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Financial bill under attack over loopholes

Package lacks adequate oversight, critics say

By Michael Kranish and Alan Wirzbicki, Globe Staff and Globe
Correspondent | October 31, 2009

WASHINGTON - As Representative Barney Frank nears his goal of pushing a massive financial regulation package through the House Financial Services Committee, parts of the legislation are coming under blistering assault from consumer groups as well as key Democrats, who say it contains loopholes that could set the stage for another financial meltdown.

Senator Maria Cantwell, a Washington Democrat, is among those who said they have watched with dismay as Frank's committee has passed provisions that they say would enable much of the controversial trading in derivatives to continue without adequate oversight.

“Loopholes got us into the problem to begin with and loopholes will continue,” Cantwell said in an interview. “If people are paying attention they will see that there is still a house of cards and that these loopholes are going to codify that.”

Derivatives are complex financial instruments whose value is based on underlying assets, such as real estate, and are used to bet or hedge on how those assets will change in value. It was the collapse of one

form of derivatives, an insurance product for subprime mortgages known as credit-default swaps, that deepened the financial crisis last year.

Frank defended his bill, saying that derivatives would face unprecedented levels of oversight, and that he has gotten at least 85 percent of what he wanted in the financial reform package, but he said that he had to accept some compromise provisions in his role as a deal-maker in the House.

“You lose a little of your political freedom,” he said in an interview. “I am constrained from criticizing the deal I have gotten. My job is to make the best deal I can.”

Frank said his compromise bill would subject most derivatives trading to federal oversight, while providing some exemptions to corporate “end users,” such as airlines that use them to protect against increases in jet fuel prices. The Newton congressman said he is convinced that corporations that need to hedge against cost increases shouldn’t be put in the same category as banks and other financial institutions that speculate on derivatives.

The derivatives measure is part of a landmark legislative package that would mark the greatest change in financial rules since the Great Depression and would be one of Frank’s premier legislative accomplishments. The package calls for creating an agency to protect consumers against shady lending practices, granting federal regulators new powers to take over businesses that are “too big to fail,” and putting hedge funds under more oversight.

Republicans object to much of the package, while fellow Democrats support Frank. But now, with his committee expected to finish its work in the next week or so, some elements - such as the rules on derivatives and the jurisdiction of the consumer protection agency - have come in for harsh criticism as details emerge about them.

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Some consumer groups said they had little chance for input when the committee discussed the exemptions on derivatives trading.

Frank adopted the position of the US Chamber of Commerce and other business lobbies and “walked away from the concerns of the major unions, consumer groups, and environmental groups,” said Michael Greenberger, the former director of trading and markets of the Commodities Futures Trading Commission, who now advises Americans for Financial Reform, a coalition of 200 organizations, including consumer groups and unions.

Frank acknowledged that “we made a mistake that we did not have broad enough testimony” from consumer groups, saying that he believed their views were echoed by administration officials.

Gary Gensler, the current chairman of the Commodities Futures Trading Commission, which oversees part of the derivatives market, said Frank had overseen an historic effort to bring new levels of scrutiny to much of the derivatives trading. But Gensler said the measure should be rewritten so that a larger number of derivatives deals are subject to scrutiny.

“If we can bring more transactions in, we further lower the risk of the financial sector,” Gensler said in an interview. He said he would try to work with Frank’s panel as well as the House Agriculture Committee, which oversees commodities-related derivatives, to strengthen the measure.

Several other members of Congress said in interviews that the bill is fundamentally flawed because of the way it treats derivatives trading. Representative Bart Stupak, a Michigan Democrat, said he plans to try to amend the bill when it reaches the House floor, which is expected in mid-November. The measure would then go to the Senate, where Cantwell and other senators are hoping to strengthen it. Senator Bernard Sanders, the Vermont independent, said he applauded Frank for going as far as possible on the legislation, but said “he has got some political issues on the committee of some

people not wanting to go as far as we should.’’

Cornelius Hurley, director of the Morin Center for Banking and Financial Law at Boston University, said the fault lies not only with Frank, but also with the Obama administration. “They have pretty much wasted the crisis,” Hurley said, calling the legislation that has emerged so far timid.

Some consumer groups are also complaining that the committee has weakened the role of the Consumer Financial Protection Agency, one of the other signature items in the president’s proposal. The agency is intended to police financial products such as credit cards, loans, and mortgages, but is widely opposed by business groups. In response to pressure, the committee exempted retailers, small banks, and some other categories from the agency’s direct oversight.

“Everybody seems to have their local hometown industry and they think, ‘Well, my industry wasn’t the problem.’ But this agency isn’t designed to address yesterday’s problems,” said Lauren K. Saunders, managing attorney of the National Consumer Law Center in Washington.

But Ed Mierzwinski, consumer program director of US PIRG, praised Frank’s effort. “He took some hits where he had to take some hits, but the bottom line is this: He reported a bill that establishes an independent agency with authority over virtually all financial products,” he said.

Objections have also been raised to Frank’s decision to drop from the bill an administration proposal that would have given the new agency power to enforce a 1977 law mandating that banks serve low-income communities.

“In the interests of Barney trying to create consensus, he has cut out the limbs and we’re left with the torso,” said John Taylor, president of the National Community Reinvestment Coalition, which dropped its support of the bill as a result of the changes.

Frank said he did not believe that enforcement of the Community Reinvestment Act belonged under the purview of an agency focused on protection of individual consumers. Representative Michael E. Capuano, a Somerville Democrat, who favored including the CRA in the bill, nonetheless strongly backed Frank's handling of the legislation.

"He's trying to balance every issue out," Capuano said. "The fact the bill is moving at all is a pretty good thing." ■