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Grassley Bucks GOP, Backs Derivatives Curbs

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WASHINGTON—Democrats won the support of a senior Republican Wednesday for a sweeping overhaul of the market for derivatives, as both sides appeared to be inching closer to a broader deal on new financial market rules after a week of bitter feuds.

The backing from Sen. Charles Grassley (R., Iowa) of a derivatives bill in the Senate Agriculture Committee is the first sign of what Democrats hope will be an eventual wave of Republican support for legislation to rewrite financial regulations. Mr. Grassley was the first Senate Republican to support any part of the financial overhaul.

Although differences remain about how to regulate Wall Street, the populist rhetoric that infected the debate has cooled. Senate Banking Committee Chairman Christopher Dodd (D., Conn.) was locked in negotiations late Wednesday with Sen. Richard Shelby (R., Ala.) over a potential compromise, which some believe could come within days.

"There's a much greater chance today for a bipartisan bill than there was a week ago," said Sen. Mark Warner (D., Va.).

Talks have collapsed many times before. One Republican senator, Tennessee's Bob Corker, emerged from a briefing with Mr. Shelby and said he was "relatively depressed" by the direction of the latest discussions. If another breakdown occurs, Democrats have vowed they would take the bill to the Senate floor next week and try to bust apart a threatened Republican filibuster.

The 13-8 committee vote came after Mr. Grassley broke with other members of his party, catching the attention of lawmakers from both parties and White House officials who have been pushing for a deal. Mr. Grassley even said he favored one of the bill's most controversial elements, a provision that could force Wall Street banks to spin off their derivatives trading desks.

The broader package would rewrite rules touching almost every part of financial markets. It would create a consumer-protection division within the Federal Reserve, give the Fed more scrutiny over large financial companies, give the government powers to break up failing firms and place limits on the practices of the country's biggest banks.

President Barack Obama will seek to raise the political pressure further for the overhaul in a speech in New York City on Thursday.

Messrs. Dodd and Shelby are focusing on issues that many lawmakers feel can be easily resolved. For example, they are still discussing how much power state attorneys general should have to sue national banks and whether banks should be shielded from certain securitization rules if they originate loans that meet certain underwriting standards. It remains unclear, though, how they will resolve differences over derivatives.

The agriculture panel's bill would require derivatives dealers and traders to execute contracts on trading platforms and through clearinghouses, exposing much of the sometimes-murky world to outside scrutiny. White House officials pushed for this because so little was known about the derivatives exposure that nearly toppled American International Group Inc.

Derivatives are a type of financial instrument used by manufacturing, energy and agriculture companies, among others, to hedge risks such as those associated with interest rates or commodity prices. Some financial firms also make large speculative bets on these products, which were at the heart of the financial crisis.

Five large U.S. banks, including J.P. Morgan Chase & Co. and Goldman Sachs Group Inc., made more than $20 billion trading derivatives last year. They have fought to change the bill's provision that would force Wall Street banks to spin off their derivatives-trading operations.

White House officials, too, have pushed back against that provision, which is being championed by Sen. Blanche Lincoln (D. Ark.), chairwoman of the agriculture committee. Administration officials fear the bill could lead some big banks to instead shed their regulatory charters, which would allow them to keep these units.

The bill sponsored by Ms. Lincoln and passed Wednesday would exempt many nonfinancial firms from some of the new restrictions. These companies have argued that new rules could cost them billions of dollars in interest and collateral and were unfair because these companies didn't pose a broader risk to the financial system.

Just how broad the exemption for these companies should be is a major flashpoint, and White House officials could try to narrow the exemption in the Lincoln bill before it sees a vote on the Senate floor.

Still undecided is how the agriculture bill passed on Wednesday would be combined with the broader bill under consideration by the Senate Banking Committee, which also contains derivatives rules. Mrs. Lincoln has said she expected the measures to be combined.

It's possible the provision requiring banks to spin off their derivatives divisions could be stripped out through amendments on the Senate floor.

Democrats need one Republican vote to pass the broader measure. Mr. Grassley said his support for the derivatives rules didn't mean he would back the broader finance bill on the Senate floor.

"The derivatives piece is significant, but that larger bill has a number of flaws that need to be resolved before I'd support it," he said.

The united Republican opposition to the financial overhaul appears to be fracturing, with some members signaling talks are improving but others openly venting and showing frustration. Mr. Shelby briefed multiple Republicans Wednesday afternoon on some of the discussions, and some lawmakers questioned whether the concessions he was making. Several hours earlier, lawmakers at the Agriculture Committee had a sometimes-testy debate over the unintended consequences of new derivatives rules.

Republican critics of Mrs. Lincoln's bill said it could cut off access to credit for small companies and community banks. "The bridge of cooperation has been washed out and ... we're not going to swim," said Sen. Pat Roberts (R., Kan.).

A lesson White House negotiators learned from the health-care debate is that piecemeal changes do not win votes for final passage. They only win more demands for piecemeal changes. For that reason, Mr. Dodd will not make any move to drop a controversial $50 billion fund created by banks to dissolve failing competitors until he has a larger slate of changes and iron-clad commitments from Republicans to vote for final passage of the bill.

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