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Republican Study Committee

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Contents:

Key Conservative Concerns

Take-Away Points

--**Would not have prevented 2008 financial crisis:** Federal regulators did not foresee the 2008 financial crisis. Creating new offices for the same regulators will not give them better foresight.

--**Does not address Fannie/Freddie:** CBO predicts Fannie Mae and Freddie Mac will ultimately cost taxpayers $380 billion (they have already cost taxpayers $145 billion). The federal government guarantees more than $1.7 trillion of their debt. This bill does nothing to reform Fannie and Freddie—the root cause of the housing meltdown/financial crisis.

--**Negative impact on economy:** The legislation is another element of the Democrat agenda that will place new costs on businesses. The legislation will ration capital and credit, and place new red-tape on job creators, leading to further job losses.

--**Delegates very broad authority to federal regulators:** The legislation gives federal regulators *very* broad authority to carry out and to promulgate regulations for the provisions of the legislation. The shape of the regulations that will result, and the cost this will impose on the private-sector, is unknowable. Many conservatives would argue that Congress should not delegate such vast authority to unelected regulators.

--**Creates Consumer Financial Protection Bureau:** The bureau will have very broad regulatory authority to issue regulations. Many conservatives may believe that the powers of this office are an unconstitutional delegation of powers by the Congress to regulators.

For more details on these concerns, see below.

H.R. 4173 Conference Report—Restoring American Financial Stability Act
(Rep. Frank, D-MA)

Order of Business: The bill is scheduled to be considered on June 30, 2010 under a closed rule (H.Res. 1490) that waives all points of order against the conference report and against its consideration, provides that the conference report shall be considered as read, and provides two hours of debate.

Summary: *Highlights* of the conference report by title:

Title I

Financial Stability Oversight Council: The legislation creates a Financial Stability Oversight Council. The council will be made up of 10 federal financial regulators (and 5 non-voting members). Specifically:

- Treasury Secretary, Chairman
- Federal Reserve Board
- Comptroller of the Currency
- Consumer Financial Protection Bureau
- SEC
- CFTC
- Federal Housing Finance Agency
- Federal Deposit Insurance Corporation (FDIC)
- National Credit Union Administration
- Independent member appointed by President

The 5 nonvoting members:

- Office of Financial Research
- Federal Insurance Office
- A state banking regulator
- An insurance regulator
- A securities regulator

The council would be charged with making recommendations to the Federal Reserve for rules on capital, leverage, liquidity, and risk management intended to prevent companies from posing a risk to the financial system.

The council, with a two-thirds vote, would be allowed to require a nonbank financial company to be regulated by the Federal Reserve if it comes to the conclusion that failure of the company would pose a risk to the financial system. The council would also be allowed to require, with a two-thirds vote, a company to divest some of its holdings—if the council believes that the company poses a threat to U.S. financial stability.

New Office of Financial Research: The legislation creates an Office of Financial Research (within Treasury Department) intended to support the council through collection of financial data/economic analysis.

Title II

Liquidation Authority: The legislation establishes a process by which the executive branch may provide for an "orderly liquidation" of a company in an attempt to prevent financial instability in the U.S. financial system. The legislation specifies how the executive branch is to come to this decision by requiring the Secretary of the Treasury, with two other federal regulators in agreement, to make the determination. The conference report allows the FDIC to borrow from the Treasury to establish the orderly liquidation fund. The FDIC is appointed receiver of a company, when this process is used, and would be allowed to asses fees on financial firms with assets above $50 billion to pay for this process. **Some conservatives may be concerned that the liquidation process established by the conference report allows the federal government to seize private property without adequate opportunity for judicial review. Some conservatives may be concerned that this title allows the federal government to bailout financial institutions.**

Title III

Office of Minority and Women Inclusion: The legislation requires every federal financial agency (including those established by this legislation) to, within six months, establish an Office of Minority and Women Inclusion. Per the legislation, the Director of each office would be appointed by the Administrator of each agency. The Director would be required to:

- Ensure equal employment opportunity and racial, ethnic, and gender diversity of the agency's workforce and senior management;
- Increase the participation of minority-owned and women-owned businesses in the programs and contracts of the agency; and
- Assess the diversity policies and practices of entities regulated by the agency.

The legislation would also require each agency to consider the race, ethnicity, and gender of an applicant in reviewing and evaluating contract proposals. **Some conservatives may believe that the federal government should not require race to be used as a factor for awarding contracts.**

The legislation further requires agencies to seek diversity by:

- Giving preferences in recruiting efforts at historically black colleges and universities, Hispanic-serving institutions, women's colleges, and colleges that typically serve majority minority populations;
- Sponsoring and recruiting at job fairs in urban communities;
- Placing employment advertisements in newspapers and magazines oriented toward minorities and women;
- Partnering with organizations that are focused on developing opportunities for minorities and women to find employment;
- Partnering with inner-city high schools, girls' high schools, and high schools with majority minority populations to establish or enhance financial literacy programs; and
- Using any other mass media communications.

Federal Deposit Insurance Corporation (FDIC) Changes: The legislation makes the deposit insurance increase to $250,000 permanent.

Regulatory Restructuring: The legislation transfers the functions of the Office of Thrift Supervision to the Office of the Comptroller of the Currency. Per the bill, the Federal Reserve Board will supervise thrift holding companies and the FDIC will supervise state-charted thrifts. As part of this restructuring, federal workers impacted by the reorganization, would have their pay and benefits protected for 30 months.

Title IV

"Private Advisers" to Hedge Funds: The legislation eliminates the "private advisor" exemption from the Investment Advisors Act of 1940.

Title V

Federal Insurance Office: The legislation creates a Federal Insurance Office, in the Treasury Department, intended to collect information about the insurance industry. The Office will be charged with:

- Monitoring all aspects of the insurance industry, including "identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the United States financial system";
- Monitoring the extent to which underserved communities and consumers, minorities, and low- and moderate-income persons have access to affordable insurance products;
- Recommending to the Financial Stability Oversight Council that it designate an insurer as an entity subject to regulation as a nonbank financial company supervised by the Board of Governors;
- Assisting the Secretary in administering the Terrorism Insurance Program;
- Coordinating federal efforts and developing federal policy on prudential aspects of international insurance matters, including representing the U.S., as appropriate, in the International Association of Insurance Supervisors;
- Determining whether state insurance measures are preempted by covered agreements;
- Consulting with states regarding insurance matters of national importance and prudential insurance matters of international importance; and
- Performing such other related duties and authorities as may be assigned to the Office of the Secretary.

The legislation gives the Office the authority to preempt state insurance measures if the Director determines that the state insurance regulation:

- Results in less favorable treatment of a non-U.S. insurer domiciled in a foreign jurisdiction that it subject to a covered agreement than a U.S. insurer domiciled, licensed, or otherwise admitted in the state; or
- Is inconsistent with a covered agreement.

Nonadmitted and Reinsurance Reform Act of 2010: The legislation places new regulations on nonadmitted insurance and reinsurance. Including:

- States may enter into a compact or otherwise establish procedures to allocate among the states the premium taxes paid to an insured's home state.
- The legislation allows a state to require surplus line brokers and insureds who have independently procured insurance to annually file tax allocation reports with the insured's home state detailing the portion of nonadmitted insurance policy premium or premiums attributable to properties, risks, or exposures located in the state.
- The bill requires a state to have in effect laws or regulations that provide for participation of states in the national insurance producer database of the NAIC for the license of surplus line brokers in order for a state to collect fees related to licensing of an individual or entity as a surplus broker.
- A state may not prohibit a surplus lines broker from seeking to procure or place nonadmitted insurance with, or procuring nonadmitted insurance from, a nonadmitted insurer domiciled outside the United States that is listed on the Quarterly Listing of Alien Insurers maintained by the International Insurers Department of the NAIC.
- If the state of domicile for a ceding insurer is an NAIC-credited state, or has financial insolvency requirements substantially similar to the requirements necessary for NAIC accreditation, and recognizes credit for reinsurance for the insurer's ceded risk, then no other state may deny such credit for reinsurance.
- The legislation provides other preemptions on extraterritorial application of a state law that is not the domiciliary state of the ceding insurer.

Title VI

Volcker Rule: In general, the legislation prohibits investments beyond 3% of a bank's Tier 1 capital in hedge and private-equity funds.

Title VII

Derivative Regulation: The legislation requires many derivatives to be traded either through exchanges or clearinghouses. The bill also imposes various other new regulations on derivative firms.

Federal Employee Ban on Insider Trading: The legislation bans insider trading by federal officials who acquire information from their position in the government.

Study on Oversight of Carbon Markets: The bill establishes a ten-member Interagency Working Group to conduct a report on the study of oversight of existing and prospective carbon markets to ensure an efficient, secure, and transparent carbon market (including oversight of spot markets and derivative markets).

Title VIII

Risk Management Standards: The legislation requires the Board of Governors of the Federal Reserve, the Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission (CFTC) to establish and enforce risk-management standards for financial market utilities and payment, clearing, and settlement activities.

Title IX

Office of Investor Advocate and Ombudsman: The legislation creates an Office of Investor Advocate and Ombudsman, intended to assist investors in their dealings with the SEC. The legislation also authorizes the SEC to promulgate rules imposing a fiduciary duty on broker-dealers and investment advisers.

Regulation of Credit Rating Agencies: The legislation gives the SEC broader authority to regulate nationally recognized statistical rating organizations (NSROs) and creates a new Office of Credit Ratings. The legislation further requires the Office of Credit Ratings to:

- Write new rules that set up internal controls over the process for determining credit ratings;
- Establish an independent board of directors;
- Make greater disclosures to the public and investors; and
- Develop universal ratings across asset classes and types of issuer.

Asset-Backed Securitization Process: The legislation requires securitizers to retain an economic interest in a material portion of the credit risk for any asset that securitizers transfer, sell, or convey to a third party.

Executive Compensation: The legislation requires an advisory vote, at least every three years, on approving the compensation of executives. The legislation also requires federal financial regulators to monitor incentive-based payments of federally-regulated financial institutions larger than $1 billion. Further, the conference report requires regulators to prohibit incentive-based payment arrangements that regulators determine could harm financial stability.

Corporate Governance: The legislation allows shareholders to nominate candidates for an issuer's board of directors, and to have the candidate listed on the issuer's proxy materials.

Municipal Securities: The legislation requires the registration of municipal financial advisors and requires the Municipal Securities Rulemaking Board (MSRB) to create rules concerning their activities.

Title X

Consumer Financial Protection Bureau: The legislation creates a Consumer Financial Protection Bureau to be an independent bureau within the Federal Reserve System, and with a funding source dedicated from the Federal Reserve Board. The bureau would have wide latitude to write rules for banks and non-banks alike. The bureau would be given "consumer protection" responsibilities currently held by the Comptroller of the Currency, Office of Thrift Supervision, Federal Deposit Insurance Corporation, Federal Reserve, National Credit Union Administration, the Department of Housing and Urban Development, and the Federal Trade Commission. The bureau will have the authority to issue rules under several existing statutes, including: the Truth in Lending Act, the Equal Credit Opportunity Act, and the Real Estate Settlement Procedures Act. The Bureau will have a Director appointed by the President (subject to Senate confirmation). The bureau would be intended to write regulations in order to bypass the legislative process. **Many conservatives may argue that this as an unconstitutionally overly-broad delegation of powers.**

Creates Office of Fair Lending and Equal Opportunity: The legislation creates a new office of Fair Lending and Equal Opportunity, within the Consumer Financial Protection Bureau, that will be intended to enforce nondiscriminatory access to credit for individuals and communities under the Equal Credit Opportunity Act (ECOA) and the Home Mortgage Disclosure Act (HMDA). Two other offices are also created under the Consumer Financial Protection Bureau: an Office for Financial Education and an Office for the Financial Protection of Older Americans.

Interchange Fees: The legislation requires the Federal Reserve to issue rules, within 9 months of enactment, concerning new regulations on interchange fees. The bill instructs the regulations to be directed to this end: "an issuer may receive or charge with respect to an electronic debit transaction shall be reasonable and proportional to the cost incurred by the issuer with respect to the transaction." **Many conservatives would have concerns with setting this kind of price control.**

Title XI

Federal Reserve Governance and Oversight: The legislation requires the Government Accountability Office (GAO) to conduct an audit of Federal Reserve emergency lending since December 1, 2007. The legislation provides additional, ongoing, audit authority for Federal Reserve authority over the discount window, emergency lending, and open market transactions. The legislation further establishes a Vice Chairman for the Supervision of the Federal Reserve Board.

Title XII

New Programs: The legislation authorizes at "such sums" three new federal programs:

- A program intended to help low- and moderate-income individuals open low-cost checking or savings accounts;
- A program to increase access to financial advice for consumers;
- A program to create a pool of capital for community development financial institutions to establish alternatives to pay day loans.

Title XIII

TARP: The legislation reduces the amount authorized under the TARP program to $475 billion to pay for new spending instead of reducing the debt.

Title XIV

This title imposes a series of new regulators on mortgage lenders that proponents will say are intended to prevent predatory lending. In addition, this title creates a new $1 billion "Emergency Market Relief program," and provides $1 billion for a third round of Neighborhood Stabilization Program funding.

Title XV

This title includes miscellaneous provisions, which would (among other things):

- Instruct the U.S. Executive Director of the International Monetary Fund (IMF) to reject loans if the loan would be to a country that has a public debt in excess of economic output and is not eligible for assistance from the International Development Association.
- Include a sense of Congress that the exploitation and trade of conflict minerals originating in the Democratic Republic of the Congo is helping to finance conflict characterized by extreme levels of violence in the eastern Democratic Republic of the Congo. Creates new reporting requirements on for public companies trading in minerals from conflict zones.
- Create mine safety reporting requirements on mine operators.
- Create new requirements for the disclosure of payments by resource extraction issuers.

Committee Action: The legislation was introduced on December 2, 2009 and referred to multiple committees. A previous version of the legislation passed the House on December 11, 2009 by a vote of 223-202. The Senate passed its version of the legislation on May 20, 2010 by a vote of 59-39.

Cost to Taxpayers: The legislation increases taxes by $13.5 billion over ten years and increases entitlement spending by $10.2 billion over ten years.

Does the Bill Expand the Size and Scope of the Federal Government?: Yes. The legislation creates new programs and greatly expands federal regulation of the private-sector.

Does the Bill Contain Any New State-Government, Local-Government, or Private-Sector Mandates?: No CBO report is available with this information. However, the bill consists of *many* new regulations on the private-sector, as well as creating new regulators that would then issue unforeseen new regulations and mandates.

Does the Bill Comply with House Rules Regarding Earmarks/Limited Tax Benefits/Limited Tariff Benefits?: The Joint Explanatory Statement states that the conference report contains no earmarks.

Constitutional Authority: No statement of constitutional authority is available. Many conservatives have argued that some of the provisions in the bill are unconstitutional, since it contains numerous overly broad delegations of authority to regulators and injects the federal government even further into private-sector financial operations than what exists today.

Outside Organizations Urging a "No" Vote:

Note: This is not an exhaustive list.

American Bankers Association
Americans for Limited Government
American Financial Services Association
Consumer Bankers Association
National Association of Criminal Defense Lawyers
National Association of Mortgage Brokers
U.S. Chamber of Commerce

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