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Lobbying Against Reform

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We are now in the midst of a very important national debate. This is not the breathless hype of 24-hour cable news--it's for real. Nothing less than the future of our financial system is at stake. Will we be beset by frequent crises, like the one experienced last year that paralyzed the financial system? Or will we address the underlying flaws in a thoughtful way that mitigates the possibility of future meltdowns?

If the lobbyists and the financial institutions that employ them have their way, we will come out of these debates doing business as usual. They have a vested interest in avoiding change. By the time the next crisis is upon us, they will have retired from the field of battle, leaving taxpayers and policymakers to ponder yet another attempt to solve the problem.

This week, the House will begin debating ''The Wall Street Reform and Consumer Protection Act of 2009'' and the Senate will begin marking up the "Restoring American Financial Stability Act." Each of these bills addresses the problem of reforming the regulatory system. Both cover many areas of substance: consumer protection, systemic risk regulation, compensation, over-the-counter derivatives, ratings agencies, etc. And there is much substance in the proposed regulations. The question is--how much of the substance will survive the political lobbying process?

By early November, more than 1,500 lobbyists had registered with Congress to work on the new rules to limit financial risks and impose stricter consumer protections. Those are only the ones who **registered** as lobbyists; there are many other industry representatives who didn't. The financial services industry is estimated to have spent more than $220 million before the legislative push even began.

Legislators have heard from small community banks and large Wall Street banks, as well as from insurance companies, credit card companies, retailers, car dealers, telephone companies, real estate companies, credit unions, mutual funds and hedge funds. In short, an army of lobbyists all looking out for some narrow special interest. Change is fine--as long it impacts the other guy, the other industry, the other business model.

Their fingerprints are all over the resulting legislation. To take just one example, consider the Consumer Financial Protection Agency present in both the House and Senate Bills. If designed and executed correctly, without adding unnecessary bureaucracy--certainly a big "if"--this has the potential to be useful. Just to be clear, it won't do anything to prevent future financial crises. (Contrary to the motivating language, it had relatively little to do with the recent one.)

Nevertheless, responsibility for consumer protection is scattered throughout all the existing agencies and as a consequence has fallen between the cracks. There's no doubt that many consumers have been battered by bad decisions (that **they** made) about mortgages, credit card debt, auto loans and so on. There is no doubt that these bad decisions were driven by some very unscrupulous business practices. The level of financial literacy among U.S. households is shockingly low and, at a minimum, addressing that problem would be a worthy outcome.

What are the major financial decisions made by households? The purchase of durables like automobiles and appliances, the purchase of homes and retirement planning. But the house bill H.R. 3126 exempts financing provided by automobile dealers, any person regulated by the Securities and Exchange

Commission, any person regulated by a state insurance regulator, smaller banks and credit unions (those with $10 billion or less in assets), mortgage, title, credit insurance, real estate brokers and agents, attorneys and most retail transactions involving credit. The Senate proposal has fewer carve-outs but does exclude small banks and credit unions, merchants, retailers and other non-financial institutions that extend credit to consumers. So who is left to regulate? By the time the lobbyists have finished their work, the legislation seems pointless--and that, indeed, is the point at hand.

It looks as though the lobbyists have done a pretty good job of ring fencing the legislation but just in case, the U.S. Chamber of Commerce stepped in as well. In their own words: " The U.S. Chamber and more than 2,100 chambers of commerce, associations, businesses and individuals from around the country sent a letter to all members of Congress last night underscoring their opposition to H.R. 3126, the Consumer Financial Protection Agency Act (CFPA). In it they expressed strong concern over the proposed CFPA legislation for not adequately addressing the failures within existing regulatory agencies. Instead, it would create a new and massive government bureaucracy that would reduce consumer choice, stifle innovation, and restrict access to credit just as we are beginning to see signs of an economic recovery." How very public spirited of them to point this out.

Much more is at stake in the proposals to address systemic risk and the regulation of the large financial institutions. This is what brought the financial system to the brink. The public, the business press, the bureaucrats and the politicians are all making a lot of noise about consumer protection, compensation, the Federal Reserve. This is mostly a side show - a diversionary tactic.

To understand what really concerns them, consider the following excerpt from a letter sent by the Business Roundtable, the lobbying group of CEO's to the lawmakers:

"We are writing to express serious concern about legislation that would give the federal government the authority to pre-emptively break up large financial institutions. … Large financial institutions provide unique and significant value to firms engaged in the international marketplace. The sheer size of credit large financial firms can deliver, the array of products they can offer and their geographic reach are critical to business operations and, therefore, contribute importantly to economic growth and job creation. If large firms were dismantled, these products and services simply might not be available."

What they fear more than anything else is losing access to the tremendous money pump they have at present. The large complex financial institutions, in case you haven't noticed, are making money hand over fist. They are greatly enabled this by the fact that they have a very low cost of funds. Why? Because they have unpriced too-big-to-fail guarantees and access to the Fed. This means taxpayers are underwriting the low internal cost of funds that these firms have. They can turn around and invest these in their own proprietary trading, hedge funds and asset management businesses--things they're afraid of losing. It is far more important to them than consumer protection or guidelines on pay.

President Barack Obama promised us a Washington in which lobbyists and special interests had much less power. In which thoughtfulness and long-term strategy were more important than politics and expediency. We all agreed that these were worthy goals.

So, what happened?

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