

Newsweek**Are Obama's Financial Regulators Weak Links?**

I think we're safe in calling it, for posterity, President Obama's "Day of Reckoning" speech (it's not FDR's "Rendezvous With Destiny," but it's not bad). In his address to a joint session of Congress this week, Obama said America was paying for the mistakes of the past, when difficult decisions about our economy were put off and "regulations were gutted for the sake of a quick profit." Now, he said, our day of reckoning has arrived.

What the president didn't say was that the people he has placed in charge of the reckoning are sometimes the ones who did the gutting. Or at the very least, they're the ones who obstructed the reckoning for years.

This is particularly true of the two people Obama has named to be the nation's top financial regulators: Mary Schapiro, chairman of the Securities and Exchange Commission, and Gary Gensler, whose hearing to be confirmed as head of the Commodity Futures Trading Commission was held on Wednesday. Schapiro failed to assert control over derivatives trading as the head of the CFTC in the mid-'90s, a time when it was already beset with fraud and manipulation. When a successor, Brooksley Born, came in, she called the unregulated derivatives market "the hippopotamus under the rug." As CFTC chair, Born tried to rein things in but was rebuffed by the Treasury Department, of which Gensler was a part.

Later, when Schapiro was running the Financial Industry Regulatory Authority (FINRA), she also missed Bernie Madoff's Ponzi scheme and now, we learn, R. Allen Stanford's alleged mini-Madoff scam. According to Reuters, associates of Stanford's, as was the case with Madoff's family, even served as advisors to FINRA, the industry's ostensible "self-regulator" (though it was widely seen as a joke in the industry). In both her jobs Schapiro followed a pattern: she tended to aggressively investigate relatively minor violations while failing to see the hippopotamus-size frauds in the room.

Gensler's past efforts to block derivatives regulation are no secret, and

Sen. Tom Harkin, chair of the Senate Agriculture Committee, wasted no time in reminding Gensler of one such case on Wednesday. At a hearing on May 15, 1999, Harkin noted, Gensler said he "positively, unambiguously" agreed with then-Treasury Secretary Larry Summers in his testimony to the committee opposing additional regulation of the institutional over-the-counter derivatives market (in other words, the market that traded off exchanges). At the time, Harkin said, Gensler went on to argue that the "vibrancy and importance" of the global over-the-counter derivatives market "put the burden on those who are suggesting changes and further regulation ... before we tamper on some of the successes of this marketplace for the economy." Well, said Harkin, "that's quite a resounding, unqualified and categorical statement, no second thoughts or ambiguity."

At the hearing, Gensler expressed some contrition and said he's seen the light. He now wants something close to what Born did 10 years ago: derivatives "should be brought into mandated centralized clearing and onto exchanges," he declared (actually, all Born wanted to do was to question whether such rules should be put in place). "Looking back now, it is clear to me that all of us—all of us that were involved at the time, and certainly myself, should have done more to protect the American public through aggressive regulation, comprehensive regulation," Gensler said. But as is so often the case with so many of those who let this catastrophe happen, Gensler then absolved himself by leveling everyone else down to the myopic mousehole he occupied 10 years ago. "I believe there are many things that at the time—that we could not foresee or didn't see. They were just dots on the landscape," he said.

Well, no, not exactly, Mr. Gensler. Some, like Brooksley Born, saw clearly enough that those dots represented incoming danger. There were others like Warren Buffett, who called derivatives "financial weapons of mass destruction" back in 2003. And Harry Markopolos, the Madoff whistle-blower. And Joseph Stiglitz, the Nobel-winning economist who warned for years against the perils of unregulated "hot money." And many others. Gensler was on the side of those who made fun of these Cassandras and said they were seeing things. Dots maybe.

No surprise there. Gensler was part of the Goldman Sachs-Treasury

continuum that blocked regulation for fear of losing business. Schapiro was a creature of the financial industry as well, having overseen the merger of the National Association of Securities Dealers and NYSE Member Regulation. She also sought to absolve herself at her confirmation hearing by saying that FINRA was not authorized to probe Madoff's investment-management side, only his broker-dealership—a claim that was disingenuous at best, given that there was ample basis to suspect the broker-dealership was at least "front running" stocks based on inside information (the only way it could earn such steady high returns), as Markopolos alleged.

Bill Singer, a former attorney for the National Association of Securities Dealers who's become a leading critic of regulators, calls Schapiro an "incredibly competent and qualified individual." But he adds: "My ultimate concern with Mary Schapiro is, we cannot afford to have the new SEC chair come in with a bucket of whitewash and a bucket of plaster. We need a wrecking ball." Schapiro has already shown she's not going to be that: among her first hires was Robert Khuzami, an ex-prosecutor, as head of SEC enforcement. He used to work for Deutsche Bank, one of the biggest culprits in the subprime-mortgage disaster.

There's no reason to doubt Schapiro's and Gensler's sincerity when they say they now want to be tough regulators. Certainly, we could use a little zeal of the converted here. But as Obama said in his speech, the key to finally restoring health to the economy is to restore investor faith in our markets. It's legitimate to ask why that faith should be restored when the people who were most prescient about the hazards of unregulated financial markets are still standing on the outside of the administration, while those who let the catastrophe happen are once again running the show. This is a practical as well as an ethical issue. The SEC and CFTC, along with other regulators, are chronically understaffed and depend on whistle-blowers to tip them off. But why whistle-blow if you believe the people on top are the same ones who ignored you the last time?

There is, ultimately, a "moral hazard" problem here as well. The ascendancy of Gensler and Schapiro demonstrates that, as a regulator, it doesn't pay to put yourself out on the line or listen to whistle-blowers. Instead, it pays to move with the herd. That's what

got us into all this trouble in the first place.

This story was updated on March 3.

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Thursday, February 26, 2009

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