



Special Report

from BMO Capital Markets Economics



**ECONOMIC
RESEARCH**

BMO  **Capital Markets**

Senate Passes Financial Reform Bill

May 21, 2010

Sal Guatieri
Senior Economist

www.bmocm.com/economics
1-800-613-0205

After months of debate, the Senate on Thursday finally approved the most comprehensive overhaul of financial reforms since the Great Depression. The Senate's legislation must now be reconciled with a broadly similar House bill that was passed in December, a process that could take several weeks but is almost certain to result in a final bill for President Obama to sign into law, likely before summer's end. Some proposals will no doubt be tweaked and watered down before final passage.

The Senate bill:

- forces banks to separate derivatives and proprietary trading from their banking operations
- provides regulatory oversight of systemic risks in the financial sector
- gives government the power to liquidate "too-big-to-fail" financial firms without exposing taxpayers to the bailout costs
- provides new oversight of the derivatives market (derivatives would trade on exchanges and pass through clearinghouses)
- sets up a new consumer-protection watchdog (within the Fed) to guard against lending abuses
- imposes new restrictions on credit rating agencies

Compared with the House bill, the Senate version contains somewhat tougher proposals regarding banks. It would force deposit-taking firms to curb proprietary trading, which could force some to spin-off their derivative and swap trading operations into affiliates and sell investments in hedge funds and private equity funds. The House bill does not contain the so-called Volcker Rule on proprietary trading, but it does allow the government to curb bank practices that pose a risk to the economy. The House bill also creates a \$150 billion fund financed by large financial firms that would be used to wind down failed companies. The Senate bill would charge big banks after the fact.

The new regulations could limit risk taking and increase costs especially for large banks. The Wall Street Journal notes that some analysts think the Senate reforms could reduce profits of large financial firms by roughly 20%. The reforms could push derivatives trading offshore towards foreign banks and new players that are likely to pop up on Wall Street. All in, the financial reforms—especially if the restrictions on proprietary trading prevail in the final bill—could shift the balance of competitive power from large U.S. banks to new, smaller and foreign financial companies.

A possible side-effect of the financial reforms is that fees and borrowing costs for American businesses and consumers could increase. But this would be a small price to pay if the bill ultimately reduces the risk of another financial calamity.

The information, opinions, estimates, projections and other materials contained herein are provided as of the date hereof and are subject to change without notice. Some of the information, opinions, estimates, projections and other materials contained herein have been obtained from numerous sources and Bank of Montreal ("BMO") and its affiliates make every effort to ensure that the contents thereof have been compiled or derived from sources believed to be reliable and to contain information and opinions which are accurate and complete. However, neither BMO nor its affiliates have independently verified or make any representation or warranty, express or implied, in respect thereof, take no responsibility for any errors and omissions which may be contained herein or accept any liability whatsoever for any loss arising from any use of or reliance on the information, opinions, estimates, projections and other materials contained herein whether relied upon by the recipient or user or any other third party (including, without limitation, any customer of the recipient or user). Information may be available to BMO and/or its affiliates that is not reflected herein. The information, opinions, estimates, projections and other materials contained herein are not to be construed as an offer to sell, a solicitation for or an offer to buy, any products or services referenced herein (including, without limitation, any commodities, securities or other financial instruments), nor shall such information, opinions, estimates, projections and other materials be considered as investment advice or as a recommendation to enter into any transaction. Additional information is available by contacting BMO or its relevant affiliate directly. BMO and/or its affiliates may make a market or deal as principal in the products (including, without limitation, any commodities, securities or other financial instruments) referenced herein. BMO, its affiliates, and/or their respective shareholders, directors, officers and/or employees may from time to time have long or short positions in any such products (including, without limitation, commodities, securities or other financial instruments). BMO Nesbitt Burns Inc. and/or BMO Capital Markets Corp., subsidiaries of BMO, may act as financial advisor and/or underwriter for certain of the corporations mentioned herein and may receive remuneration for same. "BMO Capital Markets" is a trade name used by the Bank of Montreal Investment Banking Group, which includes the wholesale/institutional arms of Bank of Montreal, BMO Nesbitt Burns Inc., BMO Nesbitt Burns Ltée/Ltd., BMO Capital Markets Corp. and Harris N. A., and BMO Capital Markets Limited. TO U. S. RESIDENTS: BMO Capital Markets Corp. and/or BMO Nesbitt Burns Securities Ltd., affiliates of BMO NB, furnish this report to U. S. residents and accept responsibility for the contents herein, except to the extent that it refers to securities of Bank of Montreal. Any U. S. person wishing to effect transactions in any security discussed herein should do so through BMO Capital Markets Corp. and/or BMO Nesbitt Burns Securities Ltd. TO U. K. RESIDENTS: The contents hereof are not directed at investors located in the U. K., other than persons described in Part VI of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001.

™ - "BMO (M-bar roundel symbol) Capital Markets" is a trade-mark of Bank of Montreal, used under licence. © Copyright Bank of Montreal.