# Financial Overhaul: Another Step Forward

*Morris Goldstein says the prospects for financial regulatory reform have improved greatly with Senate passage of a bill to rein in financial sector excesses.*



Steve Weisman: Financial regulatory reform in the United States has moved a step closer to reality now that the Senate has approved a version of an overhaul. This is Steve Weisman at the Peterson Institute for International Economics with Morris Goldstein of the Institute to discuss the latest developments in a series of conversations we've had for many months. Morris, thanks for joining me.

Morris Goldstein: I'm delighted to be here, Steve.

Steve Weisman: The Senate has passed, by a comfortable margin, a major overhaul. Is this the measure that you had earlier said was, I think, a B or B+ on your rating scale?

Morris Goldstein: Yes, I think it's quite a good bill. I, along with many others, was worried that it would get watered down in the final stages. If anything, it seems to have been strengthened.

Steve Weisman: How?

Morris Goldstein: One was concern that the resolution authority would get watered down or the consumer protection agency would lose some of its enforcement powers or there would be something else to weaken the Volcker Rule. We didn't see much of that. The bill, I think, that emerged from the Senate is pretty strong. The main provisions are there.

Steve Weisman: What are the most important provisions?

Morris Goldstein: You have resolution authority to deal with "Too Big to Fail" in the resolution of systemically important nonbanks. It's liquidation. It docks the shareholders. It dismisses management. It pays off creditors and counterparties at estimated recovery cost. It funds the authority by a tax on the financial sector so taxpayers don't pay. It sets up a systemic risk council, which hopefully will deal with identifying and pricking asset price bubbles before they get too big. We get central clearing and moving on to exchanges of trading in over-the-counter derivates. That's an important element. We have the establishment as consumer protection of a consumer financial protection agency to stop some of the abuses on these financial products. We have reduced conflict of interest for credit rating agencies.

All of that, I think, is to the good. What's left out, Fannie and Freddie overhaul, which we also need, is to be done separately. We didn't get firm size caps on larger institution. I would have liked to see that. And I would have liked to see a little more detail on dealing with asset price bubbles. But all things considered, pretty good.

Steve Weisman: This version now goes into a conference committee to be reconciled with the House version. Are there any parts of the House legislation that you would recommend be added to this bill? Which version do you prefer?

Morris Goldstein: I think it's not going to be too hard to reconcile them. I think the House version had an independent consumer financial protection agency as a separate agency not housed in the Fed. I think that would be marginally better. The House bill also had a $150 billion [resolution authority] fund that would be raised beforehand. I suspect that the House would be willing to give that up in exchange for the Senate moving closer to their recommendation on the consumer financial protection agency. The Senate has stronger provisions on conflict of interest in credit rating agencies. So I'd like the Senate version of that.

I think if we get a merging of the two along those lines we'll get an even stronger bill. What we have to worry about, I think, is very heavy lobbying on the part of financial firms, trying to water down what was been agreed in each of the separate bills.

Steve Weisman: Coming back to the Volcker Rule, not to get into the weeds too much, but I believe there was some maneuvering just in the last minute before the Senate passed the bill in which they left out a provision that would address that. Can you explain?

Morris Goldstein: That's the Merkley-Levin amendment, which was a form of the Volcker Rule. It would prohibit propriety trading by institutions accepting insured deposits. I'm in favor of that. It also would have tougher conflict of interest provisions for investment banks and the like, so they couldn't be selling securities that they're also selling to their customers. That, unfortunately, was put off for the conference by the House—

Steve Weisman: Is there a version of that in the House bill or can they add something that's in neither bill?

Morris Goldstein: I thought the agreement was that they would try and decide this in conference. I hope we get some version of it. But that is one maneuver where the financial industry perhaps gained some ground, by at least putting it off until a conference. At the same time, I think that was originally paired with another amendment to exclude auto dealers from consumer protection, which the administration was against and which I'm against.

Steve Weisman: That would have been a very big exclusion.

Morris Goldstein: Yes, it would have been, I think so. Hopefully, we get some form, I think, of the Volcker Rule in the final bill.

Steve Weisman: Why do you think that the financial industry ended up, at least so far, being less successful than it hoped in weakening the bill?

Morris Goldstein: I think the cause of this crisis was so huge and the public is so outraged that even fairly strong supporters of the financial industry felt some kind of pretty tough reform was necessary and felt that unless they were able to bring at least some of that to the voters in November, they would be punished. That said, quite a few Republicans still voted against the bill. But I think it's emerged much better than expected.

Steve Weisman: The Republicans generally voted against it but a few voted for it. The Senate Republicans charge that this was some kind of a regulatory overshooting and even takeover of the financial industry by government. That, of course, is in line with the Republican argument against the healthcare bill and the like. Is there any merit to the concern that this might be an overreach?

Morris Goldstein: I really don't think so. I think if you look at the abuses that we had witnessed in the run-up to the crisis, you really needed to deal with those. I think most of the things that are in this bill addressed those problems. There are few things, like the Volcker Rule, that were not instrumental in the crisis but [that] make sense over the longer term. But I don't see this as government overreach. I think we had a long period in which the prevailing mantra was: "Self-regulation is better than tough fiscal regulation," and that the financial industry plus the market would take care of all this. What we've discovered, plain as you can see, is that we almost went off the cliff because of that. So I think that quite a strong response was necessary, including quite a lot of government involvement. I don't really see an alternative.

Steve Weisman: Morris, it's not over 'til it's over. I'm not over asking you questions. Thanks for this session but we'll be back.

Morris Goldstein: Great, Steve.