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Democrats scramble to save reform package

Critics: Bill would not have stopped crisis

By Patrice Hill

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President Obama touts his financial-reform bill as the most far-reaching since the Great Depression, but critics are calling it a paper tiger that wouldn't have stopped the last financial crisis while imposing an intricate web of new government regulation on banks that will stifle economic growth for years to come.

In a development that could delay passage of the mammoth 2,000-page measure past Mr. Obama's July 4 deadline, the $18 billion price tag for the new regulatory regime became a sticking point Tuesday among a handful of Senate Republicans who previously supported the Senate version of the bill.

House and Senate conferees, working through the night last week, added a tax on banks to fund the cost of setting up the new regulatory system. But in an unusual move, Democratic leaders reopened the conference Tuesday night, stripped out the tax and chose instead to raise bank insurance fees and free up $11 billion in cash by closing down the Treasury Department's controversial Troubled Asset Relief Program bank-bailout fund.

The move aimed to satisfy the demands of three Northeast Republicans who were opposed to the tax — Sen. Scott Brown of Massachusetts, and Sens.

Susan Collins and Olympia J. Snowe of Maine. Most other Republicans have indicated they will try to block the bill from a Senate vote, forcing the Democratic leadership to scrounge up a filibuster-proof 60-vote majority — a job that became harder with the death of West Virginia Democratic Sen. Robert C. Byrd earlier this week.

The last-minute maneuvering to save the bill brought an angry rebuke from Senate Republicans on the House-Senate conference committee, who said the new version of the bill violated Congress' intent to devote TARP repayments to reducing the deficit.

In trumpeting the bill's virtues, Mr. Obama and his allies point to the bill's major increase in powers for agencies like the Federal Reserve and Federal Deposit Insurance Corp., enabling them to police sectors well beyond the cloistered world of banking and Wall Street, and seize and dismantle any company whose risky practices they think endanger the broader financial system.

Besides creating a new and powerful council of existing regulators to oversee firms with a major presence in the economy, the bill would create a potent new consumer regulator, housed in a new division of the Fed, which would prohibit the kind of risky mortgages that led to the 2008 financial crisis and lay down rules of the road for thousands of companies that provide financial services to America's 300 million consumers.

"Senators, hopefully on both sides of the aisle, recognize it's time we put in place rules that prevent taxpayer bailouts and make sure that we don't have a financial crisis that can tank the economy," Mr. Obama said after meeting with his economic team and Fed Chairman Ben S. Bernanke.

But analysts say that while promising to crack down on big banks and market abuses, congressional conferees at the last minute softened the bill's

most punitive limits on global banks and left important issues to regulators to hash out in consultation with the industry and other interest groups. The question of what to do with two central players in the 2008 debacle — mortgage finance giants Fannie Mae and Freddie Mac — was put off until next year.

"After all the crowing and posturing coming from the administration, this bill is effectively a worthless pile of paper that does little to address any potential problems, doesn't get rid of 'too big to fail,' and wouldn't even stop the most recent crisis, much less any crisis that could be looming in the future," said Ned Brines, a stock market commentator. "No wonder financial stocks all jumped on the news."

Among the major questions left for regulators to resolve are how much capital banks must set aside to protect against market losses in the future; how to limit conflicts of interest at credit-rating agencies who gave worthless mortgage securities top investment ratings in the past; and how much leveraged trading Wall Street banks can conduct to fatten their profits.

The Fed, FDIC, Securities and Exchange Commission and other regulators claim to have learned from their mistakes and have already started moving against some of the riskiest practices. But critics point out that these same regulators largely missed the abuses that led to the 2008 crisis and could be just as blind to any new market abuses.

Banks and Wall Street firms already are busily lobbying the regulators to shape the next stage of reform, when agencies issue more than 20 major new rules to carry out the mandates of the bill.

"My test for the financial regulatory-reform bill is whether it will prevent another crisis," said Sen. Russ Feingold, Wisconsin Democrat, in explaining why he will not vote for the bill. "The lack of strong reforms is clear

confirmation that Wall Street lobbyists and their allies in Washington continue to wield significant influence on the process."

Mr. Feingold and other bill opponents from both parties pushed to either break up the big banks to ensure their failure does not endanger the economy again, or reinstitute the Depression-era wall between banking and securities operations created by the Glass-Steagall Act, which was repealed in the late 1990s.

Despite their efforts, the only provision in the Senate bill that would have forced big banks to divest some of the riskiest derivative securities operations was narrowed considerably in conference, leading many analysts to conclude that Wall Street firms like Goldman Sachs will be able to continue many of their current activities or only gradually phase them out.

"The reforms will work to clamp down some excessive risk-taking. But if history is any guide, Wall Street will over time find new ways to maximize profits by seeking out loopholes and finding ways to cleverly circumvent some of the new rules," said **Bernard Baumohl**, analyst at the Economic Outlook Group.

"After all, what followed the repeal of Glass-Steagall was an ongoing cat-and-mouse game among financial firms, regulators and legislators. It may sound cynical, but we suspect that game will start anew."

While new regulation was necessary to reduce risks, **Mr. Baumohl** said, the tangle of new mandates on banks and uncertainties created by the lengthy regulatory process ahead will cause banks to remain overly cautious about lending, making it harder for the economy to recover.

"The more immediate threat to the economy is that banks are still too risk-averse and are keeping their lending windows shut," he said. "The pendulum

of risk-taking by lenders has swung to the side of excessive caution."

Banking groups have been warning that elements of the bill aimed at making credit available on fairer and clearer terms — including bans on various kinds of credit fees — are too punitive and restrictive and end up making credit less available to consumers and small businesses.

But the bill's advocates say the costs are worth the benefits of having a fairer and safer financial system.

"It is worth giving up a modest amount of economic growth in the good years to avoid the terrible downturns like the one we just experienced," said Douglas Elliott, a fellow at the Brookings Institution. "The bill will not eliminate financial crises, but it will make them less frequent and considerably milder, which is all we can realistically accomplish."