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EDITORIAL

Signs of Life in Financial Reform

Financial regulatory reform, which seemed to be lagging one year after the collapse of Lehman Brothers, has gotten a new boost of energy. Unfortunately, Americans still cannot be sure it will produce real reform.

On the plus side, Representative Barney Frank, the chairman of the House Financial Services Committee, recently issued proposed legislation for a new Consumer Financial Protection Agency, a step forward for one of the Obama administration's main reform initiatives.

In near daily hearings, the committee also has heard compelling proposals that would alter, and strengthen, the administration's overall reform plan. Last week, Paul Volcker, a former chairman of the Federal Reserve who is now a White House economic adviser, suggested ways to reduce risk-taking by banks that are stricter than those recommended by the Treasury.

Separately, Senator Christopher Dodd, the chairman of the Senate banking committee, has also differed with the administration. He has proposed merging the four main bank regulators into one regulatory body. He also wants a lesser role for the Fed in a reformed system. (The administration, in contrast, has proposed to keep the current regulatory regime largely intact and to give the Fed enhanced power to oversee and, if necessary, restructure or close big banks and financial firms.)

Also last week, the Group of 20 world leaders pledged to develop international rules by the end of 2010 in such crucial areas as capital requirements for banks, the orderly resolution of troubled too-big-to-fail institutions and the regulation of derivatives.

But there are still signs that major differences could stall or derail the reform effort.

To get preliminary agreement on a new consumer protection agency, for instance, Mr. Frank had to drop a provision that would have allowed the agency to require banks and other financial firms to offer so-called plain-vanilla products, like 30-year, fixed-rate mortgages, in addition to whatever more complex loans they offer.

The agency, as currently envisioned, would still be robust. It has the ability to create incentives that would encourage the provision of plain-vanilla products, for example, by charging reduced oversight fees to firms that offer simpler loans. In the proposed legislation, the agency also has broad power to stop products and practices that are unfair, deceptive or abusive.

But the change, which the White House readily accepted, is disturbing because it is an early sop to banks

whose ultimate aim is to block the creation of a consumer protection agency, or, failing that, to ensure that it would have no real power. Early concessions in the House mean that it will be up to the Senate to retain the other safeguards in the proposal. Unfortunately, the White House's willingness to fight for a strong agency and Democrats' ability to deliver are both in doubt.

Similarly, neither the White House nor Congress seems interested now in limiting the riskiest activities of commercial banks, as Mr. Volcker suggested. Rather, the emphasis is on more oversight of too-big-to-fail institutions and creating new legal tools to take control of them if they are in imminent danger of collapse.

The big banks, which have only gotten bigger and more powerful since the financial crisis, prefer that approach. But it may not provide the best protection to taxpayers who are in harm's way from banks that engage in high-risk capital market activities, such as equity and derivatives trading. The administration and its Congressional supporters have yet to make a strong case that the system can be made substantially safer with behemoth banks. Lawmakers need to consider alternatives.

The administration and Congress deserve credit for renewing momentum toward new rules and regulations for the financial industry. The real test is whether they will channel that momentum in ways that assert the interest of the public above the interests of the banks.

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