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U.S. to tackle markets rules

On the list: when and how to break up large financial firms

By Damian Paletta

WASHINGTON—U.S. lawmakers are set this week to debate some of the thorniest issues facing policy makers as they overhaul the country's financial-market rules, including the structure of the central bank, how to oversee systemic risks to the economy, and how to break up large companies whose failure could threaten financial markets.

Bills being drafted by the House of Representatives' Financial Services Committee are expected to empower the government to place into conservatorship or receivership any faltering firm whose insolvency could threaten the U.S. economy or financial markets. Government officials would likely be directed in those instances to wipe out shareholders and force debtors and creditors to take substantial hits.

Under the bills, the government could also lend money to a failing institution, and place new limits on capital and debt at large financial institutions.

Legislation drafted by the committee led by Rep. Barney Frank, a Massachusetts Democrat, is expected to make more explicit than in previous Treasury Department proposals the powers government officials will have when they take over large companies.

"These are very difficult questions, and I think there are a lot of different views on them, and an awful lot of vested interests that would be affected based on how those questions come out," said Oliver Ireland, a former Fed attorney who is now a partner at Morrison & Foerster in Washington.

Democrats and Obama administration officials consider the new powers vital to any new financial-regulatory structure, but Rep. Frank has described the process of how to break up large financial companies as one of the most difficult to solve.

"Finding the balance, where you have effective resolution authority but without money going to people who shouldn't get it; [that's a] difficult issue that we're making some progress on," he told reporters last week.

The issue of new government powers to take over and break up large financial institutions has vexed policy makers since last year, when Lehman Brothers Holdings Inc. was allowed to fall into bankruptcy and **American International Group** Inc. was bailed out by the U.S. government. Federal Reserve Chairman Ben Bernanke told a congressional panel that policy makers were hamstrung in their approach to **Citigroup** Inc. because they didn't have any power to wind down the bank's parent company.

Democrats believe new powers are necessary to restore market discipline and end the dilemma of how to handle floundering companies that are deemed too big to fail. But organizing the new powers has proven complex. Who should be able to decide when a company is shut down? Which companies should be part of this process? And who pays for it?

Treasury officials in March and July circulated separate drafts of legislation to create new government powers to place a large financial company into either conservatorship or receivership. Those bills would empower the Treasury Secretary, with the endorsement of the Fed and potentially the Federal Deposit Insurance Corp. or Securities and Exchange Commission, to seize any faltering firm whose collapse imperiled the broader economy. The government would be able to sell the firms' assets, restructure contracts, fire management, and even lend the firm money in certain cases.

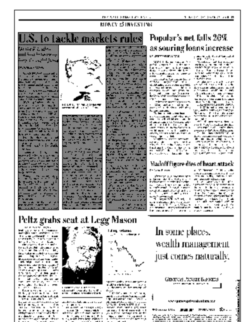
Rep. Frank's proposal is also expected to set up a trigger that mandates that the largest firms must boost their capital holdings if they run into trouble, as a way of preventing them from becoming so weak they collapse.

Banks already face such triggers, referred to as "prompt corrective action," but the government doesn't have the power to impose these policies on other types of financial companies. Companies coming under the new so-called resolution authority would likely include bank holding companies, parent companies of securities firms, insurance companies and futures commission merchants.

House lawmakers are shifting to these issues after Rep. Frank passed a separate bill through his committee last week to create a new consumer-protection agency to regulate financial products such as mortgages and credit cards.

Mr. Frank's panel plans to hold a vote on oversight of systemic risk, supervision of banks, and resolution authority beginning next week. The bills could be debated and see a vote on the House floor sometime in November.

—Michael R. Crittenden contributed to this article.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