US House panel approves pro-Wall Street derivatives bill

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The Financial Services Committee of the US House of Representatives on Thursday approved a bill incorporating loopholes and exemptions that will allow Wall Street banks to continue unimpeded their lucrative trade in derivatives—the murky financial instruments that played a major role in the near-collapse of the global financial system.

The measure, drafted by the Democratic chairman of the committee, Rep. Barney Frank of Massachusetts, was approved along party lines, with only one Republican member of the committee joining all 43 Democrats. The bill, ostensibly to regulate the $592 trillion derivatives market, was touted as a pillar of the Obama administration's scheme to "toughen" federal regulation of banks, hedge funds and other financial firms.

It will be merged with a similar bill working its way through the House Agriculture Committee before being voted on by the full House. The House bill will then be reconciled with what promises to be an even weaker bill still to be acted on by the Senate.

After passing the derivatives bill, the Financial Services Committee turned to the next major plank in the administration's financial overhaul—the creation of a Consumer Financial Protection Agency purportedly to police corporate abuses in consumer credit markets, including credit cards, auto loans, mortgages and student loans. It quickly adopted a loophole exempting 98 percent of the nation's banks from oversight by the proposed agency.

These actions make clear that no serious measures will be taken to rein in the speculative practices of banks, insurance firms and other financial companies that precipitated the deepest economic crisis since the Great Depression. The big banks and financial firms, which have received trillions of dollars in government subsidies, are using their taxpayer bailouts and government assurances that they will not be allowed to fail to generate huge profits and record bonuses for their top traders and executives. They are employing the same methods of gambling with borrowed money, including speculation in derivatives, which led to last year's financial meltdown.

The term "derivatives" embraces a broad spectrum of financial dealings undertaken by companies to hedge against fluctuations in everything from interest rates, currency values and commodity prices to weather patterns. Among the most important derivatives are credit default swaps. These are contracts agreed to between corporations in which the seller insures the buyer against the default of specific corporate bonds or securities.

The transactions are currently "over the counter," i.e., arrived at privately without being listed on any exchange, such as the stock market. Since the passage of a law in 2000 supported and signed by then-Democratic President Bill Clinton, they have been unregulated.

The 2000 law sparked an explosive growth of this form of financial speculation. The credit default swap market, according to some calculations, now has a face value of nearly $600 trillion, up from $88 trillion a decade ago. The biggest traders in credit default swaps, such as JPMorgan Chase and Goldman Sachs, make outsized profits by collecting fees for brokering credit default swap contracts.

Trading in credit default swaps played a major role in the subprime mortgage bubble that imploded in August of 2007, leading to the financial crash of 2008. The collapse of insurance giant American International Group (AIG), which has to date received $182 billion in government funds, was the result of the firm's massive holdings in credit default swaps tied to subprime mortgage-backed securities and other dubious assets. AIG bet that the underlying mortgages would not default. It lost its bet and was required to come up with huge amounts of cash as collateral, which it did not have.

AIG's imminent failure threatened to bankrupt thousands of "counterparty" banks and other financial firms around the world, provoking a panic that was stanched only by the infusion of hundreds of billions of taxpayer funds into its coffers and those of scores of other financial firms.

Wall Street has lobbied intensively against any effective federal regulation of credit default swaps and other derivatives. On June 1, the *New York Times* published a lengthy exposé revealing that Obama's treasury secretary, Timothy Geithner (formerly the president of the Federal Reserve Bank of New York), had adopted a proposal drawn up by a group of big Wall Street firms and confidentially "shared with the Treasury Department and leaders on Capitol Hill."

The banks proposed that trading in derivatives be conducted through privately-owned and controlled clearinghouses, closely tied to Wall Street firms, and that federal oversight be limited to so-called "standardized" derivatives. "Customized" derivatives would be exempt from federal regulation. The vague category of "customized" derivatives includes the most lucrative credit default swaps and other derivatives, which would be shielded from public scrutiny or government regulation.

The *Times* indicated that Geithner had in all essentials accepted the banks' proposal.

The bill adopted by the House Financial Services Committee is even weaker than that proposed by the Obama administration. It not only exempts "customized" derivatives from oversight by the Securities and Exchange Commission and the Commodity Futures Trading Commission, it also exempts so-called "end users" of derivatives. This is a broad and hazy category embracing non-financial firms that employ derivatives to hedge against "operational risks," such as rising energy costs, currency fluctuations and extreme weather.

But as *New York Times* financial columnist Gretchen Morgenson pointed out Sunday, there is nothing to stop hedge funds, private equity companies and banks from setting up dummy companies that meet the "end user" definition, so that their derivatives trades will escape federal regulation.

"Another questionable exemption," she wrote, "says that if a swap is to be exchange-traded, it must be deemed 'clearable' by facilities known as clearinghouses. Some of these are partially owned by banks…. Gee, do you think the banks might be a tad hesitant to punt a very lucrative line of business onto less profitable exchanges? Do you think they night have an incentive to say that the most profitable swaps simply aren't clearable?"

Federal regulators expressed concerns over the loopholes in the Financial Services Committee bill. Gary Gensler, chairman of the Commodity Futures Trading Commission (CFTC), in a statement Thursday called for "legislation that covers the entire marketplace, without exception, and to ensure that regulators have appropriate authorities to protect the public."

Newsweek's web site posted an article October 16 citing a "senior regulatory official" as warning that the exemption for "end users" of derivatives was a "big regulatory gap." The official added that Gensler was concerned that the bill exempted all foreign exchange trades as well as dealings on overseas exchanges and that the CFTC 'will not have enough authority over exchanges and clearinghouses, for example, to set margin requirements.' The article added that he is "worried about a provision that allows privately run clearinghouses dominated by Wall Street to change rules or contracts without CFTC review, undermining the authority of government regulators."

Newsweek commented, "But thanks to weeks of intense pressure from Wall Street banks and their customers in corporate America, the bill that was approved on Thursday by Rep. Barney Frank's Financial Services Committee is riddled with exceptions and loopholes, many critics say. If it becomes law, Wall Street's finest could be driving truckloads of new derivatives products through those loopholes for years to come."

Morgenson in her column quoted Michael Greenberger, a University of Maryland professor and expert on derivatives, as saying that "the plain language of the legislation can only be read as a Christmas tree of decorative gifts to the banking industry."

The Obama administration gave its stamp of approval to the bill. Assistant Treasury Secretary Michael Barr told reporters Thursday, "In our view this is a tough, strong piece of legislation."

The derivatives bill, as well as the committee's consumer protection bill—which exempts more than 8,000 of the country's 8,200 banks from oversight by the proposed new agency—illustrates the effective dictatorship of the US financial aristocracy over government policy. Wall Street's domination of every branch of government is bolstered in no small measure by its use of the blunt but effective instrument of bribery, in the form of campaign contributions and other perks, dispensed to politicians of both parties.

The *New York Times* on Thursday noted that the financial services industry has poured over $220 million into lobbying so far this year, much of it directed toward shaping the administration's financial regulatory plan.

The newspaper further pointed out that over the past decade, banking and other financial interests have contributed more than $77 million to the members of the House Financial Services Committee. Two of the biggest recipients are Barney Frank, who has received more than $3 million, and the ranking Republican on the committee, Spencer Bachus of Alabama.

As for the Obama administration, its leading financial officials largely consist of millionaires with close ties to Wall Street. The *Financial Times* on Thursday cited financial disclosure forms showing that before joining the government, Gene Sperling, a senior Treasury adviser, was paid $888,000 by Goldman Sachs and $158,000 for speeches to companies including the Stanford Group, the company headed by Allen Stanford, who has since been charged with massive fraud.

Matthew Kabaker, another Treasury adviser, earned $5.8 million at Blackstone, the private equity firm, in the two years before he joined the administration to help draft plans to rescue the financial industry.

Previously released forms revealed that Lawrence Summers, chief economic adviser to the White House, was paid $5.2 million by DE Shaw, the hedge fund, in the two years before he joined the administration. As treasury secretary under Bill Clinton, Summers ushered through the law that deregulated the derivatives markets.