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EDITORIAL

After Goldman

After the government sued Goldman Sachs for fraud, a lot of politicians vowed to finally clean up the system. In an important committee vote on Wednesday, 13 senators — including one Republican for a refreshing change — approved a measure that would go a long way toward regulating derivatives, the complex instruments at the heart of the bubble, the bust, the bailouts and the Goldman case.

It is still not tough enough to avoid another catastrophe. While the bill rightly calls for most derivatives deals — currently private contracts — to be traded on regulated exchanges, it has too many loopholes. And it doesn't ban the sort of excessive speculation that characterized the Goldman deal.

The taxpayers are gaining, but the banks — which make a lot of money on derivatives — are still way ahead.

The bill would allow too many trades to be done off the exchanges. Regulators would be able to police them, but there would be no ongoing investor oversight. There are carve-outs for certain corporate users of derivatives and for contracts tailored to unique purposes. The bill also would allow the Treasury secretary to exempt an entire type of derivative known as foreign exchange swaps.

Corporate pension funds that invest in derivatives would be subjected to less scrutiny than is required of many other investors. The financing arms of major manufacturers would also escape full scrutiny. All of that is going in the wrong direction.

Which brings us back to Goldman. A court will have to decide if the bank committed fraud. The Securities and Exchange Commission says that Goldman designed a derivative — a "synthetic collateralized debt obligation," or C.D.O. — that would have a high chance of falling in value, at the request of a hedge fund client who wanted to bet against it. The S.E.C. charges that Goldman misled investors by not revealing the hedge fund's role in selecting the investments. Goldman says it was not obligated to do so.

The current reforms being considered by Congress might at least have made Goldman think twice about that obligation. Both the agriculture and banking committees' bills impose business conduct standards that would require dealers to disclose conflicts of interest.

It is not clear if the current bills would require synthetic C.D.O.'s to be exchange-traded. If they were, that would give investors a fighting chance to figure out the game. In addition to providing information about prices and volumes, exchange trading would subject derivatives to a full range of regulations, including disclosure and reporting requirements and stricter antifraud rules.

The bills also call for regulators to set adequate capital requirements for major dealers and participants so that there would be a cushion when derivative investments go bad.

What all those proposals don't address is whether the type of derivative Goldman was selling should even be allowed to exist. The Goldman deal was nothing more than a bet on the mortgage market, in which one side was destined to win and the other to lose, without "investing" anything in the real economy. The C.D.O. did not hold actual mortgage-related bonds, but rather allowed the participants to stake a position on whether bonds owned by others would perform well, or tank. And that helped to further inflate the housing bubble.

That is not investing. It is gambling, and it is abusive. It has no place in banks that can bring down the system if they fail.

Yet none of the pending reform bills would ban abusive derivatives. Instead, regulators would be limited to gathering information about potential abuses and reporting their concerns to Congress.

The bill does say that the regulator cannot approve "gaming contracts." But C.D.O.'s are often so complex that it may be difficult to figure out if they are, in fact, gaming or a threat to the broader economy.

Congress should ban both gaming and abusive derivatives. That would help clarify the difference between pure speculation and true hedging. It would start to restore what has been lost in the crisis: public confidence in the integrity of financial markets.