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EDITORIAL

Congress, the Banks and Derivatives

The Obama administration has made a serious proposal to regulate derivatives — the multitrillion-dollar market in financial contracts that malfunctioned so disastrously last year. The plan goes further than many thought politically possible, especially in its call for federal oversight of all large derivatives dealers. But it does not go far enough.

Those dealers — including big banks like JPMorgan Chase, Goldman Sachs and Morgan Stanley — trade derivatives mainly as one-to-one private contracts, largely without any regulation. The plan would allow regulators to impose rules on dealers and track their activities and presumably put a timely halt to abuses. But it does not demand the full transparency that would come from trading all derivatives on exchanges, like stocks.

Exchange trading allows the market as a whole — investors, economists, researchers — to see how derivatives are structured, priced and traded. Such knowledge is the best defense against speculative excesses.

The plan would require that derivatives that are deemed "standardized" — off-the-shelf contracts with mostly boilerplate language — be traded through a central clearinghouse or on an exchange. But the plan would also allow for "customized" derivatives — no one knows yet with certainty what the difference would be — to continue to be traded privately.

The danger of perpetuating a freewheeling market in customized derivatives is real. The decision to rope them off looks like a sop to the banks, which have fought against disclosure and transparency. They know that customers who rely on derivatives — including investment funds, major corporations and wealthy individuals — would likely pay less if they could compare prices.

The question now is whether Congress will try to improve the plan. Gretchen Morgenson and Don Van Natta Jr. reported in The Times last week on the banks' post-meltdown lobbying efforts. Lawmakers are being pressed, and plied with contributions, to favor the lightest regulations and the largest loopholes.

Senator Tom Harkin has introduced legislation that would require exchange trading for derivatives. Representative Collin Peterson has introduced a bill that would tighten the regulation of derivatives' clearinghouses. He acknowledges that his bill is not as strong as he would like but that Congressional politics left him no choice, telling The Times, "The banks run the place."