

WSJ: Fed's Tarullo Shakes Up Bank Rules

By JON HILSEN RATH and DAMIAN PALETTA

The rise of Daniel Tarullo, a lawyer with a longstanding interest in bank regulation appointed to the Federal Reserve Board by President Barack Obama, is a sign the era of light-touch bank regulation is over.

New guidelines on bankers' pay proposed by the Fed last week reflect Mr. Tarullo's influence. He is shaking up the Fed's 2,858-person army of bank supervisors, weighing in on issues ranging from the way regulators deal with troubled commercial real estate loans to the rules that will govern global banking for years to come.

"Dan is filling a gap," says Richard Fisher, president of the Federal Reserve Bank of Dallas. During the Greenspan era, Mr. Fisher says, banking supervision in Washington was "de-emphasized." Now, after a banking calamity, it's a priority.

Installed by Fed Chairman Ben Bernanke as chairman of the Fed committee that oversees supervision and regulation, Mr. Tarullo is emerging as one of a handful of new Obama-appointed regulators who are changing the tone and substance of business regulation in areas from derivatives to drugs.

Inside the Fed, where Mr. Tarullo succeeded a Bush-appointed free-market economist in the banking oversight post, the transition hasn't been seamless. Some Fed officials said privately Mr. Tarullo can have an overbearing skepticism of banks and supervisors. Some Fed staffers are so wary of being second-guessed they ask him to approve even mundane bank applications.

At meetings Mr. Tarullo convenes regularly with other Fed officials, the hot topic has been commercial real estate. Mr. Tarullo has been pushing supervisors to take a hard look at commercial real estate portfolios and to make them a priority. Fed and other bank regulators are drafting guidance on how banks should account for commercial real estate holdings soon. As with the banker's pay rules, the guidance is likely to be detailed and could force some banks to take further write-downs.

Like Mr. Bernanke, Mr. Tarullo runs meetings like academic seminars and pushes staffers and others to explore problems from different angles. Both believe regulators need to carefully hone incentives that drive bank decisions. He is an assertive overseer. Mr. Tarullo returned staff proposals on new bank pay rules with long lists of questions and comments. Some staffers got emails from his BlackBerry while he was sitting beside Mr. Bernanke at Washington Nationals baseball games this summer.

Change Is Coming

"Things are going to change more," Mr. Tarullo told a Senate hearing in October as if he were speaking to bankers. "That means business models. That means the way of assessing risk. That means how you run your institution." More than 100 banks have entered into written agreements with Fed supervisors to alter their behavior -- one of regulators' toughest tools -- since Mr. Tarullo joined the Fed in February, compared with just 38 in all of 2008.

There are risks to the tough-cop approach. A regulatory clampdown could worsen the credit crunch or hurt the economy by excessively restraining Wall Street innovation. "All of the examiners have become very, very tough in the field," says Camden Fine, president of Independent Community Bankers of America, a lobby for small banks. "I'm worried about overkill," says a bank lawyer who asked to remain anonymous.

A white-haired lawyer with bushy eyebrows and a Boston accent, Mr. Tarullo has an encyclopedic knowledge of bank rules. In 2008, he published a 310-page treatise criticizing international bank capital rules the Fed helped write. Sales of the book, "Banking on Basel," surged after he was appointed, though it has sold just 2,000 copies, according to its publisher, the Peterson Institute for International Economics.

Bonding With Obama

Mr. Tarullo, 56, worked on international economic issues in the Clinton White House and then taught banking law at Georgetown University. In 2005, he was invited to Mr. Obama's Senate office to discuss financial policy over takeout Chinese food. The two hit it off. Mr. Tarullo signed on to the Obama campaign and Mr. Obama began weaving his ideas into campaign speeches. After he was elected, Mr. Obama made Mr. Tarullo his liaison to the Treasury until he had an economic team in place, and he named him to the Fed in December, one of his very first appointments. Mr. Tarullo's Honda Accord still has an "Obama '08" bumper sticker, and he talks frequently to Obama advisers.

"He sees all parts of the picture, from 100,000 feet down to the details," said Lawrence Summers, director of the White House National Economic Council.

Mr. Tarullo is pushing Fed officials to account for past regulatory breakdowns, causing friction within the Fed. The Fed board in Washington delegates supervision of individual banks to the 12 regional Fed banks. A group led by Mr. Tarullo gave the Federal Reserve Bank of Atlanta a stinging internal review for weak bank supervision earlier this year. The Southeast has been plagued by bank failures. The 60-year-old head of bank supervision at the Atlanta Fed retired shortly after Mr. Tarullo came into power, and the Fed appointed three people from

outside the area to temporarily run bank supervision in Atlanta, a sign several inside the central bank read as Washington tightening its scrutiny of regional offices.

Atlanta Fed president Dennis Lockhart, who took over in 2007, has pledged to review its practices. "After such a tumultuous period, it's important for financial regulators to fully understand what went wrong in the financial system, review their internal processes and practices and implement changes as appropriate," an Atlanta Fed spokeswoman said on behalf of Mr. Lockhart.

Evaluations Are Coming

More internal reviews are pending, including one of the Federal Reserve Bank of New York, which is in charge of overseeing some of the nation's biggest bank holding companies and more broadly ensuring the stability of the financial system. Such reviews are standard at the Fed, but officials say Mr. Tarullo has emphasized their importance in the wake of the crisis.

The Fed shares responsibility for overseeing banks with other agencies, but it has specific responsibility for parent companies of all major U.S. banks, including Citigroup Inc. and Bank of America Corp.

The scope of the Fed's oversight of financial institutions is now one of several issues pending in Congress. But Mr. Tarullo isn't waiting for legislation to clarify the Fed's future role. Among other things, he is getting Fed economists more involved in bank supervision, and recently tapped one of them, Patrick Parkinson, to be the unit's top staffer. Drawing from lessons learned from the crisis, the economists are dreaming up stressful scenarios to see how individual banks would fare, an innovation in a bureaucracy that previously relied heavily on scrutiny of individual banks.

"There's going to be a lot of blame to go around to regulatory institutions, to private institutions," Mr. Tarullo told a Senate panel in July. "This was not a single failing; this was a broad-based failing." Among the government's failings, he said, were "an inadequate or flawed approach to supervision at the banking agencies, including the Fed."