Galvin-izing the debate

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Massachusetts regulator takes lead in criticizing revamp of financial oversight

Before there was an Eliot Spitzer (and, ahem, after Mr. Spitzer), there was (and still is) William F. Galvin, Secretary of the Commonwealth of Massachusetts for the past 14 years.

Mr. Galvin has earned a national reputation as a tough cop on the financial services beat that's arguably second to one in its aggressiveness. He's taken on hometown names like Credit Suisse First Boston for research analyst practices and Putnam Investments, Massachusetts Financial Services (MFS) and the former Fleet Financial Columbia funds for mutual fund market-timing practices. "Putnam and MFS have been dramatically changed by Galvin's intervention," said James Lowell, editor of the investment newsletter Fidelity Investor "There's no doubt in anyone's mind that he can make a case."

No doubt, also, that Mr. Galvin is unimpressed with Treasury Secretary Henry Paulson's proposals last week to take away some of the states' regulatory and enforcement powers as part of a sweeping overhaul of the nation's financial regulatory system in the wake of the credit crunch and the problems it revealed.

Make that highly unimpressed.

"Absurd," Mr. Galvin said of what he called "the efforts of the financial industry to make pesky state regulators go away. [It's] a disastrous backward step that would put the investor in jeopardy. We've seen this before."

Mr. Galvin agrees with some of Mr. Paulson's ideas, such as a proposed merger of the Securities and Exchange Commission and the Commodity Futures Trading Commission. But shuffling federal regulators won't necessarily make things better, he said, citing what he calls inaction in Washington during the past year's subprime mortgage meltdown, auction rate market failures, and the spread of risky derivatives into investments once deemed secure.

"It has been the states, especially progressive ones, that have signaled these looming financial failures," Mr. Galvin said, putting Massachusetts, New York and a handful of others in that "progressive" category.

Harvard Law School professor Hal Scott, director of a congressional advisory committee on capital markets regulation, said the Treasury Secretary's proposals aren't meant to be as disruptive as Mr. Galvin suggests.

"Mr. Paulson is raising some legitimate questions here," Mr. Scott said.

For example, one proposed change would be to allow national banks, securities firms and insurance companies to seek a federal charter that would let them report to and be regulated by one entity—the federal government—which makes more sense, Mr. Scott said, than the current practice of reporting to 50 different entities, each with its own agenda.

Mr. Scott also questioned how much real power state regulators might actually lose under the proposals, given that on many issues the federal government would play a role only when it involves issues deemed national in scope.

“States aren’t always the good guys and the federal government the bad guys,” Mr. Scott added, citing the poor job many states did in their oversight of mortgage originators, who played a major role in the subprime meltdown. As a result, part of Mr. Paulson’s plan calls for federal oversight of state’s efforts to police mortgage originators.

Several of Mr. Paulson’s proposals should attract quiet support from the financial services industry, particularly those that supplant state-by-state oversight with a national authority, Mr. Lowell predicted. But few firms are likely to jump in because they fear involving themselves in a “turf war” between regulators, he said.

But if it comes down to that, Mr. Galvin has a powerful ally: U.S. Rep. Barney Frank, the Democrat from Massachusetts, who already has said Mr. Paulson’s 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.

Mr. Galvin expects that view will gain support. “I think there will be reluctance [on the part of Congress] to pre-empt the states,” he said, “and I think there is an understanding that most of the problems brought to the fore in the last few years have been brought by states.”