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Meet the 'New' Powers: Same as the Old Authority

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WASHINGTON- From its inception, a key pitch for legislation to rework the regulatory system has been that it will provide regulators with more tools to prevent another banking crisis.

Yet the most highlighted provisions of both the House and Senate bills would give regulators authority they already have, and so far have largely ignored.

The legislation would order regulators to create higher capital requirements, boost leverage limits and restrict risky activities. But Congress already passed laws to let regulators take such action more than a decade ago.

Many experts said regulators were no more likely to follow through now if legislation is enacted than they were prior to the crisis.

"It's sort of like dealing with your three-year-old," said John Douglas, a partner at Davis Polk & Wardwell, and a former general counsel of the Federal Deposit Insurance Corp. "It's like 'this time I really mean it.'"

Following the savings and loan crisis, regulators were given vast authority to raise capital, limit risky activities, set leverage limits and other broad powers.

For example, the Financial Institutions Reform, Recovery and Enforcement Act, enacted in 1989, gave regulators the power to restrict an institution's growth and limit its size. That power is the same as a much-touted provision of the House and Senate regulatory reform bills, which would allow regulators to restrict risky activities and limit an institution's size and growth.

Some observers said that is why they are skeptical of the current regulatory reform bills.

"It creates an appearance of real reform," said Rick Carnell, an associate professor at Fordham University School of Law and a former Treasury Department official. "You are creating a semblance of reform beyond what you are really doing and it makes Congress and everybody else think you are being tough and meaningful when in fact you are recycling the same provisions that failed us before when regulators didn't use their discretion when they should have."

Carnell argues that regulators already have discretion to require quarterly stress tests, place limits on credit exposure and restrict certain transactions between banks and affiliates.

They can also constrain proprietary trading, set standards for bank investments for mortgage-backed securities, and make rules for assets and liabilities that are off balance sheet, he said.

Treasury officials acknowledged that regulators already have much of this power, but said it was granted on a discretionary basis. The reform bills, they said, would place more emphasis on ensuring they use those tools, such as requiring "heightened" capital standards for systemic institutions.

"The bill would not merely authorize, but require, regulators to take stronger actions with respect to constraining risk-taking by the largest firms," Michael Barr, Treasury assistant secretary for financial institutions, said in an e-mail. "We learned painfully in the last crisis that authority, while necessary, is insufficient."

The regulatory reform bills would require the Federal Reserve Board, with the assistance of a systemic-risk council of regulators, to set heightened prudential standards for risk-based capital, leverage, liquidity and credit exposure. it sa

In most cases, however, the bills do not spell out how those standards should be crafted, leaving it for the regulators to decide. Some observers said that is a recipe for keeping the status quo.

"Just Congress putting provisions like liquidity, capital, and not breaking them out doesn't do a whole lot," said Cornelius Hurley, a professor of banking and financial law at Boston University School of Law. "If we are talking about too-big-to-fail banks, nothing has changed."

Treasury Secretary Tim Geithner often touts these provisions as a step to end "too big to fail."

But observers said that under existing rules Geithner himself could have set higher capital standards when he was president of the Federal Reserve Bank of New York.

Bill Isaac, a former FDIC chairman, said these provisions merely give political cover.

"It makes politicians pretend like they have done something," he said. "There is no purpose to be served other than to give politicians bragging rights that they are being tough and doing something."

Isaac doubted regulators would behave differently following this round of reform.

"They will do whatever they are going to do," he said. "They have power right now, so what good does it do to give them power twice or three times?"

Not everyone is convinced nothing will change.

Brad Sabel, co-leader of Shearman & Sterling LLP's Economic Stabilization Advisory Group and a former New York Fed official, said regulators are more likely to act this time.

"The agencies cannot simply decide to blow Congress off," he said. "If Congress passes a statute saying enhance and make the rules stronger, I think the lawyers would say that the agencies make them stronger."

Still, some question whether regulators will only change standards slightly, undercutting the point of reform.

Carnell said regulators could satisfy "heightened" capital levels by increasing them only incrementally.

"I think the existing capital levels are not high enough," Carnell said. "They were a second or third best solution when they were adopted. You've technically complied with the law if you've raised them two-tenths of 1%....I don't put much weight on 'shall' because I think Geithner's idea of being tough is not being very tough."

Others, however, said regulators are already using the power they were granted - a process that could accelerate if reform is enacted. They note, for example, that as the Basel Committee revamps international capital standards, most expect it to result in higher requirements.

Mark Calabria, director of financial regulations studies at the **Cato Institute,** said higher capital standards will come even if reform fails.

"A lot of this is more of a nudge for regulators than anything else," he said. "Even if Congress passes nothing, regulators are going to move forward on stronger capital requirements. That's happening. That's going to happen."

Some also note that the bills would give regulators more leeway than they currently have. For example, though the agencies have the power to limit activities at banks on an institution-by-institution basis, the reform bills would let them set industry-wide standards.

"The Fed can limit an activity if it is not being conducted safely," Sabel said. "I don't think that it can order a bank-holding company to stop engaging in a certain activity, but it can put pressure on the holding company to put the right controls in place."

But even if that power is expanded, some doubted regulators would ever take advantage of it.

"I think you are going to have the same temptations for the regulators, which is do nothing," Sabel said. "They are going to go to the path of least resistance."

The House bill would also give regulators the right to break up a bank - a power they do not have under current law. Still, many observers doubted if they would ever use it.

"That is a hard scenario for me to contemplate," said V. Gerard Comizio, a partner in the corporate department at Paul, Hastings, Janofsky & Walker LLP. "It seems counterintuitive that when a banking institution is doing well to ask it to begin disassembling itself."

But Alan Blinder, an economics professor at Princeton and a former Fed vice chairman, said change would come whether a bill passes or not. He said the regulators are reluctant to use their existing powers now while Congress contemplates legislation. But once it passes, or if it is clear it will not be enacted, he expected them to act.

"The regulators have been burned," Binder said. "All the regulatory agencies have egg on their face. ...It's perfectly reasonable for these regulators to defer to Congress. But if Congress gives up on the issue and doesn't do anything, then I think it should be the regulators' responsibility to step up to the plate."

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