STATEMENT OF THE
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PRESIDENT AND CHIEF EXECUTIVE OFFICER
THE FINANCIAL SERVICES ROUNDTABLE

ON

PERSPECTIVES ON REGULATION OF SYSTEMIC RISK
IN THE FINANCIAL SERVICES INDUSTRY

BEFORE

THE COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES
MARCH 17, 2009

Chairman Frank, Ranking Member Bachus, and Members of the Committee, I am Steve Bartlett, the President and Chief Executive Officer of the Financial Services Roundtable. The Roundtable represents 100 of the nation's largest integrated financial services firms. Roundtable members provide banking, insurance, and investment products and services to American consumers and businesses.

About three years ago, the Roundtable began to look at the question of how our current regulatory system impaired the competitiveness of the financial services industry through a Blue Ribbon Commission. Over the course of the last three years, this dialogue has evolved into a CEO-driven Executive Council focused on how this current system also undermines the stability and integrity of the financial services industry.

Our conclusions include the following:

1) The financial services industry is regulated by hundreds of separate regulators at various levels. This chaotic system of financial regulation was a contributing factor to the current crisis.

2) That is not to say that it is the only cause – the financial services industry accepts our share of responsibility – badly underwritten mortgages, compensation packages that pay for short term revenue growth instead of long term financial soundness, failure to communicate across sectors, even within the same company, and sometimes, even downright predatory practices – all were part of the crisis but an absence of coherent comprehensive systemic regulatory structure did fail to identify and prevent this crisis. <u>We still have that same regulatory structure today</u>.

3) Reforming and restructuring the regulatory system in 2009 should be Congress's primary mission moving forward to resolve this crisis and prevent another crisis.

4) We are proposing a comprehensive reform of the regulatory structure that includes a new architecture, a consolidation of agencies, clearer lines of authority, and uniform standards both across state lines and types of business. The Roundtable's proposed chart of the new financial architecture is included below and a summary of this reform proposal is attached.

5) We do advocate a systemic risk regulatory regime – what we prefer to call a market stability regulator. However, as you will see further in my testimony, the systemic risk regulator should be "NIFO" – Nose-In-Fingers-Out. That means that a market stability regulator should <u>not</u> replace or add to the primary regulator but rather should identify risks and act <u>through and with</u> a firm's primary regulator.

6) The U.S. regulatory system should be the U.S. system, of course, but should be coordinated with and consistent with international standards. This is a global crisis and a mere domestic solution will not fix it.

I appreciate this opportunity to discuss this important issue with you today. I found a significant number of misconceptions about systemic regulation and regulatory restructuring. Therefore, the structure of my testimony is addressed through frequently asked questions, starting with –

Why is reform needed?

Crises have a way of revealing structural flaws that long existed, but were little noticed until the crises. The on-going crisis in financial markets is no different. It has revealed several structural flaws in our financial regulatory system.

We have a fragmented system of national and state financial regulation that is based upon a concept of "functional" regulation. Under this system, firms are regulated according to their charter type, and there is limited coordination and cooperation between different regulators, even though firms with different charters often engage in the same or similar activities. Moreover, no federal agency is responsible for examining and understanding the risks created by the interconnections between firms and markets – domestically and globally.

This current functional system has resulted in significant, adverse gaps in U.S. financial regulation that permit some financial services firms to operate with minimal oversight and supervision, and it has encouraged firms to engage in regulatory arbitrage.

The regulation of mortgage finance illustrates these structural flaws. No single regulator was accountable for identifying and recommending corrective actions across the mortgage origination, securitization, and insurance process. Most mortgage brokers were not subject to any licensing and qualification requirements. Over half of all mortgage loans were originated by state-licensed lenders and were not subject to supervision or regulation. Other lenders that were regulated were able to engage in practices that did not meet basic safety and soundness or consumer protection standards.

The federal banking regulators recognized many of these problems and took actions to address the institutions within their jurisdiction, but they were slow to act, had no jurisdiction upstream or downstream, and lacked the power to reach all lenders. Eventually, the Federal Reserve Board's (the Fed) Home Ownership and Equity Protection Act (HOEPA) regulations did extend some consumer protections to a broader range of lenders, but the Fed does not have the authority to ensure that those lenders are engaged in safe and sound underwriting practices or risk management.

The process of securitization suffered from a similar lack of systemic oversight and prudential regulation. <u>No agency had the authority to prohibit the sale of mortgages that were poorly underwritten.</u> Likewise, no agency was responsible for addressing the over-reliance investors placed upon the credit rating agencies to rate mortgage-backed securities. Moreover, under our state-based system of insurance regulation, no federal agency was paying attention to the role of the mortgage insurance industry and other insurance companies that contribute to the mortgage origination and securitization process.

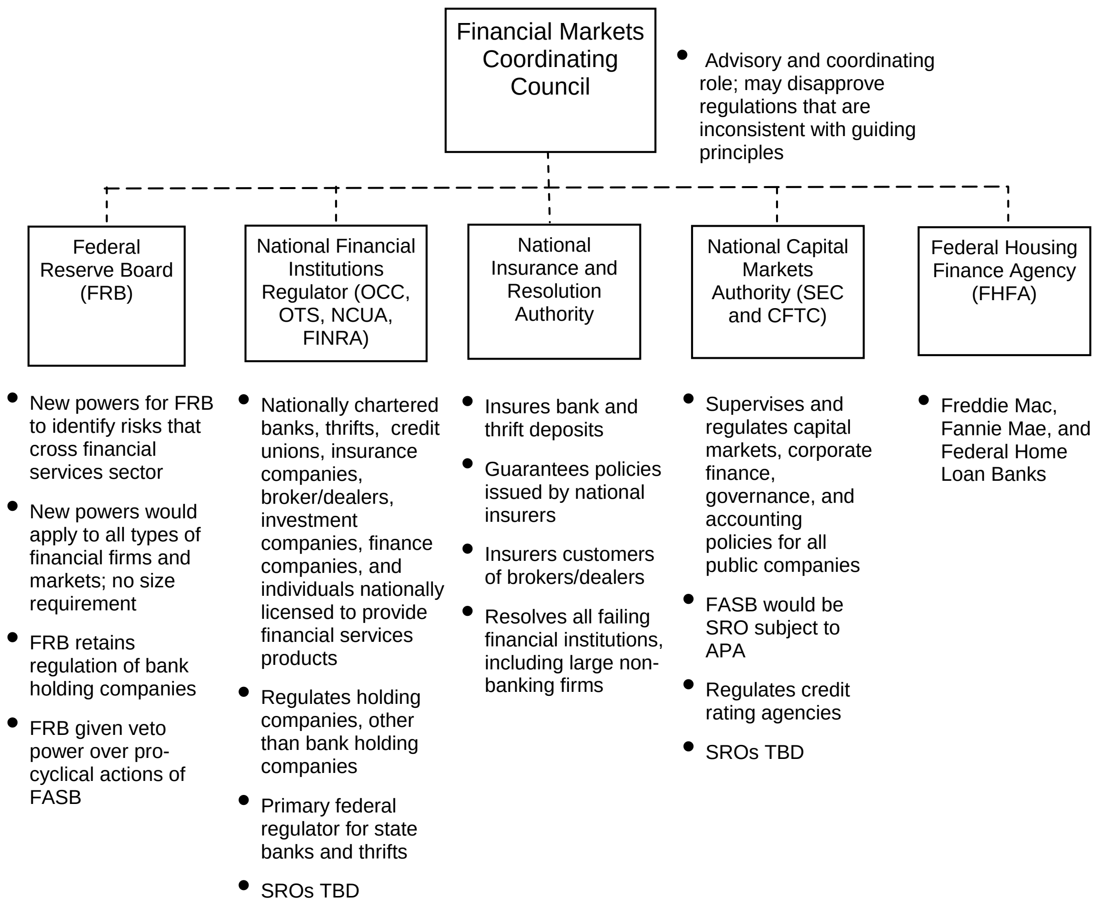
How do you propose to fix these structural flaws in the existing financial regulatory system?

The Roundtable has developed a proposed "Financial Regulatory Architecture" to address the flaws in our current system. Our proposed architecture is designed to:

- Limit systemic risk;
- Reduce regulatory overlap and close gaps in regulation;
- Provide for greater coordination among all financial regulators;
- Promote uniform regulation and supervision; and
- Preserve state financial regulation.

The following chart illustrates our proposed regulatory architecture.

FINANCIAL REGULATORY ARCHITECTURE PROPOSAL



The six components of this proposed architecture are as follows. First, to enhance coordination and cooperation among the many and various financial regulatory agencies, we propose to expand membership of the President’s Working Group on Financial Markets (PWG) and rename it as the Financial Markets Coordinating Council (Council). This Council should be established by law, in contrast to the existing PWG which has operated under a Presidential Executive Order dating back to 1988. This would permit Congress to oversee its Council's activities. The Council should include representatives from all major federal financial agencies, as well as individuals who can represent state banking, insurance and securities regulation. The Council should serve as a forum for national and state financial regulators to meet and discuss regulatory and supervisory policies, share information, and develop early warning detections.

The Council should not have independent regulatory or supervisory powers. However, it might be appropriate for the Council to have some ability to review the goals and objectives of the regulations and policies of federal and state financial agencies, and thereby, ensure that they are consistent.

Second, to address systemic risk, we propose that the Fed should be authorized to act as a market stability regulator. As a market stability regulator, the Fed should be responsible for looking across the entire financial services sector to identify interconnections that could pose a risk to the financial system. I address this function in greater detail later in my testimony.

Third, to reduce gaps in regulation, we propose the consolidation of several existing federal agencies into a single, National Financial Institutions Regulator (NFIR). This new agency would be a consolidated prudential and consumer protection agency for banking, securities and insurance. The NFIR would reduce regulatory gaps by establishing comparable prudential standards for all of these nationally chartered or licensed entities. For example, national banks, federal thrifts and federally licensed brokers/dealers that are engaged in comparable activities should be subject to comparable capital and liquidity standards. Similarly, all federally chartered insurers would be subject to the same prudential and market conduct standards.

In the area of mortgage origination, the NFIR's prudential and consumer protection standards should apply to both national and state lenders. Mortgage lenders, regardless of how they are organized, should be required to retain some of the risk for the loans they originate. Likewise, mortgage borrowers, regardless of where they live or who their lender is, should be protected by the same safety and soundness and consumer standards.

Fourth, to focus greater attention on the stability and integrity of financial markets, we propose the creation of a National Capital Markets Agency (NCMA) through the merger of the Securities and Exchange Commission (SEC) and the Commodities Futures Trading Commission (CFTC), preserving the best features of each agency. The NCMA would regulate and supervise capital markets and exchanges. As noted above, the existing regulatory and supervisory authority of the SEC and CFTC over firms and individuals that serve as intermediaries between markets and customers, such as broker/dealers, investment companies, investment advisors, futures commission merchants, and other intermediaries would be transferred to the NFIR. The NCMA also should be responsible for establishing standards for accounting, corporate finance, and corporate governance for all public companies.

Fifth, to protect depositors, policyholders, and investors, we propose the creation of the National Insurance and Resolution Authority (NIRA) to act as an insurer of bank deposits, as the guarantor of retail insurance policies written by nationally chartered insurance companies, and a financial backstop for investors who have claims against broker/dealers. These three insurance systems would be legally and functionally separated. Additionally, this agency should be authorized to act as the receiver for large non-bank financial services firms. The failure of Lehman Brothers illustrated the need for such a better system to address the failure of large non-banking firms.

Finally, to supervise the Federal Home Loan Banks and to oversee the emergence and future restructuring of Fannie Mae and Freddie Mac from conservatorship, we propose that the Federal Housing Finance Agency remain in place, pending a thorough review of the role and structure of the housing GSEs in our economy.

Are you not just rearranging regulatory boxes?

No. This proposal places authority and accountability at specific regulatory agencies and further requires those agencies to adopt coherent and consistent standards. Achieving better and more effective regulation does require more than just rearranging regulatory assignments. Consolidation of overlapping regulatory functions and greater coordination between the remaining agencies will be beneficial, but better and more effective regulation also requires: (1) greater reliance on principles-based regulations that are responsive to changes in market conditions and are focused on desired regulatory results; (2) greater reliance on a system of prudential supervision that is based upon an on-going exchange of information between regulated firms and regulators that seeks to solve common problems before they pose a risk to consumers or the financial system; and (3) a reduction in the pro-cyclical effects of regulatory and accounting requirements, including capital requirements.

As I testified last year in front of this Committee, the final report of our Blue Ribbon Commission recommended that Congress enact a set of principles to guide all financial regulators and regulated institutions. Our proposed Guiding Principles were: fair treatment for consumers as our number one principle; competitive and innovative financial markets; proportionate, risk-based regulation; prudential supervision and enforcement; options for serving consumers; and management responsibilities.

These principles would help regulators and financial services firms focus on desired policy outcomes and material risks to markets. They would not replace regulations. Regulations will remain necessary, especially at the retail level for the protection of consumers. However, a statutory set of guiding principles could serve as a touchstone against which all existing and proposed regulations could be evaluated in a policy and legal context. Regulations that were not consistent with the principles would be identified and revised to be consistent with the principles. Our proposed Financial Markets Coordinating Council could help to perform this function.

Our Blue Ribbon Commission also advocated the application of prudential supervision by all financial regulators. Prudential supervision is a form of supervision in which regulators and regulated entities maintain a constructive engagement to ensure an effective level of compliance with applicable laws and regulations. In other words, prudential supervision promotes the identification and correction of problems before they harm consumers. Prudential supervision relies upon regular and open communications between firms and regulators to discuss and address issues of mutual concern as soon as possible. Prudential supervision encourages regulated entities to bring matters of concern to the attention of regulators early and voluntarily. Prudential supervision promotes and acknowledges self-identification and self-correction of control weaknesses, thereby reinforcing continued focus and attention on sound internal controls.

Finally, pro-cyclical regulatory and accounting requirements have exacerbated the current crisis in our financial markets. These effects have been seen in the areas of capital requirements, accounting for assets held by institutions, purchase accounting, accounting for annual pension expenses, mergers/acquisitions, adjustment of loan loss reserves, and auction rate securities. U.S. accounting policy is created at the Financial Accounting Standards Board (FASB), an independent regulatory agency. However, the lack of authority over FASB has only exacerbated the pro-cyclical effects of the current accounting standards. Better and more effective regulation should minimize these pro-cyclical effects.

Where does consumer protection fit in your proposed architecture?

This crisis illustrates the nexus between consumer protection regulation and safety and soundness regulation. Safety and soundness regulation is the first line of defense and the strongest weapon for protecting the interests of all consumers. It ensures that financial services firms are financially sound, and in a position to serve consumers. In turn, consumer protection regulation ensures that consumers are treated fairly – the Roundtable's first principle as I just mentioned. This connection can be seen in mortgage underwriting standards. Mortgage underwriting standards not only help to ensure that loans are made to qualified borrowers, but they also help to ensure that the lender gets repaid and can remain solvent. Put another way, safety and soundness and consumer protection are self-reinforcing – each strengthens the other.

Further, safety and soundness regulators have the most powerful tools to enforce their regulations – an unlimited array of powers to enforce consumer protection. We cannot conceive a separate consumer protection agency that could have these same tools. Given this nexus between consumer protection and safety and soundness, our proposed National Financial Institutions Regulator would combine both consumer protection and safety and soundness regulation and supervision.

Where does the regulation of insurance fit in your proposed structure?

Federal regulation of insurance is one of the key gaps in our current financial regulatory system. As the market stability regulator interacts with other regulators, there is an evident need to create a national insurance regulator for the insurance industry, which the Group of Thirty has endorsed recently. Insurance is a national and global business that has over $1 trillion under management, including municipal and corporate securities, and yet, it lacks a national insurance prudential regulator. Only through coordination with a national insurance regulator, will a market stability regulator have the ability to both detect, and act upon, risky market activity and business practices in a timely, uniform, and comprehensive fashion. Asking the market stability regulator to seek coordinated actions by multiple state insurance regulators is not an option that will effectively address systemic risk due to the different state and territorial insurance regulators, with varying legal and budget authority, and different levels of expertise.

A national insurance regulator should have the authority to charter insurance companies, establish and enforce uniform national standards for all factors material to the solvency of nationally chartered insurance companies and the protection of consumers, and represent the U.S. internationally on behalf of federally chartered institutions. The national insurance regulator's authority should be an independent bureau within a federal agency headed by a Presidential appointee.

Does creating a national insurance regulator create regulatory redundancy?

Some may say that creating a national insurance regulator creates regulatory redundancy. The Roundtable does not believe this is accurate. Just as the dual banking system works well for the industry and the economy – so will the dual insurance system. It would provide companies the ability to decide which system, state or national, works best to serve their customers. Regardless, there should be common principles in the national and state insurance systems. We commend Congresswoman Melissa Bean and Congressman Ed Royce for their tireless work on this specific issue, and we look forward to working with this Committee toward the creation of a national insurance regulator to enhance stability in our national insurance markets and reduce systemic risk in the future.

How do you define systemic risk?

There are many potential definitions, ours is as follows:

Systemic risk is an activity or practice that crosses financial markets or financial services firms, and which, if left unaddressed would have a <u>significant, material and adverse</u> effect on financial services firms, financial markets, or the U.S. economy.

It also is important to state what systemic risk is not. It is not a risk based only the size or complexity of an organization. Nor is it a risk confined to an identified list of companies or segment of the financial services industry.

Why do you pick the Fed as the market stability regulator?

There are several possible options: a new agency; the Treasury Department, the new Financial Markets Coordinating Council (as outlined in our proposal), or the Fed as the Roundtable and many have proposed. Designating the Fed is a natural complement to the Board's existing role as the nation's central bank and lender of last resort. In its capacity as the nation's central bank, the Fed is required to focus attention on all sectors of our economy. Thus, the Fed has the institutional knowledge and perspective to be a market stability regulator.

Giving this authority to a new agency would require the establishment of a new bureaucracy. Giving this authority to the Fed would only require the Fed to reorganize its existing staff.

If the Fed is designated as the market stability regulator, it would need to establish a clear and transparent governance structure to minimize any potential conflicts with its existing responsibilities.

Also, we would recommend that the Fed establish an Advisory Council on Market Stability to review activities and practices that may pose a systemic risk, balanced against the need for continuing market innovation and competitiveness. The Advisory Council should include representatives of domestic and international financial services firms doing business in the United States as well as representatives of consumers of financial services.

Does this create a new regulator or make the Fed a super regulator?

The market stability regulator should **<u>not</u>** be just another layer of regulation added to the existing system; it should **<u>not</u>** be a "super-regulator". It should gather information with the assistance of other regulators, conduct joint examinations with other regulators, and, absent an emergency, take corrective actions <u>with and through</u> other financial regulators.

What is the role of a market stability regulator?

The purpose of a market stability regulator should be to promote the long-term stability and integrity of the nation's financial markets and financial services firms by identifying and addressing significant risks to the financial system as a whole.

A market stability regulator should be authorized to oversee all types of all financial markets and all financial services firms, whether regulated or unregulated. However, a market stability regulator should **<u>not</u>** focus on financial services firms based upon size. The designation of "systemically significant financial services firms" would have unintended competitive consequences and increase moral hazard as these firms would be deemed "too big to fail."

Does the establishment of a market stability regulator lead to institutions that are too big to fail?

No, the establishment of a market stability regulator should have the reverse effect. It should mitigate excessive risk, but not prevent failures.

Will a market stability regulator stifle innovation?

Congress should, by statute, require a market stability regulator to balance the identification of activities or practices that pose a systemic risk against the need for continuing market innovation and competitiveness. A market stability regulator should not stifle innovation, or preclude isolated failures. Companies engaged in overly risky activities should be permitted to fail.

What prevents a market stability regulator from becoming another prudential regulator?

Congress also should direct a market stability regulator to focus attention on factors that present the greatest potential for systemic risk, such as excessive concentrations of assets or liabilities, rapid growth in assets or liabilities, high leverage, a mismatch between long-term assets and short-term liabilities, currency mismatch, and regulatory gaps. A market stability regulator should **not** focus attention on products or practices that pose little or no systemic risk.

How would a market stability regulator function?

The market stability regulator should identify, prevent, and mitigate systemic risk by –

- Collecting and analyzing data from other financial regulators and individual financial services firms to understand potential or existing systemic risks in the financial system. Data on individual firms should be treated as confidential supervisory information;

- Establishing a surveillance system for activities and practices to detect early crisis warning signs and vulnerabilities, conduct scenario planning, and develop contingency planning with other prudential financial regulators across all financial markets;
- Examining individual financial services firms. If a firm is regulated by another national or state financial regulator, such examinations should be coordinated with such regulator. Examination results should be treated as confidential supervisory information;
- Issuing, as necessary, reports and public notices on activities or practices that may pose a systemic risk; and
- Taking corrective actions to prevent or address systemic risk.

To help prevent the market stability regulator from becoming a "super-regulator," we would recommend that, absent an emergency situation, the market stability regulator take actions through other regulators. In other words, in non-emergency times, the market stability regulator should be authorized to make recommendations to other regulators and Congress to address activities and practices that could pose a systemic risk, but do not pose an immediate systemic risk.

Whenever the market stability regulator identifies a practice or activity that could pose a systemic risk and such practice or activity is within the jurisdiction of another national or state financial regulator, the market stability regulator should issue a finding and recommend appropriate preventive actions to the other regulator. The market stability regulator also should submit any such findings and recommendations to the Congress and our proposed the Financial Markets Coordinating Council (Council). If the other regulator disagrees with the market stability regulator's finding and recommendation, then the regulator can submit its own findings and recommendations to the Congress and the Council. In other words, the Congress and the Council can serve as mechanisms to ensure that recommendations of the market stability regulator are appropriately addressed by prudential regulators.

If the market stability regulator identifies an activity or practice that <u>could</u> pose a systemic risk, and such activity or practice is not subject to regulation or supervision by another regulator – a clear regulatory gap – then the market stability regulator should make a recommendation to Congress on how best to regulate and supervise such activity or practice in the future.

The market stability regulator should be authorized to take unilateral actions to address activities or practices only when the market stability regulator determines that they pose an <u>immediate</u>, <u>systemic risk</u>, which could not be addressed in a timely fashion if the market stability regulator were to recommend actions by any other regulator. Such unilateral actions would include the power to issue orders or regulations affecting activities or practices of individual firms or categories of firms. Such unilateral actions should be approved by a super majority of the members of the Fed, and should be agreed to by the Secretary of the Treasury, who must consult with the President. Such unilateral actions also should be reported immediately to Congress. This authority would be in addition to the Fed's existing authority under section 13(3) of the *Federal Reserve Act* to extend credit to financial or non-financial institutions in “unusual and exigent” circumstances. The Board should retain that authority.

If market stability regulator had been in place before this crisis, how would it have impacted the crisis?

If a market stability regulator had been in place prior to these events, we would have expected that regulator to have identified many of the risks that cut across firms and markets and contributed to the crisis. For example, I can think of a couple activities or practices that a market stability regulator could have flagged, and, if such activities and practices had been adjusted, the current crisis would have been less severe. First, it is now clear that one of the practices that contributed to the current crisis was excessive leverage by large financial services firms, especially investment banks. A market stability regulator could have identified this leverage and urged the SEC to take corrective actions. Higher capital levels would have reduced the size and scope of this crisis.

Another practice that contributed to the current crisis was growth in non-traditional mortgage instruments. A market stability regulator might have recognized the value of these innovations for certain consumers, as well as the risk to other consumers. The market stability regulator could then have recommended standards for such products long before the banking agencies acted on their own joint guidance.

Would the market stability regulator have identified all systemic risks? Clearly, the answer to that question is no. However, had a market stability regulator been in place, we believe this current crisis would have been less severe.

How do your proposals compare to proposals made by others?

Frankly, I have been surprised by the degree to which our proposals are similar to others. Our proposals are broadly consistent with the reforms proposed in former Treasury Secretary Henry Paulson's Blueprint for a Modernized Financial Structure. His plan called for the establishment of a regulatory system based upon "objectives" rather than "functions". Our proposed streamlining of federal regulatory agencies, combined with guiding regulatory principles and the application of prudential supervision by financial regulators is an objectives-based approach to financial regulation.

Our proposals also are generally consistent with recent recommendations made by the Group of Thirty report. One area where we would differ with the Group of Thirty report would be in the formal designation of systemically significant institutions. As I have noted earlier, we believe that such a designation would have significant, negative competitive consequences for other firms and would create a potential for designated firms to take excessive risk because they were perceived to be too big to fail.

Our proposals are consistent with several positions taken by the Chairman of the Fed. Chairman Bernanke has supported a more principles-based approach to regulation in the past, and better and more comprehensive prudential supervision of all financial institutions, as we do. Chairman Bernanke supports new approaches to capital and accounting issues to reduce their procyclicality and negative impact in down times, and so do we. Chairman Bernanke supports an orderly resolution scheme to resolve troubled and failing nonbank financial institutions, a position the Roundtable fully endorses. Chairman Bernanke supports the creation of a market stability regulator, which he calls a macroprudential regulator. As I have discussed above, we support the creation of market stability regulator, and would propose to give this role to the Fed.

Finally, in closing, I would like to address –

Why act now? Why act in comprehensive manner?

The root causes of the on-going financial crisis are twofold. The first was a breakdown in policies, practices, and processes at many, but not all, financial services firms. The second was our fragmented system of financial regulation.

The industry practices that contributed to the crisis are well documented: Poor loan underwriting standards and credit practices, excessive leverage, misaligned incentives, less than robust risk management and corporate governance. However, since 2007 the industry has taken actions to correct these practices. Underwriting standards have been upgraded, credit practices have been reviewed and recalibrated, leverage has been reduced as firms have rebuilt capital, incentives have been realigned, and some management teams have been replaced.

The second cause of the crisis, our fragmented financial regulatory system, has yet to be addressed. Such reform is necessary to help minimize the potential for a repeat of this crisis.

Moreover, we believe that these reforms should proceed in a comprehensive fashion, rather than a piece-meal fashion. Comprehensive reform ensures that our nation's regulatory agencies function in a complementary manner that serves the best interest of consumers, financial services firms, and the economy as a whole.

The key is to do this correctly, not rapidly.

We look forward to working with the Committee in the weeks and months ahead on needed reforms.

FINANCIAL REGULATORY ARCHITECTURE PROPOSAL

Financial Markets Coordinating Council

- Advisory and coordinating role; may disapprove regulations that are inconsistent with guiding principles

Federal Reserve Board (FRB)

- New powers for FRB to identify risks that cross financial services sector
- New powers would apply to all types of financial firms and markets; no size requirement
- FRB retains regulation of bank holding companies
- FRB given veto power over pro-cyclical actions of FASB

National Financial Institutions Regulator (OCC, OTS, NCUA, FINRA)

- Nationally chartered banks, thrifts, credit unions, insurance companies, broker/dealers, investment companies, finance companies, and individuals nationally licensed to provide financial services products
- Regulates holding companies, other than bank holding companies
- Primary federal regulator for state banks and thrifts
- SROs TBD

National Insurance and Resolution Authority

- Insures bank and thrift deposits
- Guarantees policies issued by national insurers
- Insurers customers of brokers/dealers
- Resolves all failing financial institutions including large non-banking firms

National Capital Markets Authority (SEC and CFTC)

- Supervises and regulates capital markets, corporate finance, governance, and accounting policies for all public companies
- FASB would be SRO subject to APA
- Regulates credit rating agencies
- SROs TBD

Federal Housing Finance Agency (FHFA)

- Freddie Mac, Fannie Mae, and Federal Home Loan Banks

FINANCIAL SERVICES ROUNDTABLE
PROPOSAL FOR FINANCIAL REGULATORY REFORM

In anticipation of the most sweeping financial regulatory reforms since the Great Depression, the Financial Services Roundtable's Executive Advisory Council on Regulatory Restructuring has developed six proposals for financial regulatory reform. The first proposal addresses the need for a modern financial regulatory architecture, and the remaining proposals address new regulatory standards to guide the behavior of all financial services firms and regulators.

Six Proposals for Financial Regulatory Reform

1. New Architecture. *Our financial regulatory system should be better aligned with modern market conditions and developing global standards.*

2. Consumer and Investor Protection Standards. *Financial services firms engaged in offering comparable products and services should be subject to comparable prudential, consumer, and investor protection standards. In the event of multiple oversight authorities, uniform standards should apply nationwide.*

3. Balanced and Effective Regulation. *Financial regulation should be focused on outcomes, not inputs, and should seek a balance between the stability and integrity of financial services firms and markets, consumer protection, innovation, and global competitiveness.*

4. International Cooperation and National Treatment. *U.S. financial regulators should coordinate and harmonize regulatory and supervisory policies with international financial regulatory authorities, and should continue to treat financial services firms doing business in the United States as they treat U.S. financial services firms. The United States should continue to play a leadership role in the current G-20 process to develop new international norms for financial regulation across markets.*

5. Failure Resolution. *Financial regulation should provide for the orderly resolution of failing financial services firms to minimize systemic risk.*

6. Accounting Standards. *U.S. financial regulators should adjust current accounting standards to account for the pro-cyclical effects of the use of fair value accounting in an illiquid market. Additionally, U.S. and International financial regulators should coordinate and harmonize regulatory policies to develop accounting standards that achieve the goals of transparency, understandability and comparability.*

Discussion of Proposals

The on-going crisis in world financial markets has revealed both market failures and fundamental weaknesses in the U.S. financial regulatory system. Our fragmented financial regulatory system has resulted in gaps in regulation, which allowed imprudent lending and investment practices by both regulated and unregulated financial firms. Our diverse national and state financial regulatory agencies do not share a common vision and approach to supervision. There is no coordinating body where all regulators can meet to identify problems, exchange information, and devise solutions. Our rules-based system of regulation makes it difficult for regulators and firms to adjust policies and practices in response to rapidly changing market developments.

The Roundtable's six proposals are intended to guide the reform of the financial regulatory system. The Proposals would not only enable regulators to focus on desired policy outcomes and material risks to markets, but also reduce the potential for consumers to fall through gaps between the national and state legal and regulatory systems.

Proposal 1. New Architecture — *Our financial regulatory system should be better aligned with modern market conditions and developing global standards.*

Proposal 1 calls for the existing financial regulatory system to be better aligned with modern market conditions. The "Draft Financial Regulatory Architecture" that is described below is one possible approach to meeting this proposal. The "Draft Financial Regulatory Architecture" is designed to: preserve state financial regulation; provide for greater coordination among all financial regulators; provide for national regulation for insurance companies and insurance producers; reduce regulatory overlap; promote uniform regulation and supervision; limit systemic risk; and create a failure resolution mechanism for non-banking financial firms.

Financial Markets Coordinating Council

To enhance coordination and cooperation among the many and various financial regulatory agencies, we propose to expand membership of the President's Working Group on Financial Markets (PWG) and rename it as the Financial Markets Coordinating Council (FMCC). This Council should be established by law, in contrast to the existing PWG which has operated under a Presidential Order. This would permit Congress to oversee its Council's activities. The Council should include representatives from all major federal financial agencies, as well as individuals who can represent state banking, insurance and securities regulation. The Council should serve as a forum for national and state financial regulators to meet and discuss regulatory and supervisory policies, share information, and develop early warning detections.

The Council should not have independent regulatory or supervisory powers. However, it might be appropriate for the Council to have some ability to review the goals and objectives of the regulations and policies of federal and state financial agencies, and thereby ensure that they are consistent.

Federal Reserve Board

To address systemic risk, the Federal Reserve Board (Board) should be authorized to act as a market stability regulator. As a market stability regulator, the Board should be responsible for looking across the entire financial services sector to identify interconnections that could pose a risk to the financial system. To perform this function, the Board should be empowered to collect information on financial markets and financial services firms, to participate in joint examinations with other regulators, and to recommend actions to other regulators that address practices that pose a significant risk to the stability and integrity of the U.S. financial services system. The Board's authority to collect information should apply not only to depository institutions, but also to all types of financial services firms. This authority should not be based upon the size of an institution. It is possible that a number of smaller institutions could be engaged in activities that collectively pose a systemic risk. As the market stability regulator, the Board must work in coordination with the primary regulators of the financial services firms.

National Financial Institutions Regulator

To reduce gaps in regulation, we propose the consolidation of several existing federal agencies into a single, National Financial Institutions Regulator (NFIR). This new agency would be a consolidated prudential and consumer protection agency for banking, securities and insurance. The NFIR would reduce regulatory gaps by establishing comparable prudential standards for all of these of nationally chartered or licensed entities. For example, national banks, federal thrifts and federally licensed brokers/dealers that are engaged in comparable activities should be subject to comparable capital and liquidity standards. Similarly, all federally chartered insurers would be subject to the same prudential and market conduct standards. Each industry would be legally and functionally separated within the NFIR.

In the area of mortgage origination, the NFIR's prudential and consumer protection standards should apply to both national and state lenders. Mortgage lenders, regardless of how they are organized, should be required to retain some of the risk for the loans they originate. Likewise, mortgage borrowers, regardless of where they live or who their lender is, should be protected by the same safety and soundness and consumer standards.

National Capital Markets Agency

To focus greater attention on the stability and integrity of financial markets, we propose the creation of a National Capital Markets Agency through the merger of the Securities and Exchange Commission (SEC) and the Commodities Futures Trading Commission (CFTC), preserving the best features of each agency. The NCMA would regulate and supervise capital markets and exchanges. As noted above, the existing regulatory and supervisory authority of the SEC and CFTC over firms and individuals that serve as intermediaries between markets and customers, such as broker/dealers, investment companies, investment advisors, and futures commission merchants, and other intermediaries would be transferred to the NFIR. The NCMA also should be responsible for establishing standards for accounting, corporate finance, and corporate governance for all public companies.

National Insurance Resolution Authority

To protect depositors, policyholders, and investors, we propose the creation of the National Insurance and Resolution Authority (NIRA) to act as the insurer of bank deposits, the guarantor of retail insurance policies written by nationally chartered insurance companies, and a financial backstop for investors who have claims against broker/dealers. These three insurance systems would be legally and functionally separated. Additionally, this agency should be authorized to act as the receiver for large non-bank financial services firms. The failure of Lehman Brothers illustrated the need for such a better system to address the failure of large non-banking firms.

Federal Housing Finance Agency

To supervise the Federal Home Loan Banks and to oversee the emergence and future restructuring of Fannie Mae and Freddie Mac from conservatorship we propose that the Federal Housing Finance Agency remain in place, pending a thorough review of the role and structure of the housing GSEs in our economy.

Proposal 2. Common Prudential and Consumer and Investor Protection Standards. *Financial services firms engaged in offering comparable products and services should be subject to comparable prudential, consumer, and investor protection standards. In the event of multiple oversight authorities, uniform standards should apply nationwide.*

This proposal calls for comparable prudential standards (e.g., capital requirements and financial reporting) for financial services firms engaged in comparable activities. Such standards would reduce the potential for regulatory arbitrage and the potential for gaps in regulation. The proposal also calls for comparable consumer and investor protection standards for specific financial products and services. For example, residential mortgage loans should be subject to the same consumer protection standards regardless of what type of entity offers the loan. This would ensure that consumers are protected, regardless of where they live.

Proposal 3. Balanced and Effective Regulation — *Financial regulation should be focused on outcomes, not inputs, and should seek a balance between the stability and integrity of financial services firms and markets, consumer protection, innovation, and global competitiveness.*

Balanced, effective regulation requires: (i) greater reliance on principles-based regulations that are responsive to changes in market conditions and are focused on desired regulatory results; (ii) greater reliance on a system of prudential supervision that is based upon an on-going exchange of information between regulated firms and regulators that seeks to solve common problems before they pose a risk to consumers or the financial system; and (iii) a reduction in the pro-cyclical effects of accounting and capital requirements.

Proposal 4. International Cooperation and National Treatment — *U.S. financial regulators should coordinate and harmonize regulatory and supervisory policies with international financial regulatory authorities, and should continue to treat financial services firms doing* *business in the United States as they treat U.S. financial services firms. The United States should continue to play a leadership role in the current G-20 process to develop new international norms for financial regulation across markets.*

This proposal calls for the coordination of international financial regulations and the continuation of the national treatment for foreign firms doing business in the United States. The on-going financial crisis indicates that global financial markets require coordination and cooperation among financial regulatory authorities. Also, the benefits of national treatment for foreign firms operating in the U.S. are proven. National treatment promotes open, fair competition not only in the U.S., but abroad.

Proposal 5. Failure Resolution — *Financial regulation should provide for the orderly resolution of failing financial services firms to minimize systemic risk.*

This proposal calls for the establishment of orderly resolution procedures to apply to large non-banking firms. The failure of Lehman Brothers illustrated the limitations of existing receivership procedures. As discussed above, it is envisioned that the National Insurance Resolution Agency would perform this function.

Proposal 6. Accounting Standards — *U.S. financial regulators should adjust current accounting standards to account for the pro-cyclical effects of the use of fair value accounting in an illiquid market. Additionally, U.S. and International financial regulators should coordinate and harmonize regulatory policies to develop accounting standards that achieve the goals of transparency, understandability and comparability.*

This proposal calls for a review of the use of current accounting standards, such as fair value accounting and impairment accounting, when there is an illiquid market. Accounting requirements to write-down securities to observable prices encourages some companies to sell sooner than they otherwise would, further depressing prices in an illiquid market. Problematic pro-cyclical effects have created further problems in the areas of purchase accounting, accounting for annual pension expenses, mergers/acquisitions, adjustment of loan loss reserves, and auction rate securities. This proposal also recommends that the U.S. work with International Regulators to develop and harmonize accounting standards around the globe, providing both U.S. and foreign companies the opportunity to remain competitive in a global marketplace.