More regulation, please

by The St. Louis Post-Dispatch

In the middle of a grinding credit crunch, Treasury Secretary Henry Paulson on Monday unveiled plans for a massive overhaul of the way the government polices the nation's financial system.

It's a thoughtful approach worthy of full debate and discussion, but even Paulson acknowledges that it will take time - past the expiration of this administration - to carefully consider the plan, much less get it approved by Congress. In the meantime, the so-called blueprint will do very little to dig us out of our present financial mess.

We're in that mess because lenders and investors made some terrible bets, largely on mortgages to iffy borrowers, but also on other types of shaky loans. All this happened under the noses of the Federal Reserve and the Treasury Department, which failed to pay attention and take action until it was too late to avert a crisis.

On the promising side, Paulson's plan - the study for which began before the current crunch - would let the Fed snoop more deeply into the books of Wall Street firms to detect what bombs may lurk there and assess risks. That's only reasonable, since the Fed has pledged more than $50 billion in taxpayer funds to ward off a financial panic that could have investment banks falling like dominoes. It's the largest federal rescue operation on Wall Street since the Great Depression. What we really need, however - and fairly soon - are stricter soundness standards for investment banks. We need tougher capital, loss reserve and liquidity requirements. Those things can lower profits, but they also armor firms against the bank-run mentality that nearly took down Bear Stearns.

But Paulson, who came from Wall Street, appears to oppose such an approach. "I am not suggesting that more regulation is the answer," he said. He called it "premature" to assume that investment banks should be under Fed supervision permanently or have permanent access to Fed loans.

It's not premature at all. The nation's financial system has stared into the abyss, and there's no forgetting it. The events of the past few weeks show that the nation's credit system is vulnerable to severe damage based on mistakes made on Wall Street. That puts the entire economy - including the paychecks of ordinary Americans - at risk.

Without a wide-awake regulator with meaningful authority to take action, we'll see this sort of thing again.

Even if the Fed subsequently closes the emergency-lending window it has opened to investment banks, everyone would expect it to open again when the next crisis hits. That alone can lead to more risky behavior.

The long-range plan Paulson announced on Monday looks well beyond our present dilemma and proposes major structural changes to our regulatory system. It took shape, often haphazardly, between 1913 and the Great Depression, and Paulson is right to consider a broad overhaul.

For example, an alphabet soup of five federal agencies and dozens of state agencies regulate banks that provide customers with federal deposit insurance. The trick is figuring out how to eliminate wasteful overlapping authority without losing the checks and balances required for effective oversight.

The Treasury secretary would combine all regulators into three agencies. One would regulate depository banks for soundness. A second agency would play cop to lenders and investment houses, enforcing fairness and consumer rights. The third agency would be the Federal Reserve, and it would be charged with protecting the overall financial integrity of the system. It could step in when risky practices put that system in jeopardy.

Paulson and his team deserve credit for thinking out the box. His long-range regulatory overhaul deserves serious consideration, keeping a special eye on true enforcement authority and provisions for meaningful checks and balances. But we also need tighter standards right now.

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