Paulson to propose new U.S. financial regulators

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Treasury Secretary Henry Paulson is likely to call for the creation of new regulatory agencies with broad powers over lending, the securities industry and business conduct, according to the draft of a study he commissioned.

The report, which recommends more power for the Federal Reserve, also proposes combining the Office of Comptroller of the Currency -- which dates back to the Civil War -- and the Office of Thrift Supervision into a single banking overseer. In addition, the draft, which was circulated to government agencies this week and obtained by Bloomberg News, calls for the merging of the Securities and Exchange Commission and the Commodity Futures Trading Commission.

Such changes have been proposed in the past, only to be thwarted in Congress. ``We've had studies like this for the better part of 50 years, and nothing happens because there are a lot of vested interests in the status quo," said Bill Isaac, who was chairman of the Federal Deposit Insurance Corp. between 1981 and 1985 and now heads The Secura Group, a financial consulting firm in Vienna, Virginia.

At the same time, the credit crisis and market turmoil of the last half-year have fueled calls in Congress for an overhaul of the government's financial-regulatory apparatus by lawmakers who say the existing patchwork of regulators has proven inadequate to the task of monitoring a 21st-century financial system.

Overlapping Responsibilities

"With overlapping, multiple regulators supervising the same things, you've got three well-intentioned outfielders running after the same fly ball," said John Dearie, senior vice president of policy at the Financial Services Forum, a lobby group whose members include Wachovia Corp., Goldman Sachs Group Inc. and Lehman Brothers Holdings Inc.

Paulson, 62, a former chairman of Goldman who spent three decades on Wall Street, commissioned the study in June with the aim of increasing the competitiveness of American capital markets. The secretary, who has scheduled a speech on financial markets for March 31, said March 26 that the Fed ought to have greater sway over Wall Street firms now overseen by the SEC.

Treasury Department spokeswoman Brookly McLaughlin said the draft report ``is not current," but wouldn't comment on whether the final report will differ significantly in its recommendations. Paulson's speech begins at 10 a.m. in Washington.

New Authorities

The recommendations urge the formation of a "Prudential Financial Regulator" to oversee financial institutions that have an explicit government guarantee such as deposit insurance. The Treasury calls for a "Business Conduct Regulator" to monitor disclosures, business practices, chartering and licensing. It also suggests a "Corporate Finance Regulator" with "responsibilities for general issues related to corporate oversight in public securities markets."

The Securities Industry and Financial Markets Association, Wall Street's biggest lobbying group, praised Paulson's proposals. The plans would replace a regulatory framework that was ``born of Depression-era events and is not well-suited for today's environment where billions of dollars race across the globe with a click of a mouse," Sifma President Timothy Ryan said in a statement late yesterday.

The executive summary of Paulson's draft report calls for legislation that creates "uniform minimum licensing qualification standards for state mortgage market participants." The authority to draft mortgage regulations would remain at the Fed.

President's Working Group

The report breaks down its proposals into short-, intermediate- and long-term recommendations. Under short-term suggestions, Treasury proposes turning the President's Working Group on Financial Markets, which has advised the president since 1987, into a government-chartered "interagency body" to coordinate financial regulatory policy.

The group's focus should be "broadened to include the entire financial sector, rather than solely financial markets," the draft said. The President's Working Group is chaired by the Treasury Secretary and includes the heads of the Fed, the SEC and the CFTC. The report recommends expanding the body to include the heads of the OCC, the FDIC, and the OTS.

OTS Director John Reich yesterday sent a letter to employees saying he doesn't believe the "time has finally come" for restructuring the U.S. system for regulating banks.

Thrift Charter

"The financial-services industry has demonstrated the high value that it places on the thrift charter," OTS spokesman Bill Ruberry said in an e-mailed statement today. "Unlike a monolithic financial regulatory bureaucracy, the current system has laudatory checks and balances, and a range of regulatory choices for the industry."

Hal Scott, a professor at Harvard Law School who heads the Committee on Capital Markets Regulation, a group of executives and academics whose efforts Paulson has endorsed, said it will be ``very hard" to implement any of the recommendations.

"The political reality is that the merits will get lost in the argument," Scott said. "They recognize it won't be done soon."

House Financial Services Committee Chairman Barney Frank, a Massachusetts Democrat, said in a statement today the plan goes too far in reducing the role of the states and not far enough in giving new powers to the Federal Reserve over non-bank lenders.

The draft calls for the merger of the SEC, which regulates investment banks, securities and stock exchanges, and the CFTC, which oversees about $4.2 trillion of daily trades in products ranging from orange juice to foreign currencies.

Turf Wars

The two authorities have fought turf wars over instruments such as derivatives, which share characteristics of both securities and futures. The Treasury report said "regulatory bifurcation" has made separate oversight of securities and futures "untenable, potentially harmful and inefficient."

Treasury also endorsed the CFTC's use of so-called principles-based regulation, in which overarching guidelines trump specific rules. Treasury said the SEC should apply the principles approach to its oversight of stock exchanges.

The study envisions the Fed with broader oversight powers, especially in the area of market stability, and possibly less powers for bank supervision. The study suggests that the FDIC could take on the role of supervising state-chartered banks.

In other areas, the Fed gathers more power. The study proposes that the Fed become a "market stability" regulator, with powers over insurance companies and securities firms with federal charters.

The study also suggests a distinction be made between the Fed's "normal" lender-of-last resort discount window to help banks meet short-term funding needs and "market stability" lending to help stave off severe funding shortages and panics. In that function, the loans could be extended to federally chartered insurance companies and financial institutions, the study says.