



July 2010 Outlook

POLITICAL LANDSCAPE

Financial Reform Bill Takes Shape, Awaiting Final Senate Vote

On June 25th a marathon 20 hour session, capping two weeks of negotiations, produced an agreement between the Senate and House of Representatives on financial reform legislation, setting up the required votes by each chamber before it can go to the White House for signature. On July 1st the House passed the bill by a 237 to 192 margin, leaving it up to the Senate, the vote expected to occur in early-mid July. A 60% Senate vote is needed to pass the law (as opposed to the simple majority called for in the House – this vote was 55% in favor). The Senate’s own version was passed 59-39 in May, with all but a handful of Democrats in favor and all but a handful of Republicans opposed.

Final Senate arm-twisting now is in process. Proponents need to replace Robert Byrd, whose death reduces the Democrats’ majority to 58. Attention has been turned to previously opposed Democrats – on July 2nd Washington’s Maria Cantwell switched to an in-favor position – as well as previously in-favor Republicans. This includes Scott Brown, whose opposition to a \$19 billion cover charge of the big banks and hedge funds to pay for the legislation led to a revised approach in which final TARP funds would be used in combination with a ten-year payment plan administered by the FDIC.

Generally, the bill is designed to improve consumer protections, tighten regulations, curtail risky bank trading, and enable “orderly liquidations” of large firms. While recognized as necessary, it has been criticized on many levels. One major omission is a side-step of any language pertaining to Fannie Mae and Freddie Mac, two government-sponsored lenders with large risk – mortgage debt of around \$8 trillion is either directly held or backed by the two entities. This will need to be addressed separately. Also, the so-called “Volcker Rule” separating banks’ core lending from riskier proprietary trading was watered down (lobby pressure was of course intense), giving banks a full 12 years to reduce hedge fund/private equity stakes and allowing 3% of capital to remain so invested.

The bill’s support clearly reflects an understanding of narrative ahead of the fall elections, which follow the second anniversary of Lehman’s collapse. Flaws aside, it would be difficult to make a coherent argument against the legislation to voters still very much feeling the effects of the financial crisis, as it led directly to sharply curtailed lending, loss of confidence in the business community and severe job losses.

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