

Business Forum: FINRA dropped the ball on financial oversight

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With all that's been said and written about reforming financial regulation, almost nothing has been said publicly about the regulator that had direct responsibility for overseeing the Madoff and Stanford firms, and Lehman, AIG's securities business and Bear Stearns' catastrophic failures.

This regulator, the Financial Industry Regulatory Authority Inc., in theory oversaw all the Wall Street investment banks and financial companies that assembled and sold the subprime mortgage backed securities and credit default swaps that caused the financial crisis, and bears more than its share of responsibility for what happened.

This is not the first time FINRA has failed to fulfill its responsibilities. In the industrywide OTC price-fixing scandal of the mid-1990s, FINRA and the Securities and Exchange Commission, which is supposed to oversee it, failed to protect the public interest. At the time, Richard Lindsey, who was responsible for overseeing FINRA, wrote a Wall Street Journal editorial warning of the "moral hazards" in the authority's structure.

This should come as no surprise to those who follow these matters since FINRA, owned and controlled by the brokers it was meant to regulate, is a case study in conflicts of interest.

While FINRA has certain government-like powers and makes rules that have the essential effect of law, it is not a government agency. It is a non-profit given power to regulate all broker-dealers.

FINRA has power to request whatever information it chooses from broker-dealers without the hindrances placed on government agencies. If a firm or broker does not supply the information, the broker or firm can be expelled from the authority -- the industry equivalent of capital punishment.

Despite these powers, FINRA failed to stop its brokers from turning faulty, and many times outright fraudulent, mortgages into the insured AAA-rated instruments that helped to cause the economic crises.

Nevertheless, last week the House Financial Services Committee passed a version of the Investor Protection Act of 2009, one of a package of laws that form the Obama administration's proposed financial regulatory reform legislation, which includes an amendment that eliminated specific language calling for an independent direct examination into FINRA.

Americans don't allow private parties to act like taxing authorities or allow conflicted police forces without principles to exist with no constitutional constraints. For more than 70 years Americans have unknowingly allowed just that.

FINRA can continue in this role of administering exams and registrations and advocating its members' interest in rule making, but now is the time for the SEC to takeover the authority's auditing and enforcement powers, and for Congress to apply the Constitution to FINRA.

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