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Obama calls together congressional leaders in push for new financial regulation

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The battle over reshaping the country's financial regulation escalated on several fronts Wednesday, with President Obama stepping up his personal efforts to win Senate passage of an ambitious bill while senators from both parties fought to claim the anti-Wall Street mantle.

After a White House meeting between Obama and congressional leaders, Republican leaders criticized the Democrats' proposal for leaving the door open to future bailouts of big financial firms. But the president, who has turned his attention to the financial overhaul after winning passage of health-care legislation, said he was confident that a bipartisan bill could be worked out to ensure that the economy is protected from the collapse of large financial companies.

Taking center stage in the fight over the legislation are exotic financial instruments known as derivatives. A Democratic senator who chairs a key committee is advocating new rules that would force the nation's largest banks to stop trading nearly all kinds of derivatives -- a move that would dramatically reshape several critical markets and deprive the firms of a major source of revenue.

The proposal by Sen. Blanche Lincoln (D-Ark.), who chairs the Agriculture Committee, sent shudders through Wall Street. For nearly two decades, five U.S. banks -- J.P. Morgan Chase, Goldman Sachs, Morgan Stanley, Bank of America and Citigroup -- have acted as middlemen, allowing commercial firms and financial speculators to trade vital goods such as oil, natural gas and cotton, as well as contracts called derivatives. These are essentially side bets on which way such commodities, stocks and other assets will move.

Under Lincoln's plan, as described by her aides, the companies would have to spin off that activity if they wanted to remain banks.

The proposal is tougher than what the administration has sought. The Senate bill, which largely reflects administration thinking, stops short of an outright ban on derivatives trading by the Wall Street companies. Lincoln's proposal, which her staff said is due out this week, could be added to that legislation.

"The dark days of deals are over," Lincoln said in a statement. "Financial institutions will have to decide if they want to be banks or if they want to engage in the risky financial trading that caused the collapse of firms" such as American International Group.

Derivatives have been traded on Wall Street for decades, but they exploded in popularity over the past decade with the help of big banks, which reaped a windfall in fees for their services. Some private research groups estimate that acting as middlemen -- "swap dealers," in Wall Street parlance -- generates $20 billion to $40 billion every year for large Wall Street firms. Trading in derivatives, which officials estimate have a paper value of half a quadrillion dollars, exacerbated the recent financial crisis.

The Senate and House agriculture committees have long played a leading role in the oversight of derivatives related to commodities. But the activity expanded well beyond trading in farm products, and most kinds of derivatives today are beyond the reach of regulators.

At the White House meeting, Obama said he would demand strong oversight of derivatives in the final bill. Derivatives, he said, should be brought "into daylight so that regulators and ordinary Americans know what's going on when it comes to this huge segment of the financial system."

Both the administration and Lincoln want derivatives to be traded on exchanges and approved by a clearinghouse that would cover losses in case one party to a derivative contract could not pay up. An exemption would be given to manufacturers and commercial companies, which often use derivative contracts to guarantee the delivery of a commodity at a set price and time.

Under Lincoln's plan, however, if these companies chose to trade in private, the decision could cost them more money. The firms could have to put up more capital to prepare for unexpected losses on any private trades. Lincoln's proposal would also force all derivative contracts to be made known to regulators and the public. The Senate bill, which was written in consultation with the administration, calls for making derivatives known only to regulators.

Republicans and industry officials sharply criticized Lincoln's proposal, saying it would wreak havoc on the financial system and disrupt the economy.

Sen. Judd Gregg (R-N.H.), a key member of the banking committee, said in an interview Wednesday that the derivatives rules Lincoln plans to propose would make U.S. markets uncompetitive in the global economy. "You might as well say, 'Take every derivative to Singapore,' " Gregg said.

Sensing momentum on their side, administration officials have encouraged Democratic lawmakers to forge ahead and not concede too much to Republicans or financial industry lobbyists.

"I think it's a critical moment for reform, a promising moment," Treasury Secretary Timothy F. Geithner said during a briefing at the White House. "This is going to be the most sweeping set of reforms we have contemplated as a country since those put in place after the Great Depression."

Lincoln initially reached a bipartisan deal on derivatives with the ranking Republican on her committee, Sen. Saxby Chambliss (Ga.). But the administration and liberal Democrats pushed back, saying it created too many loopholes for Wall Street, industry and congressional sources said. Lincoln, who faces a strong primary challenge from a liberal candidate, then abandoned the deal, the sources said.

As Republican leaders left the White House, they called on Democrats to restart bipartisan talks about the overall shape of the legislation. Senate Minority Leader Mitch McConnell (Ky.), echoing comments he made Tuesday, said the bill amounts to an "endless taxpayer bailout for Wall Street banks."

Obama rejected that criticism. "I'm absolutely confident that the bill that emerges is going to be a bill that prevents bailouts," he said. "That's the goal."

Sen. Bob Corker (R-Tenn.) urged his colleagues to cool their "overheated" rhetoric. He agreed that loopholes in the Senate bill might allow failing firms to stay in business, "but the fact is, I think we could fix those in about five minutes."

Before the April congressional recess, which ended last week, Republicans and Democrats were sparring primarily over the proposed creation of a consumer protection agency. But industry lobbyists say they are no longer pressing that issue. And GOP lawmakers are wary of appearing to defend Wall Street at a time when polls show the industry is highly unpopular among voters, congressional aides said.

Staff writer Chris Cillizza and research editor Alice Crites contributed to this report.

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