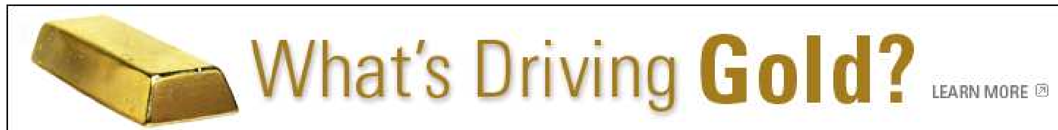

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Obstacle Course Awaits Senate Reg Reform Bill

By Stacy Kaper, American Banker
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WASHINGTON — Passing a regulatory reform bill through the House was a bruising, months-long fight that appeared ready to spin out of control. That battle may pale in comparison to the legislation's progress through the Senate.

After a rebuke by his fellow Democratic colleagues for attempting to push through reform legislation along party lines, Banking Committee Chairman Chris Dodd is now attempting to craft a bipartisan bill. He has little time to waste. With midterm elections expected to distract lawmakers later in the year, observers agree Dodd will have to move quickly to cut deals in order to build momentum back for his legislation.

Some of those compromises already appear to be in the offing. Sources said that, among other things, Dodd is considering changing his bill to allow the Federal Deposit Insurance Corp. to maintain its bank supervisory responsibilities — a move that would ease some community bank concerns with the legislation.

While observers are mixed on the Senate's chances, many members are optimistic that reform will happen in 2010. "There is a real sense that this is a moment in time where with these abuses, to not act would be a huge mistake," Sen. Mark Warner, a moderate Democrat on the Banking Committee, said in a December interview. "With the kind of mistakes that were made, to somehow say the status quo is acceptable just doesn't cut it."

The House bill largely followed a reform blueprint offered by the Obama administration in June, but the Senate bill is likely to look substantially different.

Dodd initially sought to create a single prudential bank regulator, merging the Office of the Comptroller of the Currency with the Office of Thrift Supervision and stripping both the Federal Reserve Board and the FDIC of their bank oversight. (In contrast, the House bill would combine only the OCC and OTS.)

But sources said Dodd may now opt to split bank oversight, with federally chartered entities overseen by the OCC (which would still be merged with the OTS) and state-chartered banks regulated at the federal level by the FDIC.

Such a move would please community bankers and FDIC officials, who have warned that a single banking regulator would be partial to the largest banks and effectively destroy the dual banking system.

Sources caution, however, that the bill remains in flux and subject to intense ongoing negotiations between members of the Senate Banking Committee. In particular, Dodd is said to be working closely with Sen. Richard Shelby, the lead GOP member of the panel, on certain aspects of the bill.

Shelby has already voiced support for removing the Fed from banking supervision but has said he wants to preserve the FDIC's role in banking supervision.

"The Dodd proposal threatens the very existence of the dual banking system," Shelby said at a Nov. 19 committee meeting. "I fear state charters will eventually be pushed to the side. … It stands to reason that the FDIC — and not the national bank supervisor — is the most appropriate agency to oversee these state-chartered banks."

What remains unclear is what happens to holding companies under the new scenario. Currently regulated by the Fed, Dodd's original bill would have given their oversight to the single bank supervisor. It is uncertain if the OCC would oversee all holding companies, share oversight with the FDIC, or if the Fed would ultimately be allowed to keep that power.

Some early speculation said that Dodd may propose allowing the Fed to keep oversight of holding companies that are deemed to be threats to the economy if they were to fail. Holding companies for most federally chartered banks would fall under the purview of the OCC, while the FDIC would oversee holding companies for state-chartered banks.

But a final decision on that does not appear to have been made, sources said, and it's not even clear Dodd would be willing to go along with it. Dodd has been adamant that the Fed must return to its monetary policy responsibilities, and rejected arguments that it should have oversight of systemically important firms and maintain its authority over holding companies. Shelby, too, has been harshly critical of the Fed, and may not support allowing the central bank any supervisory authority.

Overall, observers said Dodd will have to make many compromises — not just concerning regulatory consolidation — to get the bill moving.

"What we will see will be something very, very different from what Dodd put out initially," said Mark Calabria, a former aide to Shelby and now director of financial regulation studies at the Cato Institute. "The topics will be the same, but the approaches will be different. There will be a lot of moderation on it. There will be a lot of compromises made."

Dodd and Shelby released a joint statement on Dec. 24 that said negotiations were going well and that they were on track to cut a deal in January.

But Dodd acknowledged to reporters on Dec. 17 that Senate negotiations are tricky and can fall apart several times before a final deal comes together.

"It's the Senate. Anything could happen in five minutes that would change things, but we are having very strong, good meetings," Dodd said. "Things are moving well. My hope is when we get back in January and depending on how the progress is going, we'll schedule a markup on the committee, and by that time, I hope we'll have come to some real consensus on many of the issues — all of them if possible — and move forward with the bill."

Shelby offered a similarly upbeat assessment.

"We're moving from concepts to language and so forth," the Alabama lawmaker said. "Our attitudes — both Senator Dodd and I — are positive. We are going to keep it that way. We are dealing with a lot of very complex, very difficult items to get around and to get it right."

Dodd had initially hoped to broker a deal with Shelby over the summer, but talks broke down largely because of a proposed new consumer protection agency. The Connecticut Democrat then attempted to push ahead with a tough bill that he hoped to get out of committee along a party-line vote. Instead, members from both sides of the political spectrum persuaded Dodd to reopen bipartisan discussions to find a consensus approach.

Dodd then handed off major issues in the bill to bipartisan pairs of lawmakers.

Though a new draft of his bill is not expected to surface until after the Senate resumes Jan. 19, several members said in recent interviews that things were going well.

"We've been making a lot of progress, led by Senator [Jack] Reed," said Sen. Judd Gregg, R-N.H., who is working with the Rhode Island Democrat on provisions designed to strengthen regulation of derivatives and credit rating agencies. "Obviously the Senate schedule is very much in flux right now. I would hope we would have final passage of a major overhaul bill that would be bipartisan and constructive sometime in February."

Sen. Mike Crapo, R-Idaho, who has partnered with Democrat Sen. Charles Schumer, D-N.Y., on corporate governance and executive compensation issues, said the two were making headway.

"We are working aggressively, and we are making progress, but I wouldn't say that we are close to any kind of a final product yet," Crapo said in an interview last month. "Right now we are talking at the conceptual level. We are not working on language at this point."

Sens. Warner and Republican Bob Corker of Tennessee appear furthest along on their attempts to tackle systemic risk and resolution authority. The two had a head start as they had assembled their own informal effort to hammer out reform issues over the last year. In July they jointly introduced legislation to expand the FDIC's powers to resolve bank holding companies.

Corker and Warner are likely to give their section of Dodd's bill a rigorous edit.

"If this bill became law, as is, we wouldn't be talking about systemic risk. We would be talking about pandemonium," Corker told Dodd at a November hearing. "It would have a cratering impact."

Though nothing has been finalized between Corker and Warner, the two have long made clear they would not support anything they consider a bailout. They have said they are leaning toward an approach that favors exhausting bankruptcy channels before turning to resolution without providing the option of conservatorship.

Their approach to handling systemic risk is likely to focus heavily on beefing up prudential standards like higher capital requirements before turning to regulators to break up large, interconnected firms.

They are likely to task a council of regulators to monitor systemic risk, but they are considering what agency would enforce such standards. While the House bill would create a resolution fund for systemically important firms, Senate Banking Committee members still favor assessing other firms after the failure of such a company, rather than beforehand.

Warner and Corker said in separate interviews Dec. 17 that they had made significant progress, but they avoided getting into specifics and acknowledged some details were still being worked out.

"I'm as optimistic as I've ever been that we are going to be able to do something that is bipartisan, and I'm going to continue to work towards that end," Corker said.

Corker also predicted a bipartisan vote in late January or early February.

But he echoed Dodd's note of caution with a positive spin: "Something could change. There could be a dynamic thrown into this that I today don't know. It really is going exceptionally well. I think everybody is committed to getting to a 'yes' and having a bill that will stand the test of time. It's not an issue of compromise."

But the hardest issue may be the proposed creation of a consumer protection agency, a part of the bill left to Dodd and Shelby to work out.

Dodd's original bill would have created a consumer agency with broad rule-writing and enforcement power over both banks and nonbanks financial services providers. It also would have given states the power to write and enforce their own rules against all banks, effectively gutting national bank preemption.

Dodd has made the consumer agency one of his highest priorities but observers said if it survives the Senate it is unlikely to end up as powerful as originally envisioned.

Even House Democrats had to scale their version back. House Financial Services Committee Chairman Barney Frank agreed to restrict the CFPA's enforcement authority to institutions with assets of more than $10 billion — cutting out the vast majority of banks.

Frank also scaled back his preemption language by letting the OCC preempt state banking laws when they interfere with the business of banking. The House bill also carved out several niche groups, including insurance companies, auto dealers, accountants, tax preparers and lawyers. An amendment that would have stripped a CFPA from the reform bill altogether was only narrowly defeated, despite its support by many Democrats.

But Dodd may need to go even further. In a chamber where Democrats have a solid majority and Frank is among the strongest of any committee chairman in the caucus, many analysts said what they saw play out indicates the direction the bill is likely to move in the Senate.

"The House action was very instructive in the sense that obviously the expectation was they were going to pass something. But the range of the amendments and what happened on the floor was very important in terms of what has yet to come," said William Longbrake, executive in residence at the Robert H. Smith School of Business at the University of Maryland and a former vice chairman of Washington Mutual.

In the Senate, Shelby and most Republicans have objected to the notion of divorcing consumer protection from safety and soundness. Even some Democrats have suggested alternative solutions, such as focusing the agency exclusively on nonbanks.

Warner is one of several committee members who fear a consumer agency could create excessive burdens for banks that conflict with safety and soundness standards.

"I think there is a real concern that you don't separate prudential and consumer protection on the enforcement side for banks, but you absolutely must cover the nonbank lenders," he said in an interview Dec. 17.

The issue is also a sensitive one for other Democrats, including Sens. Jon Tester of Montana and Tim Johnson of South Dakota, whose states are heavily populated with community banks.

"My concern is about community banks and how we are going to handle them and make sure we don't put undue regulation on them, but rather more common-sense regulation," Tester said in an interview Dec. 3. "We're going to be working to carve out some of the CFPA ability."

Even Reed, who has generally been supportive of Dodd's approach, said that how to strengthen consumer protection shouldn't be viewed as simply an issue of whether or not to create an agency, but what the policy objectives should be.

"There's several issues," Reed said. "One is that you create a new agency. And then a very important question is to what extent is enforcement carried out by that agency or by other traditional agencies? That's one issue. To what extent is rulemaking unique to the new agency or is it a shared responsibility? What role will the new agency have in terms of coordination of enforcement if they don't have the enforcement responsibility? There's a whole series of principled questions that will be addressed."

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