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The crisis continues to be felt but questions remain around what substantive legislative changes will be its legacy, says S Todd Crider of Simpson Thacher & Bartlett

Virtually every significant piece of US financial services regulation can be linked to a crisis. The Great Depression prompted the Securities Act of 1933, the Banking Act of 1933 (Glass-Steagall Act) and the Securities Exchange Act of 1934, as well as the creation of the Securities and Exchange Commission (SEC) and the Federal Deposit Insurance Corporation (FDIC).

These key parts of the US regulatory framework were established specifically to deal with abusive practices and structural risks. The crash of 1987 led to the imposition of circuit breakers (trading halts). The collapse of Bank of Credit and Commerce International led to the Foreign Bank Supervision Act of 1991, and the bank failures of the 1980s led to the enactment of the FDIC Improvement Act of 1991 and, notably, the Enron and Worldcom scandals and dot-com crash led to Sarbanes-Oxley in 2002. In short, the social dislocation caused by historic financial crises can lead to disruptive politics but can also create the political will to address apparent abuses or risks.

At the onset of the current "Great Recession" Ben Bernanke, recently confirmed to a second term as Chairman of the US Federal Reserve (Fed) and whose doctoral thesis was on the Great Depression, encouraged interventionism and a massive spending stimulus to prevent the banking system from collapse and the economy falling into a deflationary tailspin. All of which was financed by an historic expansion of US national debt (estimated at 84% of US GDP in 2009).

Históricamente, casi toda regulación de los mercados financieros en los EE.UU. puede relacionarse con una crisis y el deseo de los legisladores de abordar los aparentes abusos y riesgos. La actual "Gran Recesión" ya ha provocado su legado legislativo propio pero los esfuerzos para hacer frente a cuestiones como los riesgos sistémicos y una excesiva remuneración están amenazados por el propio éxito de los esfuerzos para superar la crisis económica, comenta Todd Crider, Socio de Corporate de Simpson Thacher & Bartlett en São Paulo y Nueva York.
The early returns on this unprecedented Keynesian stimulus package appear promising: the US economy recorded seasonally adjusted growth of 5.7% in the fourth quarter of 2009 and unemployment (up from 5% to 10% between 2007-2009) has fallen to around 9.7%.

Ironically, the success of these policies to confine the short-term fall-out to carnage on Wall Street and manageable employment losses, may yet impede efforts to more systematically re-engineer global financial regulatory systems and enhance structural resistance to failures. The political will to carry out such changes in the face of determined industry resistance is unlikely to be sustained indefinitely. If prosperity returns, it will become increasingly more difficult to propose. Scott Brown's stunning victory in the Massachusetts Senate race has already ended the Democrats' ability to withstand filibuster challenges, complicating ambitious legislative initiatives.

In this context, proposed reforms emerging from the Obama administration should be viewed as a blueprint of uncertain execution, but nonetheless set out the principal terms of debate.

The Treasury Report on Financial Regulatory Reform controversially seeks to revive key parts of Glass-Steagall (which ended in 1999) by separating proprietary trading and private equity operations from banks and seeking to ensure that no bank is too big to fail. Additionally, the Administration favors the imposition of an asset tax over the next twelve years to recover the costs associated with the bank bail-outs. Less controversially, the administration proposes a new Consumer Financial Protection Agency. But proposed regulation of the “shadow” banking sector although receiving broad support are short of specifics and will suffer strong opposition once known. Finally, the blueprint calls for “resolution authority” intended to facilitate the orderly liquidation of exposed financial institutions and increased international coordination in financial regulation.

Such proposals reflect a serious effort to address long-term challenges to the stability of the US financial system and appear to avoid short-term populist measures, such as the one-time bonus taxes adopted in some jurisdictions. While government bailout (TARP) funding restricted executive compensation, the Treasury actively facilitated banks’ early repayment of TARP funds and the administration has otherwise resisted calls for confiscatory taxes on bonuses.

Furthermore, the proposals to regulate executive compensation presented by US Secretary of Treasury Timothy Geithner’s appear based on the notion that a compensation structure focused on shortterm quarterly or annual profit-taking can threaten the financial system. Several ways of linking equity-based compensation to long-term shareholder value are now being broadly discussed and occasionally implemented.

The Great Depression caused over a decade of global economic distress and human suffering, because of this it also prompted extensive reforms that arguably established the basis for the regulation of banking and financial markets in the US and the generally favorable outcomes ensuing in the post-war decades. The question remains, however, as to whether the current early success in re-starting the US economy will now impede meaningful reform and thereby leave us with more heavily indebted economies carrying the same systemic financial risks through this new decade.