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Finance Reforms Pared Back

White House to Preserve Regulators but Seek Tougher Rules; Avoiding a Political Battle

By DAMIAN PALETTA

WASHINGTON -- The Obama administration is backing away from seeking a major reduction in the number of agencies overseeing financial markets, people familiar with the matter say, suggesting that the current alphabet-soup of regulators will remain mostly intact. Administration officials had suggested they might push for major regulatory consolidation in the wake of the financial crisis. But now they expect to call for most existing agencies to have broader powers to limit risk-taking by financial institutions, say the people familiar with the planning.

The administration, for example, is unlikely to call for merging the Commodity Futures Trading Commission and the Securities and Exchange Commission, an idea it had considered, these people say. It also isn't expected to call for the Federal Reserve, Federal Deposit Insurance Corp. or the Office of the Comptroller of the Currency to cede their primary authority to supervise banks, they say.

Administration officials caution that no final decisions have been made, and the recommendations remain somewhat in flux.

The decision is partly practical and partly political. Key administration officials believe they can achieve many of their goals by overhauling rules, such as imposing tougher restrictions on how much capital banks must hold to cushion against losses. Officials worry that trying to start from scratch could ignite messy turf battles that might slow or even derail the entire process.

Treasury officials have said they are willing to engage in political fights they view as a "necessity," rather than those they see as a "choice."

Separately, at a meeting of Group of Eight economic officials in Italy this week, Treasury Secretary Timothy Geithner is likely to present the U.S. view that Europe should conduct more vigorous and transparent stress tests of their own banks. The Obama administration believes such tests conducted in the U.S. in recent months helped stabilize the financial system.

The revamping of Wall Street oversight, which the administration has said is vital to prevent another crisis, will nonetheless profoundly change the regulatory environment for finance.

Assuming Congress enacts the administration's proposals, unregulated parts of Wall Street, such as certain large hedge funds, will be brought under Washington's umbrella for the first time. In addition, regulators will be given power to oversee systemic risks to the economy, and to take over large, failing financial institutions.

The Federal Reserve will likely emerge stronger, gaining power to oversee companies, financial products and industry practices that might pose systemic risk. The plan also appears to be good news for the Office of the Comptroller of the Currency and FDIC, which would gain power and retain most of their jurisdiction, and the CFTC, which has faced calls for its abolishment. What it means for the SEC is less clear.

The administration may propose merging the beleaguered Office of Thrift Supervision with another agency. The OTS regulates savings and loans, and oversaw several of the biggest companies to fail or nearly collapse during the crisis.

But sidestepping a major regulatory restructuring could spark criticism that the administration has missed a once-in-a-lifetime chance.

"It's not only an opportunity, they are avoiding a necessity," says Hal Scott, a professor at Harvard Law School. "I understand all these political forces -- they've been obstructing necessary change for decades. But we are in a very serious situation. The regulatory system has demonstrated its inability to function, and I really think its incumbent on somebody to do what's right."

Just a few weeks ago, top administration officials hinted they would tackle a reorganization. "I personally believe we need to, and I think the president believes we need to have a much more simplified, consolidated oversight structure," Treasury Secretary Geithner said in May. "Our system now is too complex."

Rather than seeking additional consolidation, the administration's plan now appears to be focused on setting up new rules for containing risk.

Government officials believe that if they fill gaps between agencies and eliminate overlaps, banks and other companies will be less able to shop for light oversight.

"History shows that opportunities for real reform are often short-lived," Federal Reserve Governor Daniel Tarullo, who has close ties to the White House, said in a speech Monday. "Momentum can too easily be lost, and the return of better times too easily leads to complacency."

U.S. officials have spent months trying to convince foreign officials they are serious about revamping supervision of financial markets. Even defenders of the current system concede it leaves room for bureaucratic fiefdoms of powerful regulators who clash and jockey for turf. The White House and Treasury have spent months crafting an overhaul of financial-market rules, which Mr. Obama has said is a top priority. Senior officials, including Mr. Geithner and National Economic Council Director Lawrence Summers, have met with numerous experts, lawmakers, and policy makers, including former House Financial Services Committee Chairman James Leach and former Fed Chairman Paul Volcker.

Mr. Geithner is scheduled to meet on Tuesday with Fed Chairman Ben Bernanke, Comptroller of the Currency John Dugan, and Federal Deposit Insurance Corp. Chairman Sheila Bair to discuss the effort.

Top lawmakers have already signaled there would be little political support for getting rid of multiple regulators and centralizing power.

"There are a lot of other issues you want to talk about, it seems to me, before settling on a 'number' " of regulators, Senate Banking Committee Chairman Christopher Dodd (D., Conn.) said in an interview. "What are their functions?"

House Financial Services Committee Chairman Barney Frank (D., Mass.) said Democrats also would push to create a regulator to protect consumers from risky financial products. He said lawmakers would focus more on the powers of regulators than on the regulatory structure.

The administration also is focusing on how to improve investor protection and insurance regulation, which is currently handled at the state level.

A central component of the administration's plan could give the Federal Reserve more power to monitor systemic risk. To assuage political concerns that too much power might rest with the Fed, administration officials are considering the idea of allowing several agencies to serve as a kind of "systemic-risk council" that would operate in conjunction with the Fed. It is unclear how the Fed and this council would interact. Congress will have to approve many of the changes. Mr. Obama is scheduled to outline the plan on June 17.