revenue from the issuers of bonds and other debt instruments they are paid to evaluate and rate, have been blamed in part for the financial crisis, since they failed to identify growing risk in the subprime mortgage market and elsewhere. Democrats have proposed creating an office (Reuters) at the SEC to oversee how the agencies determine their ratings. The proposal would also make suing the agencies over flawed ratings easier, a provision the rating agencies oppose.

*"If the government is going to indirectly set monetary policy anyways, then we might as well have transparency and have Congress do it directly," -- Mark Calabria*

Of greater concern, some experts say, is the fact that financial regulators use the agencies' ratings to determine capital requirements for financial institutions. The slashing of troubled insurer AIG's credit rating during the financial crisis triggered billions of dollars of collateral payments on its derivatives trades, prompting a liquidity crisis. "The fundamental problem is legislation and regulations that enshrine credit-rating agencies as gatekeepers to the capital markets. If these were stripped away, credit ratings would simply be opinions--no different from those of equity analysts," says Steil. Whether the government would have the expertise or personnel to evaluate such securities independently is another issue, says Elliott.

## Bank Bonuses and TARP Repayment

The Emergency Economic Stabilization Act, which authorized the Troubled Asset Relief Program, requires that, by the year 2013, the White House propose a way to recoup taxpayer losses from the financial industry. In an early response, the Obama administration proposed the "Federal Crisis Responsibility Fee," which would tax approximately fifty financial firms with $50 billion or more in assets roughly $9 billion per year for at least ten years or until the TARP costs are fully recovered. Some experts say the proposal--which came in advance of sizeable bonus payouts at large financial firms and rising public anger about double-digit unemployment--was politically motivated. The banking industry and Republicans argue that the tax deprives the financial industry of needed capital to stimulate economic growth through lending. Elliott says lending, which is mostly driven by bank deposits, would not be affected, because the plan would only tax banks' liabilities, not their deposits.

An additional Obama administration proposal would restrict the activities of the country's largest banks, barring commercial banks from so-called "proprietary trading" (investing in hedge funds, private equity firms, or other risky investments to boost its own profits) and raise existing caps on banks' market share. Currently those caps do not allow commercial banks to own more than 10 percent of the country's deposits. Under the proposed changes, the caps would include banks' non-insured deposits and other assets, a move the banking industry says would "reduce liquidity and increase risk" (*NYT*).

The banking industry also warns (*CSM*) that companies would pass any increased costs on to customers and shareholders, stifling bank's efforts to raise more capital. Morgan Stanley estimated (Reuters) the fee could eat up 4 percent of Deutsche Bank's 2012 earnings per share and 2 to 3 percent for Swiss banks Credit Suisse and UBS. Other estimates (*BusinessWeek*) put the cost of the tax at 22 percent of Bank of America's expected 2010 earnings per share and 12 percent of JPMorgan's. But Elliott says the industry can afford it: U.S. banks earn roughly $200 billion in pre-tax income each year and have $13 trillion in assets, whereas the tax would collect roughly $9 billion a year. By comparison, banking industry compensation totals roughly $150 billion per year, according to the FDIC. Smaller banks, which would not be subject to the tax, would also be able to continue their lending rates, says Elliott, which would leave competitive pressure on large banks wanting to raise their loan prices.

Weigh in on this issue by emailing CFR.org.

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