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House approves sweeping, post-crisis bank reform

Lawmakers impose a Fed audit in two years, make it easier to sue credit raters

By Ronald D. Orol, MarketWatch

WASHINGTON (MarketWatch) -- House lawmakers on Friday approved the most significant increase in the regulation of U.S. banks and other corporations since the Great Depression, placing new restrictions on the nation's biggest banks, reining in the Federal Reserve and providing more help for troubled homeowners.

The mammoth legislative package -- which passed 223-202 with every Republican and 27 Democrats voting against the bill -- includes new fees, leverage limits and other restrictions on 'too-big-to-fail' financial institutions, a requirement to audit the Fed's balance sheet within two years, more say for shareholders on the pay of top executives and new investor protection safeguards.

The bill gave small public banks and corporations many exemptions from a substantial share of the new regulations.

PM Report: Consumers Get Regulatory Guardian Angel

The News Hub panel discusses legislation passed that will create a consumer-oriented regulatory body to address concerns about financial institutions, a resurgence of support for John McCain, James Cameron's new movie, Avatar, and more.

The White House applauded the House action, saying that policies in Washington had played a large part in creating the financial crisis.

"The crisis from which we are still recovering was born not only of failure on Wall Street, but also in Washington," said President Barack Obama. "We have a responsibility to learn from it, and to put in place reforms that will promote sound investment, encourage real competition and innovation, and prevent such a crisis from ever happening again."

Lawmakers narrowly defeated a bipartisan effort to destroy a proposed Consumer Financial Protection Agency and replace it with a weaker council. The proposed consumer agency would supervise and regulate mortgage and credit card products including pay-day lenders and other lenders that have so far escaped regulation.

Rep. Steny Hoyer, D-M.D., the Democrat Majority Leader, spoke in defense of the creation of the consumer agency, arguing without it, bank regulators that failed to identify problems associated with subprime mortgages in the build up to the financial crisis, would stay in control of consumer protection.

"A major failure of the previous administration was regulatory neglect," Hoyer said, seeking to appeal to Democrats in the minutes before the vote on the council.

The package includes new supervision of trillions of dollars in complex derivatives products, new power to file suits against credit raters that have been blamed for overly rosy debt ratings and the creation of a council of regulators that would set capital standards for big banks and monitor systemic risk.

The package also requires big banks to pay into a $150 billion fund that would be used to dismantle a "too-big-to-fail" bank whose collapse otherwise would unsettle the markets. The fees would be used to make payments to creditors counterparties of the failed institution so that they wouldn't fail as well.

Muted support from the Treasury Department

Treasury Secretary Timothy Geithner commended the House for passing the legislation, but added that he and administration officials look forward to continuing their work with Congress to "strengthen key provisions" as the measure moves towards final passage.

Many provisions in the legislation matched proposals released by the administration earlier this year, but the Treasury Department's proposal would have preferred to set up a system to dismantle a large failed bank by first using taxpayer dollars that would be later recouped by fees assessed on the financial industry. Instead, under the approved legislation, bank regulator collect fees in advance from banks to cover the cost of dismantling an institution.

Bank reform legislation has been introduced in the Senate but is only expected to be approved next year.

Help for homeowners

Responding to concerns from the Congressional Black Caucus, lawmakers approved using $3 billion of bank bailout funds to give out fixed-rate, low-interest loans to unemployed people facing foreclosure and an additional $1 billion to give states financial incentives to buy abandoned or foreclosed homes and prepare them to become rental properties.

But a contentious measure referred to as the cram-down provision, giving bankruptcy judges the authority to modify mortgages to help troubled homeowners avoid foreclosure was narrowly rejected. Bank groups had lobbied heavily against the measure, with community bankers even threatening to pull their support for the entire bill.

"Allowing bankruptcy courts to cram-down principles will only lead to higher interest rates," said Rep. Lamar Smith, R-Texas. "Why should those who have done nothing wrong need to pay that price?"

Bigger fees, more rules

Dozens of other measures were approved, including one that grants the Federal Deposit Insurance Corp. the authority to make assessments on large banks and other big institutions to cover shortfalls from the bank bailout program within five years.

"Large financial institutions that caused the credit crisis will be required to make taxpayers whole," said Rep. Gary Peters, D-Mich.

The package also imposed sweeping new recordkeeping, reporting and trading regulations on trillions of dollars in derivatives transactions, with extra-stringent requirements for Wall Street traders who will be required to have much of their trades in the complex securities take place through transparent clearinghouses.

Lawmakers exempted commercial operating company end users from having their transactions go through clearinghouses, which are intermediaries between buyers and sellers.

Small businesses also received an exemption from accounting rules. Lawmakers defeated an effort to void a provision giving small public corporations relief from an audit requirement that dates from the post-Enron Sarbanes-Oxley Act. Over 100 Democrats voted in support of granting small businesses the relief.

Credit rating agencies under the gun

Credit rating agencies also were targeted by lawmakers. A variation of a measure introduced by Rep. Brad Sherman, D-Calif., which would alter the Securities and Exchange Act of 1934 to make it easier for investors to file lawsuits against credit rating agencies, was also included in an amendment approved Thursday night.

The measure would lower the liability standard for credit rating agencies from "knowingly or recklessly," to "gross negligence."

Fed audit in two years

A series of measures introduced by Rep. Michael Burgess, R-Texas, were also approved by the House, including a provision that would require the Government Accountability Office to conduct an audit of the Federal Reserve's monetary policy as well as how much the central bank has lent and will lend to specific banks within two years of when the legislation was approved.

The House Financial Services Committee in November approved a Fed audit bill introduced by Rep. Ron Paul, R-Texas., but had set no deadline for when the GAO must act.