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Financial Reform Is Being Gutted … And Congress Might Not Even Realize It

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As I have repeatedly pointed out, proposed derivatives legislation will not make things better:

A leading credit default swap expert (Satyajit Das) says that the new credit default swap regulations not only won't help stabilize the economy, they might actually help to destabilize it.

Senator Cantwell says that the new derivatives legislation is weaker than current regulation

Now, Mike Konzkal points out that the new derivatives bill may be completed gutted, and that Congress might not even realize it:

Have lobbyists snuck another major loophole into the OTC Derivatives bill? This week the final touches are being put on Barney Frank's financial regulation bill – H.R. 4173 – "Wall Street Reform and Consumer Protection Act of 2009." One of the centerpieces of this reform is Title III: Over-the-Counter Derivatives Markets Act. And one of the goals of this reform would be to get as many derivatives as possible to trade on exchanges…

For a while, reformers have been worried about an "alternative swap execution facility." This would be a way of essentially allowing the current way things are done to be allowed to count as an exchange. Fighting off this loophole was a battle from a month ago, and it had appeared to be won. Nowmany are worried that this language appears to have snuck back into the final bill now.

Colin Peterson (D-MN), Chairman of the House Committee on Agriculture, along with Barney Frank, has added an amendment to the OTC Bill (opens large pdf) …

The definition of a swap execution facility has been expanded to include "a person" (different from the "or entity"). It's also expanded to an "or trading" definition, and includes voice brokerage firms. So now we are moving from the definition of something that is a platform for swaps to be traded on to instead something that simply helps swaps get traded. **This could, quite simply, be a telephone over which two people trade a derivative**(with one person declaring himself to be the exchange?). **Instead of changing the way business is done for reform it looks like it redefines reform as the way things are currently done…**

[Another provision] here allows an intermediary to execute a swap, ignoring the section 2(k) which is the meat of the reform, as long as the swap is recorded somewhere. Now we already have, from above, that a swap execution facility can be something other than the exchange. **This is a rule that guts the regulation right out the door, and for no apparent benefit to reform.** Many of these alternative swap facilities will be owned by the banks, so it won't necessarily force the price transparency that has been promised. To trust regulators to simply do the right thing is naive at best when the ability to follow fixed rules is available.

From what I'm hearing, it is possible Frank doesn't even know that this language, once in the bill as an amendment but removed, has snuck back into his reform legislation. Things are moving very quickly on the hill right now, and this is scheduled to be wrapped up by tomorrow. However this new language runs counter to the reforms Frank has promised to deliver to the American people. Either this language needs to be clarified before the bill is complete, or removed entirely.

As Ryan Grim notes, many other aspects of the financial reform package – such as the Consumer Financial Protection Agency – are being gutted as well. He points out that the states' ability to rein in financial fraud is also under attack.

Congressional Quarterly summarizes the fight over consumer protection (subscription required):

House leaders are trying to settle a dispute between liberal and moderate Democrats that threatens to sideline, at least temporarily, a bill to overhaul regulation of the financial system.

The battle centers on two proposed amendments to the bill's consumer protection provisions that moderate Democrats are demanding a vote on. Should those amendments not be made in order, members of the New Democrat and Blue Dog caucuses probably would vote against a rule to commence debate on the bill (HR 4173), a House aide said. That would in all likelihood quash the rule, given that Republicans are likely to oppose it unanimously.

But liberal Democrats are staunchly opposed to the amendments, and have threatened to abandon the bill if at least one of them is adopted. But the liberals also fear they do not have the votes to kill either amendment.

One amendment would allow federal regulators to preempt state financial laws and the other essentially would scrap the creation of a Consumer Financial Protection Agency.

"We still have some details to hammer out," said Michael E. McMahon, D-N.Y., a New Democrat who has played a prominent role in the caucus negotiations over the final regulatory overhaul bill.

The amendment that would give the federal government the ability preempt state laws on financial protection issues is being offered by Melissa Bean of Illinois, a New Democrat. Supporters argue that, without it, financial companies would face a patchwork of state and federal regulations.

The other amendment, to replace the proposed consumer agency with a council of regulators that would oversee consumer protections for financial products, was offered by Idaho Democrat Walt Minnick, a Blue Dog.

The financial industry staunchly opposes creation of the agency, saying it will squelch innovation. The Chamber of Commerce is "whipping the vote hard" on the Minnick amendment, a House aide said.

Investment analyst and financial writer Yves Smith exhorts her readers to call Congress today to fight back against the lobbyists:

OK, sports fans, I know politics sucks, but it takes VERY LITTLE time to call or e-mail your representative to give him or her a piece of your mind. If you are not trying to be part of the solution, you are part of the problem. And if you can take a few minutes to call, be sure to call an in-state office, not the DC office. One big issue is a late addition to the House financial reform bill which would further crimp state's rights (and recall it was the states, that led the charge on dot-com abuses, auction rate securities, and now on alleged rating agency fraud. This is an effort to gut the last channel willing to take on the banksters). Even Reuters is putting the state of play in unusually stark terms:

An army of lobbyists from banks and Wall Street have worked for months to block, water down and delay the bill, which would threaten the profits of many financial services firms.

A summary of all proposed amendments to the financial reform bill has been put together by the Committee on Rules.

The 242-page "manager's amendment" – a kitchen-sink amendment that pulls in all the last minute deals (so you can actually see handwriting on the PDF) is where you can see a lot of important policy changes.