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Banks Have Billions at Stake as Rulemaking Heads to Agencies

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June 21 (Bloomberg) -- While Congress puts finishing touches on its financial-regulatory overhaul, Wall Street lobbyists are preparing for a new battle out of the public spotlight and inside nearly a dozen federal agencies.

If the bill passes in roughly the form being negotiated by House and Senate lawmakers, regulators will be directed to write hundreds of new rules, conduct dozens of studies, combine two banking agencies and bring industries such as mortgage brokers under federal oversight for the first time.

The process will take place in an arena where technical knowledge and relationships with regulators take precedence over old-fashioned legislative arm-twisting. The lobbying will be intense because a slight change in the wording of a rule or in the definition of terms such as "major swaps participant" could curtail a firm's business -- or allow it to flourish.

"We ain't seen nothing yet," said David Hirschmann, president of the U.S. Chamber of Commerce's Center for Capital Markets Competitiveness.

The Chamber, reviewing a recent version of the text, counted 399 rulemakings and 47 studies that would be mandated by the bill. "This is going to be a huge implementation challenge and we are already getting ready for it," Hirschmann said.

Take the capital rules that the Federal Reserve would be required to write for the largest financial firms. The amount of capital a bank holds, and how much of it needs to be easily convertible to cash, directly impacts the bottom line. Capital is reserve funds that can't be spent on moneymaking activities like lending.

The difference between, say, a verdict that calls for banks to hold 8 percent of risk-weighted assets as capital, as opposed to 6 percent, could mean billions of dollars in lost profits.

Costly Overhaul

Analysts have already calculated that the overall impact of the regulatory overhaul will be costly to Wall Street banks. Goldman Sachs Group Inc.'s earnings per share could decline 23 percent and Morgan Stanley's would fall 20 percent, according to a June 16 report by Citigroup Inc. analyst Keith Horowitz. JPMorgan Chase & Co.'s profits may drop 18 percent and Bank of America Corp.'s 16 percent, Horowitz wrote.

That impact may change depending on how the regulations are written.

The legislation would require that the Fed, along with the new council of regulators headed by the Treasury Department, oversee financial companies deemed systemically risky. The council will have to determine which companies fall under the Fed's jurisdiction, whether they are banks, insurers, hedge funds or other financial firms.

Interchange

Under the bill's current language, Fed officials would also be charged with determining whether the so-called interchange provision, the debit-card "swipe" fees banks charge merchants, are reasonable. The Fed's view could determine whether billions of dollars end up with large banks or merchants.

Visa Inc. and MasterCard Inc., the world's biggest payment networks, set swipe fees and pass the money to card-issuing banks including Citigroup, JPMorgan and Bank of America. U.S. merchants estimate that they paid $48 billion in interchange fees in 2008.

Giving regulators with expertise a lot of room to maneuver is the only way to implement new rules, said Douglas Elliott, a fellow at the Brookings Institution in Washington.

"These things get very technical," said Elliott, a former JPMorgan investment banker. "It would be a real mistake for Congress to try to do it."

Start From Scratch

In some cases, the rulemaking has to start from scratch. The new consumer financial protection bureau would need to first write rules on how it will write rules. Then it would establish criteria for the companies and products it regulates.

The direction from Congress in the legislation is broad: The consumer agency is to police "covered persons," or any person offering or providing a consumer financial product or service. Some of the "covered persons" are defined in the bill, while others aren't.

For example, the agency would regulate mortgage brokers and anyone who is a "larger participant of a market for other consumer financial products or services." In the rule-writing, the agency would have to determine exactly what a "larger participant" is.

"It's all on-the-blackboard stuff until you get to the regs," said Wayne Abernathy, a former Treasury official who is now an executive vice president at the American Bankers Association. "That's when it becomes real life."

FDIC Fees

Another rule-writing that will be closely watched concerns the Federal Deposit Insurance Corp.'s regulation on fees that banks must pay into the deposit insurance fund. Fees now based largely on the deposits held by lenders would shift to being based more on assets. Custodian banks, which typically hold

more assets for other institutions than they manage, such as Boston- based State Street Corp. and Bank of New York Mellon Corp., could pay much more into the fund unless the FDIC agrees to treat them differently.

Proposals to tighten oversight of derivatives trading, the focus of Wall Street lobbying efforts for more than a year, will fall to the Securities and Exchange Commission and the Commodity Futures Trading Commission. The agencies will have leeway to interpret terms including “swap dealer” and “major swap participant.”

Firms classified as swap dealers and major swap participants will have to trade on regulated exchanges and through clearinghouses, and would be subject to capital and margin requirements. So-called commercial end-users that aren’t dealers or participants would be exempt from the regulation.

Technical Details

While the Senate and House bills give agencies as much as 18 months to write the most significant rules, the process could take much longer as the technical details are crafted, experts said.

“It’s physically impossible for the regulators to meet all the mandates in the bills in the timelines that are specified,” said Mark Calabria, director of financial regulation studies at the Cato Institute in Washington and a former aide to Republican Senator Richard Shelby of Alabama.

As such, the picture for financial regulation will remain cloudy until well into 2012, banking lawyers and former regulators said.

“Financial institutions of all types are yearning for clarity, but the simple truth is that certainty is many months away,” said David Nason, a former assistant Treasury secretary who is now managing director at Promontory Financial Group, a Washington-based consulting firm.

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