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To: Interested Parties
From: Americans for Financial Reform
Re: GOP Alternative to S. 3217
Date: April 28, 2010

For nearly a year, both parties in Congress have been debating the direction of financial reform. Ever since the bill moved to the final stages of Senate deliberations, however, opponents of reform have had a hard time choosing a line of attack. Is it too tough on banks and Wall Street ("stifling innovation"), or not tough enough ("a bailout bill")? We finally have an answer. Yesterday, the united Republican opposition delivered a summary of their alternative.

The Republican financial reform summary exposes that the bill's opponents are not actually as concerned with the resolution authority mechanisms in the bill—their "bailout" canard—as they are with weakening tough bank regulations and stripping investor and consumer protections from the Dodd bill. The architecture of the Dodd bill is followed but essential parts are watered-down in an attempt to maintain the status quo, which will benefit bankers on Wall Street at the expense of consumers and small businesses on Main Street.

The Republican summary follows the lead of the Dodd bill in creating an early warning system, a resolution mechanism, a consumer protection agency, enhanced investor protections, and derivatives regulations. While there may be broad agreement in principle, the teeth of the Dodd bill are necessary to hold big banks accountable, protect consumers and put the regulations in place to prevent the Wall Street abuses that led to the economic crisis.

Bank and Non-Bank Financial Regulation:
The best way to prevent bailouts is to restore the strong regulatory structure that Congress dismantled over the past 20 years, at the behest of Wall Street lobbyists. It is not surprising, then, that Republican summary contains no teeth on the upfront regulation of large, interconnected financial institutions necessary to prevent another collapse:

- **Excludes Tough Requirements to Rein in the Largest Financial Companies:** Nowhere does the Republican summary require the Federal Reserve to impose tougher capital, leverage, and liquidity requirements, as well as living wills, on the largest and riskiest banking and nonbank financial companies. The Dodd bill would mandate that the Fed make it more expensive and onerous to be bigger

and riskier; the Republican alternative would maintain the "Too Big to Fail" status quo.
- **Fails To Prevent the Next AIGs and Lehmans:** Nowhere would the Republican summary provide for oversight of "shadow banks" – large, complex nonbank financial companies to prevent future Goldman Sachs, AIGs, and Lehmans (none of which were Fed-regulated before the crisis) from also wreaking havoc on financial markets, the economy, and jobs.

Consumer Protection:
The consumer protection Council in the Republican summary would stifle important new protections, necessary to empower consumers to make good financial decisions and to prevent a future crisis:
- **Worse than the Status Quo:** In the Republican summary, the council will not be able to issue any consumer protection rules without the approval of prudential regulators, and likely cannot issue rules to address unfair, deceptive or abusive practices at all -- which will stifle consumer protections. That is the status quo, or worse. It was the failure of federal prudential regulators to address consumer protection that led to this problem.
- **Protects Abusive Lenders:** In the Republican summary, it appears that payday lenders, auto dealers brokering car loans , check cashers, debt collectors and the like will not have to fear rules to prevent unfair and deceptive practices, and it will be easy for them to violate existing laws, operating "under the radar" , because of weak supervision and enforcement.
- **Cuts States Out Of Consumer Protection:** In the Republican summary, it appears to cut out the role of the states altogether in enforcing consumer protections. Additionally, gutting AG enforcement of consumer protection laws would, in effect, inhibit states from punishing people who break the law.

Orderly Liquidation Authority:
Despite the overblown "bailout" rhetoric, the Republican summary shows that there is no real dispute on resolution; the Republican summary mimics the Dodd bill for most of the provisions in the orderly liquidation authority. The Dodd bill mandates that the failed company be liquidated, and provides that taxpayers will suffer no losses in the liquidation. Importantly, however, the Dodd bill includes a $50 billion fund <u>paid for by risky financial institutions</u> to cover any losses beyond the sale of the firm's assets. Without this fund – which Wall Street obviously opposes – the U.S. Treasury has to offer a line of credit.

Prudential Regulation:
The Republican summary includes less streamlining of prudential regulation. The alphabet-soup of regulatory bodies created a race-to-the-bottom among regulatory agencies which helped create the regulatory failures that enabled the financial crisis.

Federal Reserve Provisions:

Many of the key provisions of the Republican draft substitute are already included in the Dodd bill. These include prohibiting Fed 13(3) emergency loans to any individual company, Treasury approval of Fed emergency lending, strict collateral requirements on emergency lending, enhanced Fed accountability for emergency lending through extensive review and reporting requirements, appointment of the president of the NY Federal Reserve Bank by the President, and Presidential appointment of a Federal Reserve officer who will have responsibility for bank supervision and regulation and who will report periodically to the Congress and public.

Volcker Rule:
The Republican summary includes a watered-down Volcker rule:

- **Limited Proprietary Trading Prohibition:** The proprietary trading restrictions are only for depository institutions, and other entities (presumably affiliates of the depository institutions), and would only be restricted if the holding company is not well capitalized or if the Federal Reserve makes a determination.
- **Failure to Address Sponsored Hedge Funds:** Nowhere does the summary mention a prohibition of sponsoring hedge funds.

Investor Protections:
Many of the key provisions of the Republican summary are already included in the Dodd bill, including authorizing the systemic risk regulator to monitor large hedge funds, requiring hedge fund registration, require more disclosure for asset-backed securities, and reforms to the municipal securities market. Separate from these similarities, fewer investor protections are included in the Republican summary than are included in S.3217:

- **Limits "Skin-in-the-Game" Requirements:** The Republican summary would require risk retention ("skin-in-the-game") ONLY to residential mortgage loans leaving the financial system at risk for securitized loans of other toxic assets. The Dodd bill includes a comprehensive, flexible framework for regulators to set standards for each distinct class of assets.
- **Weaker Regulation of Credit Rating Agencies:** The Republican substitute glosses over the failure in our credit rating system, offering minor tweaks to the current broken structure rather than meaningful reform. The alternative does nothing to strengthen the SEC's ability to monitor the credit rating industry, nor would it raise obligations for ratings firms to undertake appropriate due diligence, as does the Dodd bill, or hold them legally accountable for their actions. Based on the summary, it appears that Republicans would also remove all regulatory references to NRSRO ratings, while the Dodd proposal gives regulatory discretion.
- **Fails to Include Meaningful Changes to the SEC:** The Republican summary rearranges the deck chairs on the Titanic, while the Dodd bill adds solid steel reinforcements to the hull. The Shelby draft simply rearranges the SEC Divisions

but the Dodd includes numerous provisions to strengthen the SEC and its ability to protect investors, such as the ability to reform mandatory arbitration, GAO audits of SEC internal management controls, a robust new whistleblower program, an Office of Investor Advocate. The Dodd bill provides for more resources to the SEC through self-funding.

- **Fails to Strengthen Shareholder Power:** The Republican summary does not include any provisions to strengthen shareholder power through reforms of majority voting, say-on-pay, proxy access, and compensation disclosures. The Dodd bill includes these strong provisions.
- **Excludes the SEC's Ability to Monitor Hedge Funds for Fraud.** The Republican summary excludes the ability of the SEC to monitor hedge funds for fraud.
- **Changes to Sarbanes-Oxley Would Increase Risk of Fraud:** The Republican summary makes a drastic change to a provision of the Sarbanes-Oxley Act that would decrease the reliability of financial statements, weaken internal controls, weaken the integrity of business operations, increase the risk of internal financial fraud, increase accounting restatements, and reduce investor confidence in financial statements.

Derivatives Regulations:
Most important derivatives provisions in the GOP summary are in the Dodd bill and the Banking-Ag derivatives bill. These include mandatory clearing, mandatory exchange trading, mandatory speculative position limits, prudential capital requirements for swap dealers and major swap participants, margin requirements for uncleared swaps, public reporting requirements, segregation of assets requirement to protect counterparty collateral, and regulation of clearinghouses. Despite these similarities, other provisions in the GOP summary would weaken provisions in the Dodd bill:

- **Less transparency:** GOP summary has no mandatory exchange trading requirement, meaning no pre-trade price transparency and hence no lower costs for users of derivatives, as well as less transparency for regulators and market participants.
- **Bureaucratic Process for Identifying Swaps for Clearing:** in the GOP summary, the Federal Reserve, SEC and CFTC would first establish criteria for mandatory clearing, then the CFTC and SEC would use the criteria to identify swaps for mandatory clearing. How long will it take for the 3 regulators in the first step, and the 2 regulators in the second step to reach agreement; will clearing be stalled if the regulators fail to reach agreement?
- **Unworkable End User Exemption:** by using the "*bona fide*" definition of an end user, the GOP proposal would include Swaps Dealers, hedge funds, other financial institutions, and systemically risky entities within the end user exemption. This is an unacceptable level of risk to American taxpayers.