In guise of reform, Democrats further weaken financial regulation

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One year after the near-collapse of the US financial sector, the Democratic-controlled Congress continues to strip away even the minimal regulations to the financial system that existed prior to the 2008 meltdown. This is going on behind the scenes of a largely pro-forma debate over the number of regulatory bodies required to police the financial system, and over the role of the Federal Reserve in regulation.

Earlier this month, the House Financial Services committee voted to largely neuter the Sarbanes-Oxley Act. The Sarbanes-Oxley Act, passed in 2002 in the wake of the Enron scandal, requires companies to have independent auditors evaluate their internal protections against fraud. The vote would allow companies worth less than $75 million to be exempt from this requirement and sets the stage for even larger companies to follow suit.

The measure was so brazen that even the *New York Times* felt compelled to protest. In a November 6 editorial, the newspaper wrote that the measure "would make it all too easy for thousands of publicly traded companies to cook their books." Arthur Levitt, the former chairman of the Securities Exchange Commission under Bill Clinton, also denounced the measure, saying it is "deeply disturbing" that the Democrats have overturned "the most pro-investor legislation in the past 25 years."

Around the same time, House Financial Services Chairman Barney Frank sent a letter to the country's top regulatory authorities, urging them to relax their enforcement standards. Frank went so far as to claim that regulators were leading banks to accept "artificially low prices" for the securities on their books by applying mark-to-market rules. He said that if regulators continue to pursue stringent policies, banks will further constrict lending and exacerbate the downturn.

Frank and his fellow committee members are fully aware that relaxing financial regulation will allow the banks to cheat and swindle at will. Members of the Financial Services Committee receive more in Wall Street campaign contributions than any other section of the House of Representatives. Frank, for instance, has received more than $3 million in donations from the financial sector.

Congress and the White House have ignored all calls to tighten regulation. Paul Volcker, the former Federal Reserve chairman under Jimmy Carter and Ronald Reagan, has made calls for a reinstatement of the Glass-Steagall Act, a law that separated and commercial and investment banking. The law was passed in the wake of the 1929 stock market crash and was repealed in 1999.

The White House is largely staffed by people who spent the last two decades gutting regulation. Lawrence Summers, the director of the White House's National Economic Council, for example, supported the repeal of Glass-Steagall when he was treasury secretary in the Clinton administration, declaring that it would "better enable American companies to compete in the new economy."

As financial regulation is weakened piece by piece, legislators are debating how best to prepare for the next financial crisis that will inevitably follow. The debate takes the form of competing proposals for regulatory overhaul proposed by the House Financial Services Committee and, most recently, by the Senate Banking Committee.

Senate Banking Committee chairman Christopher Dodd unveiled a proposal earlier this month to overhaul the US financial regulatory system. The proposal is essentially similar to that developed jointly by the White House and House Financial Services Committee, but goes further in limiting the powers of the Federal Reserve. The proposal would also more sharply restructure the present financial regulatory system, bringing it closer in line with that of the United Kingdom.

Dodd's proposal would convert the Office of Thrift Supervision, the Comptroller of the Currency and the Federal Deposit Insurance Corporation—smaller bodies that oversee different parts of the banking system—into one body. The Federal Reserve would cease to exist in its present form, and would instead be divided between the new, large regulator and a new "Consumer Financial Protection Agency."

The White House and Federal Reserve have come out explicitly against moves to limit the regulatory power of the Fed, and it is generally considered unlikely that most of Dodd's suggestions will become law.

The proposal largely has the air of a publicity stunt. David Wessel of the *Wall Street Journal* said in an interview November 4, "It's very unlikely that what Chris Dodd is proposing will actually become law.… Because he wants to be seen as a populist, he's running for reelection, and he's using this as an opportunity to put forward ideas that are deliberately different from those of the Fed."

Dodd has reason to try to cosmetically distance himself from Wall Street. Over the last five years, he received nearly $4 million from the financial industry, more than twice the amount he received from the next-largest contributing sector. His largest contributor over that time was Citigroup.

The favored plan of the White House, Federal Reserve and House Financial Services Committee consists of three main parts: phony derivatives regulation, a "consumer protection agency" that would have no power over most banks, and additional emergency powers for the Federal Reserve.

The White House proposal would also expand the authority of the Federal Reserve, giving it power to "unwind" banks that are too big to fail. This would be, ultimately, a standardization of the semi-legal methods used by the Fed to bail out Bear Stearns and AIG last year. The reforms aim explicitly to make it easier for the Fed to intervene the next time a credit bubble bursts and the banks are to be bailed out at taxpayer expense.

The House Financial Services Committee's proposal also includes a Consumer Financial Protection agency, ostensibly to defend consumers against bank fraud. But the agency exempts 98 percent of banks from oversight, making it largely meaningless.

In mid-October, the House Financial Services Committee passed a bill that would ostensibly regulate derivatives, the complex, hard-to-value securities that played a large role in the financial crisis. But the bill passed by the committee is so full of loopholes as to be nearly meaningless. Any firm that claims to be an "end user" of the securities is exempt from regulation, and the values of particularly obscure "customized" derivatives are free from scrutiny.

Both the White House and the Dodd plans are intended as cosmetic overhauls. The financial crisis was the outcome of deliberate policies implemented under the Clinton and Bush Administrations in tandem with regulators and the Federal Reserve; they are by no means simply products of the peculiar financial regulatory structure in the United States.

Numerous commentators have pointed out that the UK already has a system similar to the one Dodd is proposing, with a single regulator, the Financial Services Authority, controlling all sections of the financial services industry. This did not prevent the country from experiencing a financial bubble and consequent economic crash similar to that of the US.

One year after the worst financial crisis in postwar history, nothing has been done to rein in the banks. Quite the opposite: The government has handed trillions to the banks while the Federal Reserve is holding interest rates at extremely low levels. Meanwhile, the Democratic Party is busy stripping away whatever is left of corporate and banking regulation.

As a direct result of these policies, Wall Street is set to reap bumper profits year, with record-breaking year-end bonuses likely to follow.