RSC Republican Study Committee

Financial Services Working Group

Congressman Scott Garrett (R-NJ), Chairman

Congressman Tom Price (R-GA), RSC Chairman

November 18, 2009

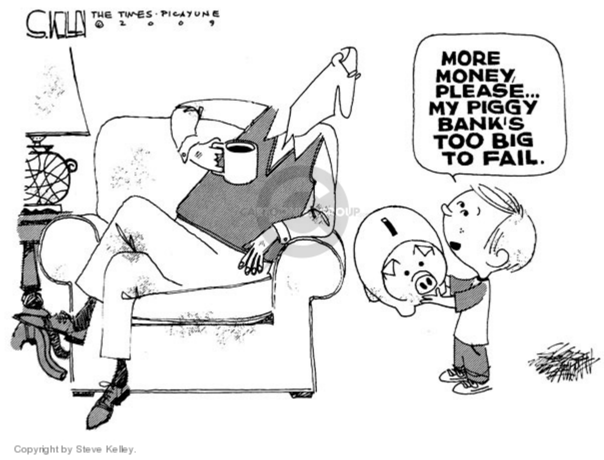
Democrats Want Permanent Bailout Authority

The Financial Services Committee is continuing its marathon markup of Chairman Frank's Bailout Authority Bill.

This week alone, during consideration of the Financial Stability Improvement Act of 2009, Democrats have voted to extend TARP, continue deficit spending, and continue government interventions in financial markets.

Republicans continue their mantra, "No More Bailouts," however, Democrats don't seem to mind codifying this bailout authority

Timeline: Markup of this legislation should conclude this week, and the bill is expected to be on the floor of the House of Representatives in early December.



Democrats Vote To Continue Government Interventions In Financial Markets

(courtesy of Financial Services Committee Minority Press office)

During consideration of the Financial Stability Improvement Act of 2009, Financial Services Committee Democrats voted against an amendment that would bring an end to the era of taxpayer bailouts by prohibiting federal agencies from using taxpayer funds to rescue financial institutions.

The amendment, offered by Reps. Lynn Jenkins (R-KS) and Erik Paulsen (R-MN), would send a clear message to the market, that no firm is considered "too big to fail." Adopting a no bailout message would incentivize creditors and counterparties to properly monitor their credit exposure, promoting greater market discipline.

Since 2008, the federal government has injected trillions of dollars to prop up failing firms. The U.S. Treasury Department, FDIC and Federal Reserve used a number of tools, in addition to capital investments, to bail out various firms and their creditors. This includes lending taxpayer funds against the assets of a company, as the government did with Fannie, Freddie, AIG, Chrysler, and GM; selling or transferring a company's assets, as the government did with AIG; purchasing the assets of a company, as the government did with AIG; and guaranteeing a company's obligations, as the government did with Bear Stearns, AIG, Citigroup, and Bank of America.

All of these actions put the taxpayer at risk for unprecedented losses and all of them would have been prohibited by the Jenkins-Paulsen amendment.

The amendment was defeated on a vote of 27 to 40.

Democrats Vote To Extend TARP, Continue Deficit Spending

(courtesy of Financial Services Committee Minority Press office)

During consideration of the Financial Stability Improvement Act of 2009, Financial Services Committee Democrats voted against an amendment that would prevent the Treasury Department from extending Troubled Asset Relief Program (TARP) beyond December 31st, when it is set to expire.

The amendment, offered by Rep. Erik Paulsen (R-MN), would direct non-committed TARP funds to pay down the deficit. Winding down TARP would protect taxpayers from continued losses resulting from those bailouts of financial institutions. The Wall Street Journal reported today that taxpayers may lose as much as $5.1 billion under TARP, which is just one of several government bailout programs.

Currently, the Administration has complete discretion to continue TARP beyond December 31st.

Republicans believe that TARP must be terminated and the money returned to the taxpayer in the form of deficit reduction. However, TARP is viewed by many Democrats as a way to fund their policy priorities without Congressional appropriations. Chairman Frank has introduced two such bills to fund a number of housing subsidy initiatives.

The vote on the amendment was 30 to 37.

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

THE WALL STREET JOURNAL.
WSJ.com

The Permanent TARP

Current financial reform proposals would establish 'too big to fail' as national policy.

By PETER J. WALLISON

It's hard to imagine a worse piece of financial regulatory legislation than the bill Barney Frank and the administration put before the House Financial Services Committee last month. But Sen. Chris Dodd's effort, introduced last week, clears this hurdle.

Much attention has focused on the fact that his "Restoring American Financial Stability Act" differs from the administration and Frank proposals by creating an entirely new agency to function as a "systemic regulator" of nonbank financial institutions, instead of the Federal Reserve. Far more important, however, is the regulatory and bailout powers it gives to the government. Here the Dodd bill follows the same flawed ideas advanced by the administration and Mr. Frank, but in some ways make things worse.

Both bills are intended to cover more than just companies that are engaged in financial activities. Following the administration's lead, both provide that a company engaged in a financial activity "in whole or in part, directly or indirectly" could be subject to enhanced regulation and supervision.

The Frank bill seems intended to regulate all financial firms as though they are banks. Thus it requires financial activities to be transferred out of operating companies into a separate entity, which would then be regulated like a bank (even in its relations with its parent company).

The Dodd bill is a blunter instrument, proposing to regulate all companies that include financial activities "in whole or in part." But almost all companies—retailers, manufacturers and service organizations—engage in some financial activities, if only to promote the sale of their products and services. If the administration's health-care proposal has the potential to nationalize one-sixth of the economy, Messrs. Frank and Dodd are bidding to cover the rest.

The administration's original legislation would give the Federal Reserve authority to regulate and supervise all large nonbank financial institutions and, if they are in danger of failing, take control of them and resolve their problems outside the bankruptcy system. The underlying notion is that the failure of one of these companies—which include bank holding companies, securities firms, insurance companies, finance companies, hedge funds and possibly others—could cause a systemic collapse.

Although the administration likes to give the impression that its proposal is limited to exceptional cases and the largest financial institutions, its draft legislation, and the Frank and Dodd bills, use very broad language to describe the triggering event for either enhanced supervision or a subsequent bailout.

For example, all would permit bailouts for companies that might, in the language of the Dodd bill, "have serious adverse effects on . . . economic conditions in the United States." This is not financial collapse; rather it creates a standard much closer to the rationale for bailing out GM and Chrysler. The Dodd bill, by covering all companies engaged in part in financial activities, like financing their sales, would have explicitly authorized the Detroit bailout.

The danger here is that the legislation would spread the Fannie and Freddie model over the whole economy. Because those two government-sponsored enterprises were implicitly guaranteed by the government, they drove all competitors from the portion of the residential mortgage market they played in. The result was a lack of market discipline and competition. And with their implicit government backing, they had easier access to credit and built up huge losses—in the neighborhood of $200 billion to $400 billion—that taxpayers will eventually have to bear.

Putting it bluntly, the administration's proposal, and the House and Senate draft bills, would establish too big to fail as national policy. Whether the companies are regulated by the Fed or by a new agency, they will still have been marked as threats to economic well-being—and thus seen by creditors and investors as specially protected by the government. This will give them the same advantages enjoyed in the mortgage business by Fannie Mae and Freddie Mac, with the same result for competitors and taxpayers.

On the resolution and bailout issue, the problems are even clearer. The whole purpose of granting the government the power to deal with failing companies outside the bankruptcy system is to give creditors a better deal. The administration proposed that the government should have the ability to take over and provide financing to failing nonbank financial firms, and the Frank and Dodd bills have followed this lead.

The Frank bill would explicitly authorize the Federal Deposit Insurance Corp. (FDIC) to provide financing that would restore a failed company to health. The craftier Dodd bill implies that creditors will take a hit, but then authorizes the FDIC to pay off creditors in full if that would avoid "serious adverse effects to financial stability or the United States economy."

Moreover, under the Dodd bill, after the government has settled with its creditors, a failed company can have a public offering of its shares and return to the competitive fray. That's good news in one sense, of course, but not for everyone; under the Dodd plan, the government is authorized to recover what it spent by taxing all financial firms—that is, firms such as bank holding companies and others involved "in whole or in part" in financial activities—with total assets of more than $10 billion.

In effect, the legislation creates moral hazard by transferring the risks and losses of a failing company from its creditors to its competitors. The protection of taxpayers may be a mirage anyway, since the FDIC is authorized to put off these collections indefinitely to avoid an "adverse effect on the financial system or economic conditions."

The Dodd bill calls this a plan to ensure "the orderly resolution of complex financial institutions." The rest of us will call it a permanent TARP.

Mr. Wallison is a senior fellow at the American Enterprise Institute.