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Unresolved Issues Haunt Systemic Bill; Lawmakers to spar over Fed power and fund for resolutions

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WASHINGTON -A House Financial Services Committee vote on a bill to create a systemic-risk regulator is likely to be a long, painful slog, given the myriad unresolved issues still outstanding.

Though debate is set to begin today on the legislation, observers pointed to a host of issues that need to be addressed, including how much power the Federal Reserve Board should wield over other regulators, how to create a resolution fund to handle the failure of systemically important firms and how high to set proposed risk retention requirements for securitizations.

"This is going to be very contentious," said Mark Calabria, director of financial regulations studies at the Cato Institute and a former Republican staffer on the Senate Banking Committee. "This is going to be close and I think it's going to be a very long markup."

Chairman Barney Frank acknowledged Tuesday that he does not expect a final vote on the bill for at least a week as lawmakers deal with various amendments.

But debate on the legislation is also likely to be heavily interrupted by outside events, including a planned vote on health-care reform and a break for Veterans Day next week.

Many panel members, meanwhile, are still struggling to read the 379-page bill and have not come close to tackling the complexities of a measure that remains fluid. There have been at least two drafts of the bill in just a week.

The bill's scope is vast. It would designate the Fed as the systemic-risk regulator, create an interagency council to help advise it, merge the Office of Thrift Supervision into the Comptroller of the Currency and create a resolution process to dismantle systemically important institutions.

Much of the negotiations have focused on how to fund the resolution process. The bill would require institutions with assets of at least $10 billion to contribute to a fund after the failure of a major firm to help the government recoup its costs.

But Frank said Tuesday that he would change the bill to require banks to pay into a separate fund before the failure of a systemically important firm. The switch comes at the request of Federal Deposit Insurance Corp. Chairman Sheila Bair, who has said it is important that affected firms pay for their own potential cleanup. Some sources have said the Massachusetts Democrat is considering the creation of a $200 billion fund, though the FDIC has estimated that $100 billion would be sufficient. The systemic resolution fund would be separate from the Deposit Insurance Fund, and would be paid by bank holding companies based on nondepository assets.

"I hope at some point it gets enormous, because I don't think you will need it for many years after you get this in place," Frank said. "Exactly how big it is you don't know."

Frank said that he would wait six months to a year before requiring firms to pay into the fund, and that he does not expect the government to to useit for years.

The change is unlikely to sit well with Treasury Secretary Tim Geithner, who warned last week that prefunding the resolution process was a mistake.

"If you create a fund in advance, there's a risk you're going to create more moral hazard," Geithner said at a hearing Thursday. "People will live with the expectation where the government will come in and protect them. We don't want to create that expectation. That's why we think it's better to do it after the fact."

The debate goes well beyond how the money is obtained, however. Under the bill, the FDIC would be allowed to borrow from the Treasury Department to resolve a firm if it did not yet have sufficient funds of its own to handle a resolution. But Rep. Brad Sherman, D-Calif., is expected to offer an amendment that would require Congress to act before the FDIC could borrow from Treasury.

Lawmakers are also considering eliminating a provision that lets the FDIC make loans to a systemically important institution to keep it afloat. The idea is to force the agency to put any such firm into receivership and prevent further bailouts.

Midsize banks, meanwhile, oppose being included in the assessment. They argue the $10 billion threshold for funding is too low, since many of them would not be viewed as systemically important.

Brian Gardner, a political analyst at KBW Inc.'s Keefe, Bruyette & Woods Inc., said such banks have a fighting chance of gaining some kind of additional leeway in the bill. "I would expect the smaller regional banks that would be covered in this are going to have much more success in getting what they want than the large banks in getting what they want," Gardner said.

Just as controversial are provisions that would give the central bank the power to act as a systemic-risk regulator. While many members of Congress have sharply criticized the Fed, the latest draft of the legislation gives the Fed more power than the Obama administration originally asked for. Under the bill, the central bank would have the power to overrule other agencies,though it would also answer to the systemic-risk council. The provisions may encounter a tug-of-war in the House and are certain to spark one in the Senate, observers said.

"While there are some members of the House Financial Services Committee that are OK with expanding the Fed's role, there are certainly members in the Senate wanting to go the other way," Gardner said.

The other regulators are also fighting the provision that would allow the Fed to override their authority for systemic-risk regulation.

The banking industry, meanwhile, is opposing a provision that would require creditors to retain 10% or more of credit for securitized loans and let regulators adjust that level to between 5% and 10%. Financial institutions argue the 10% base is too high and prefer a 5% base similar to one passed by the House earlier this year.

Another issue up for debate is a provision that would limit commercially owned banking companies. Those companies, such as industrial banks, would not have to divest but they would have to restructure and create a bank holding company. They would also have to face limits on their transactions between the holding company and its affiliates.

Given the calendar constraints, Frank said the earliest the bill could reach the full House floor is the first week in December.

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