

Memo to Obama: Time to get real about Wall Street

President Obama's speech today may revive interest in financial reform, but little will change and we will thus set ourselves up for another, bigger crisis not far down the road, unless one of two things happen: 1) Banks can no longer get too big to fail or 2) Banks too big to fail are effectively regulated.

Can either of these scenarios come to pass?

I for one am seriously doubtful. And while I think the first more likely to be effective simply because regulators are too easily captured, the Obama administration obviously thinks otherwise.

So far, however, the administration's policy prescriptions for Option No. 2 are woefully inadequate. So I suggest keeping an eye on Congress to see whether legislation emerges there that contains some particularly sharp regulatory teeth. What would those look like?

Here's a short list of what I think is necessary:

- Effective limits on derivatives. (No naked swaps that let speculation continue in OTC credit default swaps.)
- An end to off-balance sheet activities. (No more structured products that let banks defy capital reserve requirements.)
- Real fair value accounting. (Income statements as well as balance sheets must reflect economic reality.)
- The Tobin tax on financial transactions. (This will be small enough to matter only to in-and-out trading.)

Alas, my guess is that none of these things will see the light of day. Instead, we'll see a weak consumer protection agency, a wrong-headed prescription for making the Fed even more of a "systemic" but completely captured regulator, and some bland pronouncements about reigning in excessive pay.

(I would have added restrictions on the latter to my list had I not just come across this analysis <http://baselinescenario.com/2009/09/13/economic-donkeys/> that reminded me that Lehman's Dick Fuld personally lost big time.)