Wall Street Reform Next Up For Dems

By James Oliphant
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For weeks, President Obama has been pushing hard on his plan to revive the nation's economy, driving the $787-billion stimulus package through Congress, following up with a plan for homeowners facing foreclosure and readying a strategy for reviving the moribund credit system.

But on one crucial piece of his overall strategy, Obama and his economic team have kept a relatively low profile: an overhaul of the federal regulatory system that sets and enforces the rules under which banks, hedge funds, stockbrokers and the rest of the nation's financial institutions must operate.

Of all the elements in Obama's strategy, regulatory reform could be the toughest -- and take the longest time to achieve.

The White House and Capitol Hill Democrats are separately developing the new framework for the sprawling and increasingly complex financial services industry, a step many experts view as essential for preventing future disasters.

Many factors contributed to the meltdown that struck Wall Street last year, to such calamities as the demise of investment bank Lehman Bros. Holdings and to the emergency bailouts that kept Citigroup and American International Group from collapsing as well.

But there is widespread agreement that an outdated regulatory system and lackluster oversight by watchdog agencies also played roles in bringing on the crisis. And in political terms, persuading Congress to pony up more money to support the financial system -- which many experts believe will be necessary -- will be nearly impossible without new safeguards.

Although many agree on the shortcomings of the current system, devising and winning agreement on a new one present a thicket of challenges, from overcoming industry opposition and defusing turf wars among federal agencies to striking a balance between protecting consumers and encouraging growth in finance and the economy as a whole.

"The challenge is going to be separating politics from policy," said Scott Talbott, the lead lobbyist for the financial services industry in Washington.

Read about the push to reform the nation's financial services industry in Monday's edition of the ***Los Angeles Times***.

One hopeful sign is that many in the industry agree that the rules need revamping. They call the oversight regime outdated, with too many agencies whose missions are unclear and overlapping.

One example: There is widespread industry support for having Congress create a "systemic risk regulator" -- a super-agency empowered to monitor financial institution transactions. Such an

agency could identify trouble before a company enters a death spiral of the type that felled Lehman, Bear Stearns & Co. and other once-proud firms.

Hal Scott, a professor at Harvard Law School and the director of the Committee on Capital Markets Regulation, said that the near-collapse of Bear Stearns demonstrated why a new regulatory scheme was needed.

"We had multiple agencies trying to deal with the problem. The Securities and Exchange Commission had supervisory authority over Bear Stearns, but it was the Federal Reserve that ultimately had to decide whether to let it fail," Scott said.

"The agency that had to deal with the problem wasn't the agency that was charged with being on top of the problem."

Rep. Melissa Bean, a Democrat from Illinois and a member of the House Financial Services Committee, said in an interview that there was strong sentiment for giving the Federal Reserve increased powers to watch over Wall Street, but she stopped short of saying this was the course that any potential legislation would take.

Her committee, which is chaired by Rep. Barney Frank (D-Mass.), is expected to begin hearings on reregulation next month, with legislation soon to follow.

Bean is vice chairwoman of a coalition of moderates in the House called the New Democrats, which supports business-friendly and technology-focused initiatives.

And it's not a coincidence that her coalition has been charged with helping develop the revamp. A sweeping bill will need the support of moderates in both the House and Senate to survive, especially if liberals on the Hill seek more stringent controls on the industry.

The White House is likely to play a significant role in crafting legislation as well. Bean said members of her group would soon meet on the issue with Rahm Emanuel, Obama's chief of staff.

"As the president has long said, there are multiple legs of the stool that are essential to putting us on a road back to economic recovery, and regulatory reform is one of those legs," said Jennifer Psaki, a White House spokeswoman.

Beyond the creation of a system-wide risk regulator, there is less agreement on what shape the rest of the package should take.

Some want to reduce the "alphabet soup" of agencies that regulate banks and financial houses, with the goal of improving efficiency.

Last year, then-Treasury Secretary Henry M. Paulson called for the elimination of the Office of Thrift Supervision, which oversees savings and loans, or for its absorption into the Office of the Comptroller of the Currency, which regulates banks.

But almost immediately, the director of the OTS, who worked under Paulson at Treasury, publicly disagreed with the plan, saying his office should be expanded, not eliminated.

In addition to internal resistance, members of Congress may object if their committees were to lose jurisdiction when one agency folds into another.

Other potential land mines: Democrats may push to create a single office to protect consumers who buy financial products, something the industry argues is unnecessary and would drive up costs.

They may also seek some sort of federal oversight of the insurance industry, which is now largely subject to state-by-state regulation only. The majority party is eager to pass another version of a bill that cleared the House last year, which sets minimum underwriting standards for mortgages.

But Democrats want to avoid prohibiting lenders from setting risk-based interest rates, which they believe would increase borrowing costs.

There is also likely to be an effort to regulate credit default swaps and other financial instruments that currently fall outside the government's oversight. Part of that could involve adjusting when so-called mark-to-market accounting methods must be used to value the assets held by financial institutions.

Some critics believe that practice triggered fire sales of mortgage-related assets and helped spark Wall Street's meltdown.

Despite the obstacles, there may be an opportunity for progress in the coming months. "Maybe out of crisis you get reform," said Scott, the Harvard law professor. "These regulators, the industry and Congress face enormous pressure from the American people to do something."