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WALL STREET

Obama to propose strict new regulation of financial industry

The plan would give the government new powers to seize key companies whose failure jeopardizes the financial system, as well as creation of a watchdog agency to look out for consumers' interests.

By Jim Puzzanghera

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Reporting from Washington — The Obama administration this week will propose the most significant new regulation of the financial industry since the Great Depression, including a new watchdog agency to look out for consumers' interests.

Under the plan, expected to be released Wednesday, the government would have new powers to seize key companies -- such as insurance giant American International Group Inc. -- whose failure jeopardizes the financial system. Currently, the government's authority to seize companies is mostly limited to banks.

But critics say the easing of the financial crisis that gripped the country last year appears to have reduced the momentum for some of the most far-reaching proposals, such as merging several banking regulatory agencies.

They're also concerned that the proposed agency whose mission would be to protect consumers against financial misconduct wouldn't have the authority to do so for a wide-enough range of products.

"This is too little, too late," said Rep. Brad Sherman (D-Sherman Oaks), based on his understanding of the plan. "It's going to be way less than it should be."

On Monday, Obama administration officials sketched the outlines of the plan the president is to unveil Wednesday. They said it would seek to reduce gaps in regulatory oversight, rein in the use of mortgage-backed securities and other complex derivatives, reduce incentives for companies to take excessive risk and give the government new power to quickly intervene during any future crises.

"We had a system that proved too unstable, too fragile. . . . Those are things we have to change," Treasury Secretary Timothy F. Geithner said Monday at an economic forum in New York.

The administration also is expected to propose creation of a regulatory body for financial products marketed to consumers, such as credit cards, whose oversight is now spread over several agencies.

In addition, the administration wants to impose regulation over the market for derivatives -- the murky financial contracts used to hedge risky investments -- including new reporting and disclosure requirements. Institutions that originate loans would be required to retain 5% of the credit risk when the loans are turned into securities.

All the proposals would have to be approved by Congress in a process the administration hopes to complete by the end of the year.

In the heat of the financial crisis last year, there were widespread calls for the government to merge several banking regulatory agencies into one to reduce gaps in oversight and stop what might be called "regulator shopping."

For example, AIG was able to choose the Office of Thrift Supervision for its non-insurance financial business when it bought a small savings and loan in the late 1990s. That office has been viewed as a weaker regulator, and was strongly criticized in a government report this year for ignoring repeated warning signs about Pasadena-based IndyMac Bancorp before the thrift's failure last summer.

"I'm concerned that people think we've stepped back from the brink of disaster and so they're not as committed to seeing real meaningful reforms adopted," said Barbara Roper, director of investor protection for the Consumer Federation of America.

For their part, business groups have worried that the Obama administration might go too far in responding to the financial crisis with new regulations, stifling the market and hurting financial firms at a time when the economy is still weak.

They have been pushing back against some of the proposals floated by the administration, lawmakers and consumer advocates, such as a consumer protection agency for financial products.

But Scott Talbott, chief lobbyist for the Financial Services Roundtable, which represents large financial institutions, said there was still a strong impetus in Washington for regulatory reform and dismissed the suggestion that the Obama administration had missed its chance to implement it.

"This has moved at lightning speed," he said. "You're talking about a historic piece of reform."

Administration officials also have dismissed suggestions that they had moved too slowly, saying they had pushed ahead despite calls from some quarters for them to wait until the end of the crisis before acting.

"There are people who believe that the wrong time to reorganize the fire department is while the fire may still be burning," Lawrence H. Summers, chairman of the White House's National Economic Council and Obama's chief economic advisor, said in a speech Friday. "The president has concluded very strongly that that view is wrong. . . . Experience teaches that once the crisis has passed, the will to reform will pass as well."

Douglas J. Elliott, an economics fellow at the Brookings Institution and a former investment banker, said there was still enough political momentum to pass major reforms. But as the financial crisis has eased, there is less ability to tackle the difficult turf battles involved in merging regulatory agencies.

For that reason, Elliott said, the Obama administration appeared more focused on setting new rules and principles than on the blowing up the government's regulatory structure.

"There are entrenched interests that benefit and are allied with each of these agencies. . . . That just makes it hard," he said.

"As far as I can tell, the administration doesn't think it's as important to get that structure right as to get the rules right and make sure people are focused on acting the right way."

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