Obama's Latest Monstrosity

By John Berlau

The 2,315 page Dodd-Frank financial regulation bill that President Obama will sign today should not be called "financial reform." Instead the bill, which passed the Senate 60-39 last week when Massachusetts Senator Scott Brown joined Maine Senators Olympia Snowe and Susan Collins to grant cloture, should be called what for what it is: pages and pages of massively costly, counterproductive and possibly unconstitutional mandates on nearly every type of business except for those government-sponsored enterprises at the root of the crisis. And while the bill claims to crack down on excesses on Wall Street, its harshest impact will likely be on Main Street businesses that had nothing to do with the meltdown.

A front-page Wall Street Journal article this week noted that "far from Wall Street, President Barack Obama's financial regulatory overhaul... will leave tracks across the wide-open landscape of American industry." The Journal notes that "the bill will touch storefront check cashiers, city governments, [and] small manufacturers."

But one thing it will leave totally untouched is the government-sponsored enterprises Fannie Mae and Freddie Mac, which new research by Congress's Financial Crisis Inquiry Commission and other bodies shows was even more of a prime factor in the subprime boom than originally assumed. The Federal Housing Finance Agency now reports that Fannie and Freddie purchased 40 percent of all private-label subprime securities in 2003 and 2004. Indeed, according to Edward Pinto, housing scholar and Fannie's former chief credit officer, millions of mortgages to borrowers with credit scores of less than 660, considered by prominent researchers to be the dividing line for subprime loans, had been labeled by Fannie and Freddie as prime going back as early as 1993.

Rather than wait for Congress's own Financial Crisis Inquiry Commission to issue its report in December to examine the role of the GSEs and other causes, Congress passed a bill that will not prevent future bubbles and imposes untold costs that will put the country in danger of slipping back into a recession.

New collateral requirements on derivatives could cost U.S. companies as much as $1 trillion in lost capital and liquidity, according to the International Swaps and Derivatives Association. And as the WSJ piece notes, these costs would hit not just big banks, but farmers who use derivatives to hedge the price of their crops and fuel for their tractor. The new Consumer Financial Protection Bureau could also hit retailers that issue credit tangentially related to their business, such as small stores that offer layaway plans.

On the other side of the retail ledger, some of the biggest retailers also got an unjustified mandated benefit with the Durbin amendment that puts price controls on the interchange fees they pay to process credit cards. This corporate welfare for fat cat merchants will mean higher costs to consumers, community banks, and credit unions.

In addition, the bill contains provisions that will empower special interests at the expense of ordinary shareholders and that may exceed the limits of the U.S. Constitution. The bill's "orderly liquidation" authority will allow the Federal Reserve and the Treasury Department not only to bail out firms whose

failure is deemed to be a threat to "financial stability," but to actually seize firms that are not even asking for a bailout.

The "proxy access" provisions would override longstanding state rules in corporate director elections and force companies and their shareholders to subsidize director elections of special-interest shareholders -- such as unions, environmentalists and others. This would give progressive groups leverage to cut deals with management to push through agenda items, such as the "card check" abolition of secret ballots in labor elections and carbon cap-and-tax reductions, that they can't get through the halls of Congress.

The silver lining is that the more people found out about the potential unintended consequences of this bill, the less popular it became. The bill cleared cloture with the bare minimum 60 votes that it needed. In the House, almost all Republicans, as well as 19 Democrats, voted no on the final bill.

Brown's vote was certainly disappointing to those who supported him and expected him, if not to be conservative on every issue, at least to be one who doesn't go along with phony big-government reform. But other ostensible conservatives in safe seats who would eventually vote against the bill also share much of the blame for smoothing passage. Sen. Bob Corker (R-Tenn.) and retiring Sen. Judd Gregg (R-N.H.) became the media's favorite Republicans in the spring by constantly making comments to the effect that they agreed with "90 percent" of the bill, and it would take just "5 minutes" for the parties to resolve their differences.

Their soft-pedaling of the disagreements, rather than sounding the alarm about the bill's flaws, made the parties' differences seem trivial and gave red-state Democrats, as well as Brown and the "Maine sisters," cover to offer their support. In the end, both Corker and Gregg would become more vocal in their criticisms -- Gregg gave a particularly impassioned floor speech last week calling the derivatives rules "simply a punitive exercise" that will "make it harder for Americans to be competitive" -- but the damage of their playing to the cameras had already been done.

Republicans also should have insisted on Fannie and Freddie reform from the beginning as a precondition to negotiation on any bill. The bill's lack of action on the GSEs became a valuable talking point in the end in communicating to the public that this bill was anything but "reform." Given Dodd and Frank's allegiance to the GSEs, insistence on action from the beginning may have stopped the bill in its tracks.

As a result of the growing skepticism of the bill, a few of the most horrific provisions publicized by the Competitive Enterprise Institute and other free-market groups -- such as those that would have hurt angel investors and ensnared manufacturers in the definition of "financial companies" -- were dropped. And one genuinely pro-growth reform was adopted.

That measure, which was added over Chairman Dodd and Chairman Frank's objections, helps fix costly and counterproductive provisions of the last "financial reform": the Sarbanes-Oxley Act of 2002. This provision will permanently exempt smaller public companies -- those with market valuations of $75 million or less -- from the law's section 404(b), the mandate of an audit of a company's "internal controls." This requirement and the rest of Sarbox did nothing to stop the accounting schemes at companies like Lehman Brothers and Countrywide, but instead frustrated honest entrepreneurs with audits of trivial items like possession of office keys and number of letters in employee passwords, and

cost the U.S. economy $35 billion a year. (I wrote about Sarbanes-Oxley's burdens and lack of investor benefits in my paper, "SOXing it to the Little Guy.")

Thanks to this relief, many smaller companies should once again be able to afford the cost of going public and get the financing they need to grow into the next Microsoft, Facebook or Google. That is, if they don't get strangled by the other mounds of red tape in this bill.

In this bill, much arbitrary power is delegated to an army of new regulators. In the end, it was heartening that many informed citizens and their lawmakers did their own due diligence on this bill, and weren't stampeded into supporting a measure labeled as "getting Wall Street." They will need to continue this scrutiny in examining the mounds of regulations to be implemented under the bill's authority.

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