Competitive Enterprise Institute
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Advancing Liberty – From the Economy to Ecology

April 10, 2008 No. 134

A Flawed *Blueprint*

A Free Market Analysis of the Treasury Department's Financial Regulation Proposal

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The Treasury Department's 202-page *Blueprint for a Modernized Financial Regulatory Structure* offers a sweeping vision for remaking America's financial regulatory landscape.[1] It promises to replace a vast array of financial services agencies, overseers, and regulators with three enormous bureaus—one of them an expanded version of an existing government entity—with sweeping powers to reach into every corner of the American economy.

The report seeks to replace a confused, sometimes inconsistent financial regulatory system with a clearly defined one that would bring a strong regulatory state to bear over many financial institutions. It discards institutions, forms, and ideas that have grown up organically in response to specific problems and replaces them with large, one-size-fits-all regulatory mechanisms structured along functional lines. Although certain portions of the framework have considerable merit, particularly regarding insurance regulation, many more of them have serious flaws.

This paper analyzes the *Blueprint* from the basis of how it advances the principle of regulatory competition—that regulation works better when a degree of choice allows private entities to select their regulators and when those regulators evolve as a result of long, learned experience rather than commands issued from on high.

This analysis seeks to offer guidance to policy makers interested in strengthening free market institutions. The first section briefly analyzes the *Blueprint*'s short term recommendations. Two longer sections look at the medium and long-term recommendations. The conclusion outlines some considerations going forward.

Short Term Recommendations. On balance, the Treasury's short-term recommendations can potentially improve decision making within agencies and the administration as a whole.[2] The recommendations are:

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1. An expanded President's Working Group on Financial Markets, the group that advises the President and other top policy makers on market stability issues;
2. Clearer regulations and more study surrounding mortgage origination. Mortgage origination, a potential root of the subprime crisis, has been a controversial topic and more study could help identify the pitfalls of the recent subprime crisis; and
3. Clarifications surrounding the Federal Reserve's opening of its discount window to non-depository institutions. The recent Bear Stearns bailout—the first occasion in which the Fed lent money to an institution that is not a bank—essentially made the Fed the lender of last resort to investment firms as well as banks. While the *Blueprint's* authors implicitly approve of the action, they desire clearer guidelines surrounding it.

None of the recommendations would change the way things are done and, while Congress could encourage (or possibly prohibit) some of them, none of them require Congressional action. Essentially, the three recommendations boil down to a call for decision making efforts that involve more people within the administration and are more clear to those outside it.

As all of these measures involve changes in process, rather than specific regulatory modifications, none of them, by themselves, will change the way America's financial markets operate and are regulated. They may do some help and will not do any harm, so there is no good reason for Congress to oppose implementing them. They are a product of internal executive decision making and the President should have the power to structure his own advisors as he or she sees fit.

The *Blueprint's* authors, however, should have considered even more short term action. For example, the recommendations, as written, include no short term actions related to the Treasury's medium term recommendations concerning insurance. At minimum, the Secretary of the Treasury should investigate additional actions that he might perform within the Department.

Medium Term Recommendations. The Treasury's medium term recommendations envision a variety of changes to the way the United States regulates banking and insurance. Some appear wise and well thought out, others less so. Of the former, Congress should enthusiastically pursue an optional federal charter (OFC) for insurance, while approaching most banking and payment regulations with a great degree of caution, and eschewing some counterproductive proposals.

Banking Systems. Banking is a prime example of an area where Treasury's recommendations go awry. Whatever the *Blueprint's* long-term goals—and they are not very clear—its intermediate recommendations for banking would likely reduce access to credit at a time when a greater variety of credit mechanisms is most needed.

Since the 1930s, U.S. law has recognized three major types of depository institutions: banks, thrifts (also known as savings and loans), and credit unions. Historically, each had distinct roles: Credit unions focused on providing non-mortgage services to their specific fields of membership, thrifts focused on the mortgage business, and banks did just about everything else.

These distinctions have weakened since the current structure first went into place during the New Deal era: Credit unions have entered the mortgage business and thrifts have begun to offer checking accounts and mortgages. The 1999 Gramm-Leach-Bliley Act ended many of the distinctions between investment and commercial banking while allowing more-or-less unrestricted interstate competition between banks. At the same time, it curtailed the ability of non-financial businesses to acquire thrifts through a holding company structure.

As a result, some minor but significant differences in the permitted activities of banks and thrifts persist. Namely, thrifts still have a greater degree of freedom to affiliate with non-financial entities. A grandfathered holding company can still own a thrift as well as nonfinancial firms. Thrifts also can invest up to three percent of their assets in "service corporations," such as in real estate. Banks cannot do any of this.[3]

The *Blueprint* argues that non-financial activity restrictions make no sense, either for banks or for thrifts—yet its misguided quest for regulatory parity would eliminate this flexibility for *any* financial institution in the "intermediate" run. In fact, the report notes, in addition to "the potential for increased competition and innovation," affiliating with a non-financial entity can help provide the "safety and soundness benefits of diversification" to the financial system.[4]

However, the Treasury proposes to further restrict this activity during its undetermined "intermediate" period. In recommending a two-year "phasing out" of the national thrift charter to force thrifts to become more like federal or state-chartered banks, the *Blueprint* makes no provision for incorporating this flexibility into the new bank charter.[5]

Its reasons for ending the thrift charter are unconvincing. The report states that, "asset securitization" is "rendering depository institutions…and thrifts in particular less relevant in the context of residential mortgage lending."[6] Well, the recent failures of many securitized instruments will almost certainly make thrifts, credit unions, and other financial institutions at least slightly more relevant. Securitization will not come to an end; financial firms will learn from their mistakes and improve the process. But, given the current and possible future crises in securitization, depository institutions having the flexibility to carry mortgages on their own books will remain a crucial alternative for borrowers and for the financial system.

Rules that have been shown not to improve a financial institution's soundness should be swept away for banks, thrifts, and credit unions alike. The *Blueprint,* in its "intermediate" recommendations, takes the financial system a step backward by letting its vision of "the perfect" become the enemy of the good that comes from regulatory competition.

Payment Systems. The *Blueprint*'s recommendation for new regulations on payment and settlement systems is mostly a solution in search of a problem. The report complains that "major payment and settlement systems are generally not subject to any uniform, specifically designed, and overarching regulatory system." "The Federal Reserve…should have discretion to designate a payment and settlement system as systemically important," it concludes, and adds that the Fed "should have a full range of authority to establish regulatory standards."[7]

Such a policy would be unnecessary and counterproductive. The Treasury report overlooks that payment and settlement systems, such as those of major credit cards, have become what they are largely due to a *lack* of heavy-handed regulation. They have worked out individual agreements, including fee structures, with millions of consumers and thousands of merchants. As a result, a Visa or Master Card issued by a small community bank in Kansas can be used for purchases around the world.

It is hard to see what stronger federal regulation can do to improve this. Moreover, under the *Blueprint*'s proposed regulatory system, the Fed will almost certainly be tempted to interfere in pricing policies between credit cards and retailers. Such regulation of terms between private parties will mean more disruptions to the system and higher costs to consumers.

It is worth noting that payment and settlement systems, with minimal government assistance or regulation, came through relatively unscathed from what could have been massive systemic shocks—the September 11, 2001, terrorist attacks that destroyed the World Trade Center offices of some of the biggest financial institutions in the country and the Y2K programming glitch that threatened to disrupt transactions after the new millennium. In fact 9/11 and Y2K demonstrated that decentralization is essential to weather systemic risk. Destroying the offices of several New York banks did not halt the financial system because the payment and settlement operations were so spread out. And more payment systems that evolve with their own unique rules will mean more options in the face of disruption by a cataclysmic event. Moreover, payment businesses have powerful incentives to keep systems running.[8]

Having the Federal Reserve as a payments regulator would increase the likelihood of federal regulation of interchange fees. Retailers, from small stores to large chains, have called for *de facto* price controls on what credit card companies charge them to process transactions. But, as the experience of Australia in limiting fees shows, consumers will lose benefits, such as the popular rewards programs, as card companies look to make up their costs and retailers do not pass on their savings.[9]

Moreover, retailers themselves would lose from the lack of choices that would result from such price controls. Today, retailers have a lot of room to negotiate with card companies. The discount warehouse store Costco, for instance, has negotiated a special deal with American Express and will only let customers use that card in its store. With new payment systems arriving on the Internet, the most notable being PayPal, choices for retailers and consumers will likely expand even further. Government should encourage this competition and innovation by staying out of the way—both to spur further benefits for all parties and to lessen the risk of systemic shock.

Insurance. The Treasury's recommendations for restructuring America's insurance markets deliver on the promise of broad, forward-looking modernization and—unusually in the context of the *Blueprint*—would actually strengthen the degree of regulatory competition within the American economy.[10] The next few pages describe the scope of the Treasury's recommendations and their potential strengths and weaknesses. Under the system proposed, America would drop its balkanized, unwieldy system of separate state regulation and replace it with a dual system of competitive regulation similar to that for banks. The new system would rest on two major pillars: an optional federal charter (OFC) and a new Office of National Insurance to oversee the OFC.

The optional federal charter would give insurers the option of federal—rather than state—regulation.[11] It would have four fundamental features:

1. An absence of rate regulation;
2. Measures to provide for insurer solvency;
3. Freedom for innovation through a quicker, national approval process; and
4. National consumer protection regulation.

Rate regulation. Today, most states regulate insurance rates. The Treasury report, like pending legislation introduced in both the house and Senate, envisions a system free of rate regulation.[12] As the Treasury *Blueprint* correctly points out, there is no evidence that government rate setting and approval benefits consumers or insurers in any way. Rather, it tends to distort insurance markets in ways that benefit politically favored groups at everybody else's expense. Dropping rate regulation at the federal level would also pressure states to follow suit, which would benefit consumers, business, and the economy.

Insurer solvency. The proposed regulations involve a degree of solvency oversight, a current feature of every state regulatory system. Although states and the federal government alike should explore alternative measures for solvency oversight, insurance, as most consumers understand it, requires a third party overseeing the solvency of insurers. Without some degree of third-party solvency oversight, it would become easy for unscrupulous peddlers of insurance to commit fraud in the medium term: Since an insurance contract is a promise, someone must provide reasonable assurance that the insurer will keep the promise.

A freer environment for innovation. A lack of innovation has long bedeviled personal property and casualty insurance: While some new ways of arranging policies have come into existence, not a single fundamentally new, mass-market product for insurance consumers has gone on sale since the St. Paul Company wrote the first homeowners' insurance policy in *1950*.[13] The Treasury promises faster approval of forms, products, and business models. However, there is no reason to think that a federal regulator would be any more efficient than those of the most efficient states. The existence of a single-point-of-approval rather than the need to pass more than 50 different state approvals, which an OFC would provide, would enormously speed the rate at which insurers could bring new products to market across the nation.

Consumer protection. The Treasury proposes new national programs to protect consumers from the use of force and fraud in the insurance business. Given that insurance is a national business, it only makes sense that government should perform these consumer protection functions on a national basis. In fact, these programs would likely do more to protect consumers than all existing state-level programs combined, and are politically necessary for an OFC to become law.

Treasury also proposes the creation of an Office of Insurance Oversight, to be later replaced with an Office of National Insurance, which will administer an OFC. The head of the Office of National Insurance, a Commissioner of National Insurance, would have powers analogous to a state insurance commissioner—to issue regulations, oversee market conduct, and revoke charters for insurance companies—which would be necessary for the creation of an OFC.

The precursor to the Office of National Insurance—an Office of Insurance Oversight—would, in theory, precede the implementation of a major regulatory reforms and would simply focus "immediately on key areas of federal interest in the insurance sector."[14] It would have statutory authority to deal with federal and international issues, such as reinsurance collateral, and serve as a repository for knowledge about insurance within the Treasury Department. In rare cases where state commissioners operating through the National Association of Insurance Commissioners cannot reach an agreement on an issue of international significance, it would have the authority to impose a policy while leaving implementation to the states.

The *Blueprint's* insurance recommendations have considerable merit. They would enhance consumer choice and make America safer. A single regulator would allow insurers to introduce new insurance products, something the current regulatory climate has made nearly impossible. The existence of a federal regulator would subject every state regulator to competition, as states that fail to regulate in a prudent fashion would find insurance companies fleeing their regulators for the new federal one. The lack of rate regulation would result in rates that, over time, would reflect the most accurate calculation of actual risk available. The risk-prone would pay the price while the risk-avers would receive benefits in the form of lower insurance rates. This, in turn, would tend to make society safer by discouraging risky behavior.

The Treasury plan, however, has three potential flaws:

1. **It could evolve into a system of dual regulation.** Over time, the federal government could come to claim substantial regulatory authority over all insurers as happened in the banking sector. Insurance companies could find themselves subject to both federal and state regulations simultaneously, which would further slow the development of new products for consumers.[15] An optional federal charter must remain *optional*.
2. **It could potentially go back on its promise of risk-based rates.** After all, 49 states impose some regulation on rates.[16] If politically favored groups, such as coastal property owners, see their premiums soar under an optional federal charter, they could organize to demand federal rate regulation.
3. **Its incremental nature could undermine it.** Parties who oppose the creation of a federal insurance regulator will have more opportunities to derail its creation, which could yield a regulatory hodgepodge of half-baked and partially implemented reforms.

That said, the potential weaknesses of the Treasury plan seem mostly theoretical and distant. while the benefits appear real and immediate. From a free market perspective, the plan has much to recommend it and it deserves serious, speedy consideration from Congress.

Long Term Recommendations. The Treasury *Blueprint* claims to arrive at an "optimal" regulatory structure that would replace sector-by-sector regulation—separate regulators for insurance, investments, loans, and depository products—with principles-based functional regulation consisting of agencies devoted to stability, prudential, and business conduct regulation. While it would achieve some good results, this "optimal regulatory framework" places far too much emphasis on making things easy for bureaucrats and far too little on actually improving the nature of financial regulation in the United States.

Regulatory niches evolved for a reason. Competition between different regulators helps consumers and businesses optimize the level of regulation in a way that no amount of central planning—no mater how clever—could ever do. Differing regulatory frameworks, more often than not, recognize differences between business types. A single regulator simply cannot offer the same flexibility as multiple competing regulators. Above all else, lawmakers should view any effort to consolidate or eliminate regulator options and the flexibility they bring with skepticism.

Stability Regulator. By its own admission, the Treasury *Blueprint* envisions "broad powers" for the Federal Reserve.[17] The Fed would become the federal government's "market stability regulator" with "enhanced regulatory authority…to focus market discipline to deal with systemic risk." It would have the power to collect "detailed information about the business operations" of firms defined as "financial institutions" to discern if they present a threat to "market stability."[18] The Fed's new duties would be "broad, important, and difficult to undertake," the *Blueprint* states. They are also unnecessary and would likely be counterproductive.

The Fed's current authority is based on a political bargain. Compared to other government entities, the Fed operates relatively free of political interference and many of its operations are shielded from public scrutiny. Although its chairman and board of governors are appointed by the president and subject to Senate confirmation, they serve fixed terms that are generally not subject to changes in presidential administrations. And since it does not receive an annual appropriation, it does not receive the Congressional oversight that goes with such funding.

Moreover, many of the Fed's meetings and even policy directives are exempt from "sunshine" laws such as the Freedom of Information Act.[19] The Fed has long been criticized for its perceived excessive secrecy. Even Fed Chairman Ben Bernanke has pledged to make Fed policy-making more open and transparent[20].

Nevertheless, it is generally accepted by policy makers that in pursuing its economic objectives, the Fed should have a wide degree of autonomy—which can also mean a lack of political accountability. But a crucial aspect of this bargain is that the Fed does not have direct regulatory authority over many specific businesses and individuals. Currently, the only businesses subject to its jurisdiction are those banks that choose the Fed, rather that the Office of the Comptroller of the Currency or the Federal Deposit Insurance Corporation, as their federal bank regulator.

The *Blueprint*'s recommendations, if adopted, would change this instantly. The Fed would have the ability to examine the papers of a variety of financial institutions. With the Bear Stearns bailout, the most obvious businesses under Fed authority would be broker-dealers. The *Blueprint* also singles out "private pools of capital," such as private equity and hedge funds, for Fed regulation. And under various statutes and regulations, such as those for money laundering reporting, the term "financial institution" is defined very broadly to include such routine businesses as travel agencies, jewelry stores, and car dealers.[21] There would likely need to be legislation to give the Fed the power to issue administrative subpoenas to such parties. When abuses under these powers inevitably occur, as they do with every agency exercising investigative powers, questions will be raised about the remedy an individual or firm can pursue against the Fed, as well as about the Fed's independence..

The alternatives appear equally unpleasant. Either the Fed can operate with the same lack of accountability, in which case individuals may be deprived of vital due process protections and other civil liberties in Fed investigations. Or the Fed can surrender some of its independence. But once the Fed is subject to more political supervision, this scrutiny can easily extend to its monetary policy. Thus in taking on the greater role of "market stability," its core function of ensuring monetary stability could be jeopardized.

Prudential Regulator. The Treasury's vision for prudential financial regulation—regulation that deals with financial condition and risk management—appears contradictory, confused, and potentially destructive.[22] It includes three major proposals:

1. The creation of a new prudential regulator;
2. Homogenization of depository institution chartering; and
3. A revision of the way that the federal government provides an insurance backstop to financial institutions.

Each proposal has flaws.

Creating the regulator. The new regulator, called the Prudential Financial Regulatory Agency (PFRA), would oversee all "prudential" regulations. Its activities would affect all financial institutions that enjoy an explicit government guarantee for their business activities—banks, insurers, credit unions, thrifts, and most investment firms. Absent the creation of an optional federal charter for insurance, the creation of a new PFRA would essentially fold nearly the "prudential" functions of nearly all of the nation's depository regulators together.[23] (Following the creation of an OFC, it would also include an insurance guarantee capacity.) Besides implicit promises of administrative efficiency, the Treasury never puts forward a case as to why one regulator will do better than several.

Chartering homogenization. For the most part, the Treasury sees the single regulator as an overseer for a new federally insured depository institution (FIDI) charter. All banks, thrifts, and credit unions under federal regulation would need to obtain this type of charter if they sought any type of federal insurance. (They nearly all do.) The stated goal of this charter seems worthy—"to create a level playing field where competition among financial institutions can take place on an economic basis, rather than on the basis of regulatory differences."[24] Regulatory differences can cause harm. Banks make a valid point when they complain that credit unions do not pay taxes while credit unions correctly complain that their abilities to lend to businesses and set interest rates fall under too many regulations. This might be worth considering if Congress could somehow guarantee that a new single-all-purpose regulator would devise the optimal regulatory structure in every case.

The real world, however, is much messier than Treasury suggests. The availability of different types of charters with their own unique attributes and restrictions tends to create competition between different types of lending institutions. For example, while the entire credit union movement is much smaller than any one of the nation's three largest banks, it still provides important competition to banks and thrifts in areas such as car loans, loans secured with taxicab medallions, and other niche financial products.[25]

In any case, the proposed system would not end regulatory differences. Institutions that chose to remain small or adopt "community" charters that impose field of membership restrictions similar to those of credit unions today would remain exempt from federal taxes just like credit unions and certain banks are today. Credit unions originally had limited fields of membership because, at the time they were created, a limited field of membership seemed the best way to provide an assurance that loans would be repaid. As credit unions now make loans based on the same credit information which all other lenders use, little advantage seems to exist in mandating a limited field of membership or geographic reach.

Under a single federal regulator, institutions seeking the federal tax exemption would likely go through all sorts of machinations to prove that they were actually "community based." On the other hand, some organizations that serve a distinct group of consumers—such as Navy Federal Credit Union—might not pass the "community" test because they might not impose "meaningful" field of membership restrictions. On the other hand, a small shareholder-owned for-profit corporation devoted only to serving millionaires would get the exemption under the *Blueprint*'s plain language.

Treasury's plan proves self-contradictory. It would eliminate competition between regulators and replace for competition *within* a single regulator. Rather than picking a charter type—thrift, bank, or credit union—that best suits its needs, and changing it if those needs change, institutions would compete for the favor of the PFRA alone. The amount of market pressure for better regulation would actually decline.

Depository insurance changes. The *Blueprint* also proposes merging federal deposit insurance function into a single agency.[26] Insofar as government is to provide any federally backed insurance to any private entity—a dubious policy to begin with—it is preferable for it to be spread out among separate insurance capacities. The Treasury should consider two additional options: a more flexible system for bank insurance and a general tax exemption for depository insurance.[27]

Under a fractional reserve banking system, depository insurance of some sort is necessary to prevent bank failures and retain confidence in the banking system. However, the federal government should seriously consider alternatives to the existing structures, such as mutual guarantee systems and systems of competing private bank insurers.[28] While depositors and policyholders need protection, taxpayers should not be placed in the position of bailing out investors who make poor business decisions. Any consolidation of insurers should not be adopted with undue haste.

In addition, there is a strong case for exempting all depository institutions from the federal income tax.[29] For companies involved in other lines of business—say consumer products or retail—only a small percentage of customers have ongoing billing relationships and none get *paid* by their institution. All depository customers, by definition, either get billed—make loan payments—or paid—receive interest and dividends—by their financial institutions. Thus, it is quite easy for any depository institution to directly pass taxes—and tax hikes—directly onto its customers by adjusting interest rates. A consolidated federal depository charter that included a corporate income tax exemption for *all* depository institutions—regardless of structure—might provide the best competition for state-chartered institutions while simultaneously adding vitality to the nation's banking system, and eliminating a hidden tax on consumers. Under these circumstances, an elimination of the distinctions between banks, thrifts and credit unions could make sense. But the proposed system would do none of this.

The Treasury *Blueprint*'s prudential regulation proposal would reduce regulatory competition without truly creating a level playing field for different business models. Implemented literally, it would create an enormous incentive for profit-making institutions to seek community charter and reap the benefits of both stockholder investments and tax-exempt status. This proposed regulatory framework opts for bureaucratic ease of regulation over a pragmatic recognition of the differences between various financial institutions.

Business Conduct Regulator. The Treasury *Blueprint* proposes a single, consolidated agency to carry out all or nearly all business licensing and consumer protection within the financial services sector. The new Conduct of Business Regulatory Agency (CBRA) would divide consumer protection—also known as business conduct regulation—from prudential oversight functions.[30] Right now, most of the agencies that would be folded into the CBRA perform both consumer protection and prudential oversight functions.

In some cases, this could provide some benefits. For example, the Treasury identifies four major federal laws, at least five federal bureaus, and 31 state laws that could be involved with mortgage business conduct cases—and this is probably a conservative figure.[31] Each of these agencies (plus state agencies) imposes its own requirements on mortgages, making the entire process of getting a mortgage needlessly opaque and bureaucratic. A single federal mortgage regulator or greater coordination between the existing regulators probably would make things easier for consumers.

In other cases, the benefits seem far less clear. For example, nearly all complaints about securities violations already flow through one federal agency—the Securities and Exchange Commission—that oversees nearly all federal laws. Administrative consolidation along the lines the Treasury proposes would, to some extent, lump securities regulation in with regulation of other potentially unrelated financial products. Besides some minor, implicit administrative savings, it is not clear what this particular consolidation would accomplish.

The case for separating insurance regulation from insurance consumer protection—which would be unified in an office of national insurance under the *Blueprint*—is even weaker. In the case of insurance, efforts to protect consumers and prudentially regulate the industry are inexorably intertwined: Consumers, above all, need an as-close-as-possible-to-absolute promise that insurers will pay all legitimate claims and this involves, above all else, prudential regulation. Thus, separating solvency regulation from business conduct in the insurance sector thus seems almost impossible.

The Treasury's proposal for an all-purpose federal financial services provider (FFSP) charter that nearly all securities firms, insurers, and banks would have to secure would confuse things even more. These charters would exist independently of the charters issued by the PFRA, even though the same entities that receive charters from the PFRA would also need charters from the CBRA. The charters, the Treasury *Blueprint* says, would be "flexible" so that every type of firm—from a tiny financial planner's office to a massive international financial services conglomerate—would need to meet different "fit and proper" requirements to receive one depending on the range of financial services it provided.[32]

However, many firms that provide a variety of services would to segregate their assets to comply with charter requirements: A bank could not, for example, play the stock market with more than a small portion of its federally insured deposits although a bank holding company could buy as many stocks as it wished. A firm that failed to meet these requirements could be forced into bankruptcy or denied its ability to operate. Moreover, there appears to be no good reason why a firm should need more than one charter for its different service and product lines.

The end result, for many firms, would be less flexibility and less regulatory choice. Rather than being able to optimize regulations for its particular business model, a firm would end up in a one-size-fits all model for business conduct regulation. This would not serve stockholders, customers, or the interests of the financial system.

The United States almost certainly needs changes to its financial regulatory system and many of those changes might affect business conduct regulation. Yet the Treasury *Blueprint* does not make a convincing case for a unified business conduct regulator, which in many cases would do more harm than good. A CBRA is a bad idea.

Conclusion. Several years ago, senior Ford Foundation official Louis Winnick came to an important conclusion about efforts to restructure government programs: "Genuinely radical transformations in government cannot occur without radical transformations in policy in the fundamental 'what' of government as distinguished from the procedural 'how.'"[33]

In some cases the *Blueprint* does ask important questions about what government should do. In fields as diverse as insurance and mortgage lending, it asks fundamental questions and comes to sensible solutions. However, in far too many other places, it proposes creating new bureaucratic structures with new powers and new missions as if these will automatically result in a better financial system for the United States. They will not.

America, instead, needs a fundamental rethinking of its system of financial regulation that asks questions about what activities properly fall under governmental regulation, which ones might be dealt with through semi-private means, and which ones belong entirely in the hands of the free market. The *Blueprint* fails on this fundamental count.

Notes

[1] Department of the Treasury, Henry Paulson et al, *Blueprint for a Modernized Financial Regulatory Structure*, March 31, 2008, http://www.treas.gov/offices/domestic-finance/regulatory-blueprint/.
[2] Department of the Treasury, pp. 75-86.
[3] Ibid., pp. 93-95.
[4] Ibid., pp. 164.
[5] Ibid., pp. 89-96.
[6] Ibid., pp. 96-97.
[7] Ibid., pp. 104-105.
[8] The threat of identity theft raises similar issues. Having one mandated system to prevent identity theft may actually make things easier for criminals by providing a massive, and luring, repository of personal information. Multiple security systems help limit the damage one group of identity thieves can cause. See Wayne Crews and Brooke Oberwetter, "Preventing Identity Theft and Data Security Breaches: The Problem With Regulation," *Issue Analysis,* Competitive Enterprise Institute, May 2006, http://cei.org/pdf/5316.pdf.

[9] See John Berlau, “Credit Card Ricochet,” *Washington Times*, September 17, 2006, http://cei.org/gencon/019,05527.cfm,

[10] Department of the Treasury, pp. 126-133.

[11] See Eli Lehrer. “Optional Federal Charter for Insurers: FAQ,” *OnPoint* No. 122, Competitive Enterprise Institute, October 2, 2007, http://cei.org/gencon/004,06170.cfm.

[12] H.R. 3200 and S. 40. Both called “The National Insurance Act.”

[13] Eric Wieninc et al.. *Personal Insurance,* First edition, Malvern, PA: American Institute for Chartered Property Casualty Underwriters/Insurance Institute of America, 9.

[14] Department of Treasury, p. 132.

[15] While it has a number of problems, the dual system for banking regulation does not appear to have slowed down the development of new products.

[16] Only Illinois operates under a no-file system although Vermont, Idaho, Nebraska, New Hampshire, and several other states require information-only filings following the use of rates.

[17] Department of the Treasury, p. 15.

[18] Ibid., pp. 146-147.

[19] David C. Vladek, “Freedom of Information: Overview,” Fist Amendment Center, available at http://www.firstamendmentcenter.org/press/information/overview.aspx

[20] Edmund L Andrews, “Fed in a Fishbowl? An Era of Secrecy Seems Over,” *International Herald Tribune*, 1 November 2005, available at http://www.iht.com/articles/2005/11/01/business/fed.t.php.

[21] See John Berlau, “Show Us Your Money,” *Reason*, November 2003, http://www.reason.com/news/show/28935.html; Also, Robert O’Harrow Jr., “In Terror War, Privacy vs. Security,” *Washington Post*, 3 June 2002, http://www.washingtonpost.com/ac2/wp-dyn/A49323-2002Jun2?language=printer.

[22] Department of the Treasury, pp. 157-170.

[23] Although the report is not specific, the new agency would presumably supplant the National Credit Union Administration (including its share insurance activities), Office of Thrift Supervision, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and some functions of the Federal Reserve Board.

[24] Ibid, 160.

[25] See e.g. Eli Lehrer. “Taxicab Medallions and Heirloom Tomatoes to the Rescue,” *OnPoint* No 121,Competitive Enterprise Institute, September 18, 2007, http://cei.org/gencon/004,06139.cfm.

[26] It would consolidate the functions of the Federal Deposit Insurance Corporation, the Share Insurance Fund of the National Credit Union Administration, and a new federal insurance guarantee fund capacity for federally chartered insurers.

[27] Depository insurance and insurance guarantees tend to function differently. The Federal Deposit Insurance Corporation and Navy Federal Credit Union share insurance collect premiums on an ongoing basis so they have reserves to bail out failing institutions. In all states except New York, on the other hand, agencies that provide insurance guarantee operate on a “post fund” basis—that is, they levy assessments only *after* a failure happens. If insurance guarantees remains post-funded and bank insurance remains pre-funded, that would make administrative consolidation difficult, to put it mildly. Moreover, the case for retaining the separation between share insurance (for credit unions) and depository insurance deserves further investigation. Credit unions, because of their historically narrower fields of membership may have a higher risk of failure than the average bank: A credit union tied to a single employer, for example, will likely go under if the employer does.

[28] See Peter Wallison, *Back from the Brink: A Practical Plan for Privatizing Deposit Insurance and Strengthening Our Banks and Thrifts*, American Enterprise Institute, 1990.

[29] For a general overview of the literature of business taxation see William M. Gentry, “A Review of the Evidence on the Incidence of the Corporate Income Tax,” United States Department of the Treasury, Office of Tax Analysis, Paper 101, December 2007, http://www.treas.gov/offices/tax-policy/library/ota101.pdf.

[30] Department of the Treasury, p. 14. The CBRA would consolidate functions of the Securities and Exchange Commission, Commodities and Futures Trading Commission, parts of the Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, parts of the Office of the Comptroller of the Currency, Federal Trade Commission, Securities Investor Protection Corporation, Office of Fair Housing and Equal Opportunity within the Department of Housing and Urban Development, and Federal Accounting Standards Board, plus a wide variety of other services.

[31] Department of the Treasury, p. 70.

[32] Ibid., p. 176.

[33] Louis Winnick, “Is Reinventing Government Enough?” *City Journal*, Summer 1993.