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How to Restore Confidence in Our Markets

A unified regulator would be a start.

By ARTHUR LEVITT

Our nation's financial markets are in the midst of their darkest hour in 76 years. We are in this situation because of an adherence to a deregulatory approach to the explosive growth and expansion of America's major financial institutions. Our regulatory system failed to adapt to important, dynamic and potentially lethal new financial instruments as the storm clouds gathered. There is now a total breakdown in the trust necessary for a free and functioning market.

In response, we need to take dramatic and prompt action. For the past several months, there has been a debate about restructuring our financial regulatory architecture. Even in this environment that process could take many months, if not years. That's why we should move immediately to correct one of the most antiquated and dangerous flaws in that regulatory structure and merge the Securities and Exchange Commission (SEC) with the Commodity Futures Trading Commission (CFTC).

For most of its nearly 75-year history, a strong SEC has been the investor's advocate. It has succeeded in maintaining investor confidence, helping to make our markets the envy of the world. Unhappily, over the past few years, the SEC has failed in this mission.

Less well known to the broad investing public is the CFTC, since few individual investors are involved in the commodity markets. Yet what many people may be surprised to know is that the CFTC's responsibility includes financial products that are inextricably linked to our securities markets and the current meltdown -- derivatives, to name just one.

It is now time to end the artificial distinction of differing regulatory schemes for economically equivalent markets. Combining the best of what each agency has to offer will improve what they do, resulting in a deeper economic understanding of how markets are functioning, and strengthening the guiding principles of transparency and investor protection.

This newly empowered agency -- call it the Securities Futures Commission (SFC) -- would supervise markets (OTC, exchanges, boards-of-trade and municipal debt), broker-dealers, commodities merchants, investment banks (as boutique firms arise to fill the current void), accounting standards, rating agencies, mutual funds, hedge funds, corporate reporting, and the clearance and settlement systems.

This new agency should be given an old mission with new powers. The SFC's mission should be investor protection, built upon tough enforcement and ensuring efficient financial markets. Its new powers should include enhanced authority over hedge funds, OTC products and rating agencies. For investment banks, the SFC should supervise their global business lines and be able to establish appropriate capital standards.

This new agency also should be self-financing -- to be able to fund the types of programs and hire the talent necessary to keep up with the rapidly changing financial marketplace.

To further insulate the SFC from political winds, the chairman, like the chairman of the Federal Reserve, should be appointed for seven years, and the commissioners should be appointed without regard to political party. This agency should also be allowed to have a formal advisory board consisting of representatives of investor groups, to help it maintain a focus on investors and their issues.

This approach differs dramatically from the one proposed by Treasury Secretary Henry Paulson last year. He advocates gutting the SEC and the CFTC of their mandates, and placing the Federal Reserve and (mostly) Treasury at the helm of our markets.

The Federal Reserve's responsibility is monetary policy and the stability of depository institutions, a mission often at odds with investor protection, and it should remain separate. Treasury is a political entity controlled by the president -- just imagine what our financial markets would look like if controlled by the White House.

Trust in our institutions and faith in the system are not just theoretical niceties, they are imperative to the functioning of our markets. Creating a regulator that stands on the side of investors and oversees the broad market will help restore that trust.

Mr. Levitt was chairman of the Securities and Exchange Commission from 1993 to 2001.

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