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House Bill Hands More TBTF Power To Bernanke

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WASHINGTON - For all the invective directed at the Federal Reserve Board over the financial crisis, the central bank still emerged as the big winner under draft legislation to rein in systemic risk.

The proposal, crafted by the Treasury Department and House Financial Services Committee Chairman Barney Frank, would give the Fed power to overrule fellow regulators, force undercapitalized companies into involuntary bankruptcy and even to break up firms. The central bank also would gain a seat on the Federal Deposit Insurance Corp., the power to regulate thrift holding companies and the jurisdiction to write and enforce new rules for systemically important institutions.

"This bill is written by the Treasury and Fed for the Treasury and Fed and does not deserve congressional consideration," said former FDIC Chairman William Isaac. "I really don't think any agency should have as much power as is being granted here."

The role of the Fed is likely to be the focus of a Financial Services hearing today featuring Treasury Secretary Timothy Geithner and the banking regulators as witnesses. Most Republicans on the panel, and even some Democrats, are expected to oppose the proposal.

"The Republicans are not going to support this," said Mark Calabria, a former Republican aide to the Senate Banking Committee who is now the director of financial regulation studies at the Cato Institute. "That's a given, and I think there's probably a handful of Democrats who will not either."

Critics of earlier proposals had pushed for a strong council of regulators to oversee systemic risk and dilute the Fed's power. The new legislation does attempt to give the Financial Services Oversight Council a larger role than it received in an early Treasury draft, and all the regulators would stand to gain powers, including the ability to consider systemic-risk concerns when supervising any institution. But many observers said the ultimate authority for monitoring risk is centralized with the Fed.

Under the bill, the council could recommend "heightened prudential standards" for banking agencies to follow when supervising firms, and would settle disputes that arose between regulators that sat on the council. But the Fed would still be the only agency that could enforce the council's wishes.

"The structure doesn't seem strong," said Oliver Ireland, a former Fed lawyer and a partner at Morrison & Foerster LLP. "In a lot of cases, the council will act through the Fed. The Fed is going to have a strong influence on council decisions."

The Fed would even have the authority to recommend that another regulator take a supervisory action against one of its institutions. If the regulator refused - explaining its decision in a letter to the central bank - the Fed could push the other regulator out of the way and take the action itself.

"It makes the Fed the only financial regulator of substance," said Joshua Rosner, the managing director of Graham Fisher & Co.

Observers said they expected the Fed would take that course sparingly.

"You haven't seen a lot of examples where the Fed has gone in and made the" Office of the Comptroller of the Currency "look like an idiot," Calabria said. "The Fed would be pretty reserved in how it would step on people's toes."

The Fed would also be able to force a company into bankruptcy against its will if it was undercapitalized.

Isaac said he "could not be more opposed to" that provision.

"No one should do that," he said. "That's why we have bankruptcy laws."

To be sure, the Fed is likely to lose some power too. Congress is poised to strip the central bank of its ability to oversee firms' compliance with consumer protection laws. The Fed would also have to get Treasury approval before using its emergency lending powers. Currently the Fed has free rein to use those powers under the "13(3)" provision of the Federal Reserve Act, and did so more than once at the height of the crisis.

"It's a narrowing of focus to an extent but" the bill is "certainly an overall increase in powers," Ireland said.

The hearing today is likely to include debate on whether the Fed should share its authority more broadly with other regulators.

"Giving the Federal Reserve more authority and responsibility is a mistake," said Allan Meltzer, a professor at Carnegie Mellon University and a noted Fed historian. "Multipurpose agencies usually fail to perform any of their tasks well. The Fed is not an exception."

But supporters of the administration's approach argued that centralizing power is the most effective way to regulate.

"It's appropriate to have clarity of accountability in terms of who has ultimate authority in these things," said Richard Spillenkothen, the Fed's former director of supervision who is now a partner at the Deloitte Center for Banking Solutions. The new authorities "don't seem unreasonable to me given what a central bank has to be able to do to maintain financial stability."

While Frank's bill is the starting point on systemic risk, it is not expected to be the final word. Members of the Senate are much less enthusiastic about handing more authority to the Fed.

"As for all of financial reform, the battle is not going to be over what you can get out of the House," said Jaret Seiberg, a policy analyst with Washington Research Group, a division of Concept Capital. "It's what can garner 60 votes in the Senate, and there are a lot of Fed critics on the other side of Capitol Hill. So for better or worse, this language is likely to change."

It is unclear what role the Fed played in helping the Treasury and Rep. Frank draft the legislation. However, a Fed official, Patrick Parkinson, detailed to the Treasury earlier this year did have a hand in writing the administration's overall regulatory reform plan. Earlier this month, the Fed promoted Parkinson to head of supervision.

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