. Garrett plans to introduce an amendment to extend the exemption for small businesses from the burdensome costs found within Section 404b the Sarbanes-Oxley (SOX) Act of 2002. Although the stated intent of Sarbanes-Oxley was to provide investor confidence in our markets through greater accountability and disclosure, the Act has had the unintended effect of creating undue—and often unbearable—burdens on small businesses. It is diverting valuable resources away from other legitimate business needs; creating massive and tedious documentation requirements; and discouraging the public listing of both international and domestic companies on U.S. markets. In summarizing survey responses from businesses regarding the benefits of Section 404 compliance, the SEC wrote, "[A] majority felt that the costs of compliance outweighed the benefits. This was especially true among smaller companies."

When businesses have been conducting their affairs within the confines of pre-SOX law and acting with integrity it is reflected in the trust of their shareholders and the strength of the market. There is a place for Federal oversight, but the weighty cost of compliance under Section 404 is slowly strangling small businesses. This amendment will lessen the burden Section 404 unnecessarily imposes on U.S. small businesses, while continuing to bolster confidence in the integrity of publicly held companies.

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Rolling up the TARP
The $700 billion for banks has become an all-purpose bailout fund.

The Troubled Asset Relief Program will expire on December 31, unless Treasury Secretary Timothy Geithner exercises his authority to extend it to next October. We hope he doesn't. Historians will debate TARP's role in ending the financial panic of 2008, but today there is little evidence that the government needs or can prudently manage what has evolved into a $700 billion all-purpose political bailout fund.

We supported TARP to deal with toxic bank assets and resolve failing banks as a resolution agency of the kind that worked with savings and loans in the 1980s. Some taxpayer money was needed beyond what the FDIC's shrinking insurance fund had available. But TARP quickly became a Treasury tool to save failing institutions without imposing discipline (Citigroup) and even to force public capital onto banks that didn't need it. This stigmatized all banks as taxpayer supplicants and is now evolving into an excuse for the Federal Reserve to micromanage compensation.

TARP was then redirected well beyond the financial system into $80 billion in "investments" for auto companies. These may never be repaid but served as a lever to abuse creditors and favor auto unions. TARP also bought preferred stock in struggling insurers Lincoln and Hartford, though insurance companies are not subject to bank runs and pose no "systemic risk." They erode slowly as customers stop renewing policies.

TARP also became another fund for Congress to pay off the already heavily subsidized housing industry by financing home mortgage modifications. Not one cent of the $50 billion in TARP funds earmarked to modify home mortgages will be returned to the Treasury, says the Congressional Budget Office.

As of the end of September, Mr. Geithner was sitting on $317 billion of uncommitted TARP funds, thanks in part to bank repayments. But this sum isn't the limit of his check-writing ability. Treasury considers TARP a "revolving fund." If taxpayers are ever paid back by AIG, GM, Chrysler, Citigroup and the rest, Treasury believes it has the authority to spend that returned money on new adventures in housing or other parts of the economy.

A TARP renewal by Mr. Geithner could thus put at risk the entire $700 billion. Rep. Jeb Hensarling (R., Texas) and former SEC Commissioner Paul Atkins sit on TARP's Congressional Oversight Panel. They warn that the entire taxpayer pot could be converted into subsidies. They are especially concerned about expanding the foreclosure prevention programs that have been failing by every measure.

TARP inspector general Neil Barofsky agrees that the mortgage modifications "will yield no direct return" and notes charitably that "full recovery is far from certain" on the money sent to AIG and Detroit. Mr. Barofsky also notes that since Washington runs huge deficits, and interest rates are almost sure to rise in coming years, TARP will be increasingly expensive as the government pays more to borrow.

Even with the banks, TARP has been a double-edged sword. While its capital injections saved some banks, its lack of transparency created uncertainty that arguably prolonged the panic. Federal Reserve Chairman Ben Bernanke and former Treasury Secretary Hank Paulson recently admitted to Mr. Barofsky what everyone figured at the time of the first capital injections. Although they claimed in October 2008 they were providing capital only to healthy banks, Mr. Bernanke now says some of the firms were under stress. Mr. Paulson now admits that he thought one in particular was in danger of failing. By forcing all nine to take the money, they prevented the weaklings from being stigmatized.

Says Mr. Barofsky, "In addition to the basic transparency concern that this inconsistency raises, by stating expressly that the 'healthy' institutions would be able to increase overall lending, Treasury created unrealistic expectations about the institutions' conditions and their ability to increase lending."

The government also endangered one of the banks that they considered healthy at the time. In December, Mr. Paulson pressured Bank of America to complete its purchase of Merrill Lynch. His position is that a failed deal would have hurt both firms, but this is highly speculative. Mr. Barofsky reports that, according to Fed documents, the government viewed BofA as well-capitalized, but officials believed that its tangible common equity would fall to dangerously low levels if it had to absorb the sinking Merrill.

In other words, by insisting that BofA buy Merrill, Messrs. Paulson and Bernanke were spreading systemic risk by stuffing a failing institution into a relatively sound one. And they were stuffing an investment bank into one of the nation's largest institutions whose deposits were guaranteed by taxpayers. BofA would later need billions of dollars more in TARP cash to survive that forced merger, and when that news became public it helped to extend the overall financial panic.

Treasury and the Fed would prefer to keep TARP as insurance in case the recovery falters and the banking system hits the skids again. But the more transparent way to address this risk is by buttressing the FDIC fund that insures bank deposits and resolves failing banks. The political class has twisted TARP into a fund to finance its pet programs and constituents, and the faster it fades away, the better for taxpayers and the financial system.

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