

Financial Regulatory Reform: Another Romp Through The Hundred Acre Wood

With apologies to A.A. Milne

Last month we were entertained by a Financial Service Primer set in Winnie the Pooh's Hundred Acre Wood. Since then, Christopher Robin has unveiled his big plan to reform the financial services markets. The Heffalumps were not impressed and have come out of the shadows to introduce a proposal of their own.

On Thursday morning, less than 24 hours after Christopher Robin unveiled his sweeping proposal, Piglet sat before the Senate Banking, Housing and Urban Affairs Committee, fielding senators' questions and trying to sell the administration's plan.

Piglet testified that he favors an uber-regulator for systemic risk in the form of the Federal Reserve Board. Obviously Owl is pleased, and Winnie-the-Pooh seems to support the idea. Still, others are concerned that the proposal simply adds to the layering of the system without addressing underlying and fundamental problems.

Indeed, the committee's top Heffalump said he had strong misgivings about making the Federal Reserve a systemic-risk regulator, a role that would enable it to supervise financial institutions whose failure could lead to the collapse of entire markets or harm the overall economy. "I don't think we can expect the Fed or any other agency can play so many roles," he said Thursday. "I personally believe this represents a grossly inflated view of the Fed's expertise." Pooh joined that critique, wondering whether the Fed could juggle the responsibilities of a systemic-risk regulator and its mandates to keep inflation in check and promote maximum employment.

Piglet countered that he believed there was no conflict between the Fed's current mandate and its newly proposed role. The Fed, he said, would be better equipped to handle the position than any other existing regulator.

Piglet was expected to testify in front of the House Financial Services committee Thursday afternoon, but the hearing was postponed due to a long series of floor votes. Eeyore, the committee's chairman, said he supports giving the Fed greater responsibility to set capital, liquidity and risk-management standards for major institutions, though he did acknowledge that the actual mechanics will be difficult to figure out. "I don't think overnight we can develop the expertise that we need," he said. "It's one thing to say you want to regulate systemic risk; it's another thing to have the sophistication to actually do it." The key question, according to Eeyore, is "how do you combine the need for some kind of action with the concern about too much power for the Fed?"

It is well known that citizens of the Hundred Acre Wood continue to have serious problems accessing credit. It is a wonder then that the Robin Administration has proposed closing down existing Savings & Loans and Industrial Loan Companies (ILCs) that provide such credit. Indeed, Eeyore has already come out in strong opposition to the repeal of the thrift charter for savings and loans. While he is on board with shutting down the Office of Thrift Supervision (OTS), Eeyore has argued that the thrift charter should remain intact. "The new National Bank Supervisor can supervise two charters," he remarked. "The problem wasn't the thrift charter, it was the combination of the thrift charter and the OTS, which let people manipulate it. We can prevent the abuse without abolishing the charter."

Another area of contention – the administration's plan makes every effort to squeeze risk out of the system. While this may sound like a good thing, as it does to Pooh and his many friends,

others worry that this will have the effect of squeezing out the reward and chasing away new capital – exactly the opposite of what one would want to occur.

On top of that, almost everyone agrees that current financial regulations have not been enforced effectively over the last decade or so. The simple answer is to enforce existing laws and regulations. Instead, Piglet and his friends reason that if the regulations are not enforced, we should change them – “if they are not being followed, let’s make up new rules.”

In an effort to address “too big to fail,” the Robin Administration leans toward more expansive government involvement to support those large institutions – including Fannie Mae and Freddie Mac. The GSEs are no longer government sponsored as the name would imply, but effectively government owned, managed, and subsidized. Other than investing billions of dollars into the GSEs to prop up the mortgage market, at no point does Robin’s plan propose to reform Fannie and Freddie – which entities many would argue were at the root of the housing bubble and subsequent financial meltdown.

Although Christopher Robin continues to maintain that, “I’ve always been a strong believer in the power of the free market,” federal intervention with AIG, GM, Chrysler, Fannie Mae and Freddie Mac tells a different story. We are beginning to see much more government control of the marketplace and big companies working with, protected by, and relying on big government.

While Eeyore has already planned a series of hearings in his financial services committee, the timeline for House consideration of the bill has been bumped until after the August recess. Winnie-the-Pooh has proposed to take a slower path, and the Senate is expected to move on its overhaul bill later in the fall. With so much of the economy of the Hundred Acre Wood at stake, policymakers will need to approach a revamp of our financial regulatory structure carefully and thoughtfully.

Cast of Characters:

President - Christopher Robin, is everyone’s best friend in the 100 Acre Wood. He is great friends with all the other characters like Piglet, Roo, Rabbit, Tigger, Kanga, Owl and Eeyore. He is always helping his friends with their problems. For example, he helps Pooh get honey, rescues Tigger and Roo from high trees in the forest, tacks Eeyore’s tail back into place when it falls off, and rescues Piglet when he is surrounded by water. Although Pooh is the most revered character there is no doubt as to whom the leader is and that is Christopher Robin.

Secretary of Treasury - Piglet is quite close to Christopher Robin and is capable of showing braveness way beyond his diminutive frame of a timid pink pig. Piglet has the ability to read and write, well enough to be able to write short notes. Piglet never hesitates one bit when Christopher calls upon everyone to take part in an expedition. But that’s him – Piglet, in spite of his diminutive size, takes up every challenge and has faced Heffalumps, Woozles, Wizzles and even Jagulars.

Senate Banking Committee Chairman - Winnie the Pooh tends to be a bit on the slow side (his head is full of fluff, you know...a common occurrence among teddy bears) but his heart more than makes up for that. Pooh has a love of honey (or, hunny, as it is sometimes spelled) but he can also do with a smackerel of whatever tiny quantity he can get his hands onto to soothe that insatiable “rumbly in his tumbly”.

House Financial Services Chairman - Eeyore is a favorite amongst most admirers of Winnie the Pooh characters, and he is an unbelievably loveable donkey, who is dismally gloomy for almost eternity. But that's not Eeyore's perception of himself. Eeyore is an intelligent animal, and is actually quite knowledgeable. His appearance is highlighted by a small light pink bow on his tail; this reflects well on this animal when there is an occasional hint of joy that surfaces in Eeyore.

Federal Reserve Chairman - Owl is supposed to be the wisest in the 100 Acre Wood. In some sense Owl is special; he not only is knowledgeable about vast matters but has the ability to explain things as well. The most admirable thing about Owl is that he is very happy to offer his advice, anecdotes, and opinions irrespective of someone wanting them or not.

Republicans – Heffalumps are fictional characters that have been mentioned in Winnie-the-Pooh. The Heffalump is considered to be a hostile animal in the 100 Acre Wood and comes in different shapes and sizes, though most often it is thought that a Heffalump resembles an elephant. The Heffalumps are shown to be the enemies of Pooh and his friends.