REVIEW & OUTLOOK | APRIL 23, 2010

The New Master of Wall Street

Obama surveys the financial kingdom that may soon be his.

President Obama is a gifted man, but until yesterday we hadn't known that his achievements include having predicted the financial panic of 2008. It was a "failure of responsibility that I spoke about when I came to New York more than two years ago—before the worst of the crisis had unfolded," Mr. Obama said yesterday in a speech on financial reform at Cooper Union in New York City. "I take no satisfaction in noting that my comments have largely been borne out by the events that followed."

We wish for the sake of our 401(k) we had noticed this Delphic call, not least when Senator Obama was opposing the reform of Fannie Mae and Freddie Mac. But let's not fight over history. The current reality is that the President had better be very, very smart because the reform bill he is stumping for would give him and his regulators vast new sway over financial markets and risk-taking.

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This is the most important fact to understand about the current financial reform debate. While the details matter a great deal, the essence of the exercise is to transfer more control over credit allocation and the financial industry to the federal government. The industry was heavily regulated before—not that it stopped the mania and panic—but if anything close to the current bills pass, the biggest banks will become the equivalent of utilities.

The irony is that this may, or may not, reduce the risk of future financial meltdowns and taxpayer bailouts. A new super council of regulators will be created with vast new powers to determine which firms pose a "systemic" financial risk, to set high capital and margin levels, to veto certain kinds of business for certain firms, and even to set guidelines for banker compensation—or maybe not. The point is that these crucial questions will be settled not by statute, but by regulatory discretion after the law passes.

If you think Wall Street beats a path to the Beltway now, wait until the banks seek to influence how regulators will define, say, "proprietary trading." Whatever its flaws, the Glass-Steagall Act of 1932 clearly defined the difference between a commercial and investment bank. This time, the rules will be written by regulators at Treasury, the Federal Reserve, the CFTC, SEC and FDIC, among others. As he so often does, Mr. Obama yesterday denounced "the furious efforts of industry lobbyists to shape" the bill "to their special interests." But if his reform passes, this lobbying is certain to continue, more furiously.

Consider the esoteric matter of derivatives, most of which seem headed for daily settlement on exchanges and a clearinghouse if the bill passes. But not all derivatives. The new master of this universe would be Gary Gensler, a Goldman Sachs alumnus who now chairs the Commodity Futures Trading Commission. Under the bill moving through the Senate, he would decide which derivative transactions must be "cleared" and traded via electronic exchanges, and which can continue to be traded over-the-counter.

Perhaps Mr. Gensler is as wise as King Solomon, or at least John Paulson. Perhaps, like Mr. Obama in 2008, he—and his successors—will be able to foresee the next crisis and determine the derivatives contracts that pose the most future risk. He will need to be, because under such a reform some of the risk of a transaction moves from the two financial parties (say, J.P. Morgan and Goldman) to the clearinghouse—which will almost certainly be "too big to fail" if enough trades go awry in the next crisis.

Or consider the Senate provision, too little discussed, to let the SEC give shareholders more clout over corporate board elections. This would federalize what has long been state predominance in corporate law, while giving the largest and most activist investors far more leverage to impose their agendas on business.

In practice, this means giving more influence over corporate decisions to labor unions and their political surrogates who run the large public pension funds. Their goals are as likely as not to include political causes such as easier unionization, cap-and-trade regulation, or disinvestment in this or that unpopular business or country. This, too, comes down to giving more power to the political class to run business—in this case, even nonfinancial businesses.

The people who oppose these and other provisions do so for a variety of reasons, some principled, some self-interested. But they have every right to fight them. Yet Mr. Obama once again yesterday cast such opposition as dishonest: "What is not legitimate is to suggest that we're enabling or encouraging future taxpayer bailouts, as some have claimed. That may make for a good sound bite, but it's not factually accurate," he said. "A vote for reform is a vote to put a stop to taxpayer-funded bailouts. That's the truth."

Perhaps Mr. Obama should consult Democrat Ted Kaufman of Delaware, who said recently on the Senate floor that "by expanding the [federal] safety net—as we did in response to the last crisis—to cover ever larger and more complex institutions heavily engaged in speculative activities, I fear that we may be sowing the seeds for an even bigger crisis in only a few years or a decade." Mr. Kaufman wants to break up the biggest banks, which may well be preferable to making them wards of the Treasury. Is *he* lying too?

As in health care, Democrats are intent on ramming this reform through Congress, and Republicans ought to summon the will to resist. Absent that, the only certain result is that Washington will be the new master of the financial universe.

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