RSC Republican Study Committee

Financial Services Working Group

Congressman Scott Garrett (R-NJ), Chairman

Congressman Tom Price (R-GA), RSC Chairman

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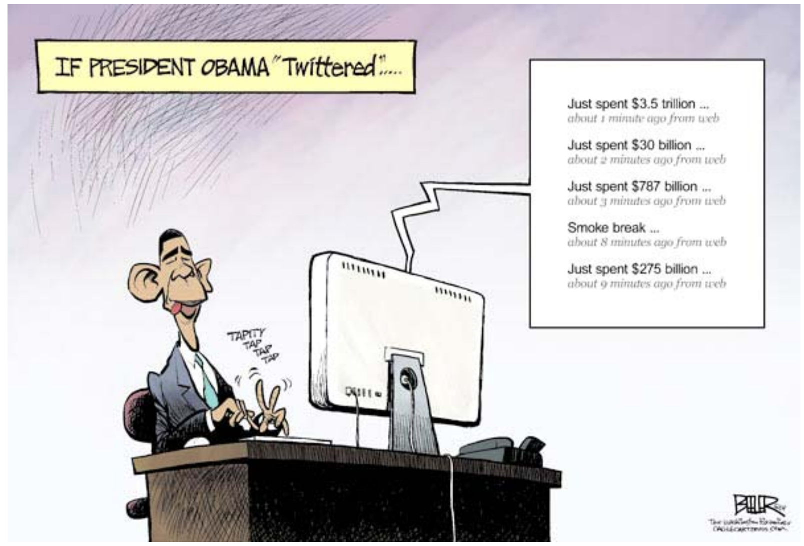
Over-the-Counter Derivatives

Derivatives have proved to be effective tools for helping American companies manage their financial risks, even though poor practices have allowed some companies to use derivatives in a way which harmed their own financial health. In this debate it is important to preserve and protect the important benefits these financial contracts provide for American businesses while proceeding with reform of a broken and outdated financial services regulatory structure. Derivative products provide firms the ability to minimize risk and benefit individual consumers. The use of these products spans multiple industries such as agribusiness firms and energy users; in doing so, these products provide consumers protection against energy and food price spikes. Good risk management reduces costs for consumers, increases economic growth, and creates more jobs.



Chairman Frank's Derivatives Bill

While there are some improvements over the Administration's initial derivatives proposal, the Frank draft still represents characteristics of so many Democrat proposals over the last several months – intrusive government over-reach into yet another sector, marked by cumbersome, unnecessary and counterproductive layers of regulation (up to 2-3 additional new layers), and "solutions" that don't address the actual problems that caused the financial crisis. The legislation's goal of forcing much of the OTC derivatives market onto an exchange or through central clearing facilities and to impose capital and margin requirements will do more harm than good – making it too expensive for many companies to enter into prudent risk management.

- **This will kill jobs and raise food and energy prices**
- **Proposed capital and margin regime will reduce, rather than increase competition in the dealer community, further concentrating the market with the largest dealers and thus exacerbating systemic risk.**
- **Other provisions could have the effect of sending more of these markets overseas**

On the Horizon

Derivatives and Consumer Financial Protection Agency Legislation Mark-Up This Week

The Financial Services Committee will be marking up Chairman Frank's derivatives legislation, as well as his legislation for a new Consumer Financial Protection Agency, this week.

A Consumer Financial Protection Agency (CFPA) has the potential to reduce consumer choice, and limit innovation and credit availability by establishing a new bureaucracy to regulate individual financial products and services, from credit cards to annuities, and gives government bureaucrats the job of deciding which financial products are suitable for sale to the public.

Ultimately, it could damage the financial system and consumer well-being by separating consumer protection from supervisory functions, ensuring that consumer protection is undertaken in a regulatory vacuum.

The CFPA could lead to the extinction of many widely used financial products such as home equity lines of credit, adjustable rate mortgages, ATM cards, and certain debit card services offered by community banks.

For more information contact Chris Russell at 5-4465 or Brad Watson at 6-9719

Another Scary Czar
Some Blue Dogs have a better way to protect financial consumers.

THE WALL STREET JOURNAL.
WSJ.com

The time of year has arrived again when the stores fill up with the masks and costumes of Halloween. Some folks probably think Washington has spent most of the past year creating scary things, from the Stimulus Monster to the Trillion Dollar ObamaCare castle. But wait, there's more. Moderate Democrats in Congress, small-town bankers and their customers are now trying to protect themselves from yet another Beltway "czar."

The name of this proposed Frankenstein is the Consumer Financial Protection Agency, or CFPA. Under the current draft in Barney Frank's Committee on Financial Services, the consumer czar would have the authority to collect fees from financial firms and dictate the "manner, settings and circumstances for the provision of any consumer financial products or services." The agency could require lenders to submit an unlimited amount of information, as often as the czar demands.

America's new regulator of lending would have the power to declare products and services "unfair" and "abusive." Obviously any such designation by a federal agency would create massive liability for services that were legal at the time they were offered. There will be no escape from the lawyers and their pitchforks: The lending czar could prohibit consumers and companies from agreeing to settle their disputes with arbitration instead of litigation. Boo.

The CFPA would get an oversight board made up of the heads of other financial regulatory agencies. But this is merely an apparition: The legislation explicitly states that the board has no executive authority. None. It can only "advise" the director. This absence of effective checks and balances doesn't exactly fit with the mantra of responsibility in Washington these days.

The nominal point of this effort is to again punish the Wall Street titans for their sins.The good news is that it is dawning on Members of both parties in Congress that the CFPA monster is likely to damage the availability of consumer credit for their constituents. As analyst Meredith Whitney recently wrote in these pages, credit card lines have dropped 25% since last year. Credit lines available via credit cards are a critical source of financing for small businesses.

Is this decline entirely the result of the financial crisis, or are card issuers responding to new Federal Reserve regulations finalized in December? The Fed rules make it harder to change credit terms on existing customers. Congress and the President went further this past spring, enacting new restrictions on the ability of card issuers to raise rates, including on customers who don't pay on time.

This means that many former customers are simply no longer going to be profitable for banks. Expect more reductions in credit lines as the issuers try to adapt.

Undeniably it would benefit both lenders and borrowers if less credit were the result of stronger underwriting. That would prevent loans destined for default. But the consumer-protection diktats of the CFPA czar in far-off Washington will be explicitly divorced from considerations of bank safety and soundness.

Moderate Democrats, making yet another run to protect their constituents back home, have been circulating an alternative to the Frank proposal. They would immediately assign the existing federal regulators to a council that would ensure consistent rules for serving consumers across all institutions. They would also add state financial and insurance officials, elected by their peers among state regulators, to benefit from their expertise. The council would set broad rules on consumer protection and disclosure to eliminate perceived regulatory gaps.

Mr. Frank wants his committee to throw the switch on his own CFPA bill next week. Does he have the votes? As always, moderate Democrats fear that crossing the Chairman would mean the end of their influence.

Supporting Mr. Frank also has a cost, however. Rural members are hearing from community bankers that their strapped institutions can't afford new layers of Washington regulation to pay for the sins of Wall Street. In truth, many smaller banks also bet heavily on real estate, but are in no shape to take another hit to profitability.